

U.S.-Iranian Engagement: The View from Tehran

I. OVERVIEW

For perhaps the first time since Iran and the U.S. broke ties in 1980, there are real prospects for fundamental change. The new U.S. president, Barack Obama, stated willingness to talk unconditionally. Iran's Supreme Leader, Ayatollah Khamenei, implicitly blessed dialogue, and presidential candidates are vying to prove they would be the most effective interlocutor. Yet, while U.S. objectives and tactics are relatively familiar, little is known of Iran's thinking, even as much is assumed. Western interaction with its opaque political system and decision-making has both shrivelled and been narrowly focused on the nuclear file. Understanding Iran's perspective is critical if engagement is to succeed. This briefing, based on meetings with officials and analysts, seeks to shed light on what Tehran thinks about dialogue, its goals and visions of a future relationship. It concludes that while full normalisation might be out of reach for now, there is a chance to achieve a more realistic objective: the start of a long-term dialogue that minimises risks of confrontation and advances areas of mutual interest.

Mutual expressions of a desire for a new relationship aside, there are sound reasons for the two countries to turn the page. Among the Bush administration's unintended legacies is Iran's strengthened posture and demonstration of the shortcomings of a policy exclusively based on isolation. Washington has much to gain by Iranian cooperation in its two Middle Eastern battlefields, Iraq and Afghanistan – and as much to lose by Iranian hostility. Years of sanctions, international pressure and threats have not slowed Iran's uranium enrichment. Other aspects of U.S. policy have enhanced Tehran's influence among regional public opinion and strengthened its ties to Syria, Hamas and Hizbollah. This policy did not merely fail; it roundly backfired.

The Islamic Republic may feel vindicated, but its situation is far from rosy. There is no assurance its regional influence will continue to grow; it faces mounting resentment from Arab regimes; and sanctions, while wholly ineffective in producing policy shifts, have been quite effective in exacting a heavy economic price. Even its more conservative leaders likely see value in consolidating gains through some arrangement with the

U.S. There is also an apparent convergence of interests on important regional questions – Iraq's territorial integrity and stability; keeping the Taliban at bay in Afghanistan; stopping the flow of narcotics across the Afghan border. Although all this means dialogue is possible and potentially fruitful, none of it means it will be easy. The U.S. and Iran must overcome three decades of estrangement punctuated by seminal events that further deepened the chasm.

During his campaign, President Obama openly embraced engagement with what formerly were known as rogue states, most notably Syria and Iran. Four months into his presidency, the broad outlines of his Iran policy are coming into focus: unconditional U.S. participation in multilateral nuclear talks; initiation at some point of wider-ranging bilateral dialogue; maintenance of sanctions as an instrument of leverage; and intensive regional as well as wider international diplomacy to increase pressure should engagement fail to produce demanded policy changes.

But what is Iran thinking? Understanding the Islamic Republic's power structure and decision-making is difficult, and one needs modesty in reaching conclusions. The regime has reasons – some justified, many contrived – for suspecting outside researchers, who thus face significant obstacles. The Iranians interviewed – officials, analysts with often close ties to the regime and heads of influential research centres – cannot be said to offer an exact view of the leadership's thoughts. This briefing should be read and filtered with these limitations in mind.

That said, during the course of several weeks of interviews in Tehran, Crisis Group found remarkable consistency of views regarding how the regime contemplates renewed dialogue, what it fears and how far it believes an improved relationship can go. To relate these is to neither endorse nor dismiss them; rather, they should be taken into account as the Obama administration embarks on one of its most important Middle Eastern undertakings – and one of its most daunting. The most notable conclusions are:

- Tehran's most oft-repeated demand also is its most abstract and thus the most readily (albeit misguidedly) dismissed: that the U.S. change the way it sees

and treats Iran, its regional role and aspirations. It is central to the thinking of a leadership convinced that Washington has variously sought to topple, weaken or contain it. It has practical implications: insistence that the U.S. forsake any effort to change Iran's regime; respect for its territorial integrity; and acknowledgment of the necessity and legitimacy of its regional role.

- Tehran will be highly suspicious of an approach imposing preliminary "tests" – progress on the nuclear file; cooperation in Iraq and Afghanistan – rather than first seeking to redefine the relationship and its parameters as a whole. A policy predicated on marrying engagement with pressure – while understandable from a U.S. perspective – risks triggering a negative Iranian reaction. U.S. officials present diplomatic efforts to build an Arab-Israeli coalition against Iran or forge an international alliance willing to tighten sanctions as creating leverage needed for successful negotiations. Iranians perceive them as a disingenuous ploy to produce a broad consensus for toughened containment measures under the expectation negotiations will fail.
- Tehran will regard U.S. handling of the nuclear file as a litmus test. Its red line is the right to enrich on its soil; anything less will be viewed as unacceptable.
- Officials contemplate dialogue occurring against the backdrop of enduring regional rivalry, particularly regarding Israel. Iran at this point does not intend to stop backing Hamas or Hizbollah or opposing Israel. Its conception of a future U.S. relationship comprises three distinct levels: wide-ranging dialogue covering both bilateral and regional issues; targeted cooperation on specific regional files, especially Iraq and Afghanistan; and the persistent reality of deep-seated differences and an overall strategic competition.
- Sanctions are taking their toll, and Iran faces a serious economic predicament. But this is highly unlikely to produce meaningful policy shifts. Iran's decision-making on core strategic issues is only marginally affected by economic considerations.
- For all its benefits, normalisation with Washington would entail serious political costs for the regime. Hostility toward the U.S. is one of its ideological pillars; economic adversity can be blamed on sanctions, while technological success – notably in the nuclear field – can be hailed as a powerful symbol of resistance against Western powers. The greater tensions are with Washington, the easier it is for the regime to rally supporters, suppress dissent and invoke national unity against a common enemy. Likewise, internal competition between various factions

will complicate engagement. U.S. officials already express frustration at the difficulty of opening channels to Iran. It is a taste of things to come.

This is not the first effort at improving ties, but it is the most promising. If it fails, all could pay a heavy price.

II. A TORTUOUS RELATIONSHIP

Iran and the U.S. broke diplomatic relations in 1980, following the seizure by Islamist students of the U.S. embassy; 52 American hostages were held captive for 444 days. The event – a defining moment for Iran and a traumatic one for the U.S. – capped a process that saw the overthrow of one of Washington's closest regional allies and the loss of a major strategic location, at the crossroads of Asia and the Middle East. The parties' duelling narratives and the fact that each side's perception is so profoundly coloured by competing interpretations of the past were summed up by an Iranian official: "Each protagonist is prisoner of its history, which is what makes it deaf to the other side's grievances".¹

Within Iran's revolutionary mythology, the takeover of the so-called "den of spies" is akin to a founding moment – one of the regime's ideological pillars, the first manifestation of its political independence and the most striking example of its anti-U.S. outlook. As Ayatollah Khamenei, the Supreme Leader, reminded his audience in January 2008, "breaking off ties to the United States is one of the bases of Iran's policy".²

The anti-American trajectory of the Iranian revolution reflects several complementary dynamics: the regime's desire to find its place between the then-competing superpowers;³ the reflection of two centuries of humiliation at the hands of the West, most lately and visibly of the U.S.; and the utility of a foreign scapegoat to explain the nation's enduring difficulties. The regime sought to portray the U.S. as its inveterate foe or the "Great Satan"; wittingly or not, successive U.S. administrations lent a helping hand. U.S.-imposed sanctions, coupled with U.S. military assistance to Baghdad during the Iran-Iraq war, validated the dominant narrative and bolstered the sense of patriotism among Iranians who recalled Washington's intrusive meddling

¹ Crisis Group interview, Tehran, 3 March 2009.

² See the Supreme Leader's January 2008 speech delivered in Yazd, at www1.irna.com/index2.php?option=com_news&task=popup&code=0801062004110229&pinde=&pfrom=0&no_html=1&lang=en.

³ One of the revolution's best-known slogans was "neither East nor West".

in the 1950s.⁴ The Islamic Republic was operating on fertile ground. Popular resentment toward Washington was rooted in the 1953, CIA-instigated coup against Prime Minister Mossadegh – a far more relevant episode in the minds of Iranians, regardless of age or political background, than the regime's rote denunciation of more recent American misdeeds.

That said, bilateral relations have not been wholly static. Over time, the official discourse has lost pertinence and resonance. According to most polling and anecdotal evidence, the vast majority of Iranians are not hostile to the U.S. and, for some time, have been eager for dialogue and the restoration of normal ties.⁵ There have also been timid attempts to change relations at the official level. In the 1980s, the Iran-Contra affair brought to the surface a web of complex, secret bilateral contacts.⁶ In 1995, then-President Rafsanjani invited a U.S. company, Conoco, to operate two Iranian oil fields; the \$1 billion dollar contract did not materialise due to new U.S. sanctions.⁷

The Clinton administration sought a rapprochement with Iran after the 1997 election as president of the reformist candidate, Mohammad Khatami; among its steps were Secretary of State Madeleine Albright's March 2000 acknowledgment of U.S. responsibility in the 1953

coup⁸ which followed the 1997 dispatch of an American wrestling team to an Iranian-hosted meet and inclusion of the Iranian opposition group Mojahedin-e Khalq on its list of terrorist organisations.⁹ Nothing came of this despite – or arguably as a result of – the presence of reformists in leadership positions. Amid an intense power struggle in Tehran, Khatami and his colleagues lacked the authority to overcome resistance from more hardline factions and effect such a major policy shift.

A new chapter fleetingly appeared possible in the aftermath of the 11 September 2001 attacks. In Tehran, spontaneous demonstrations expressed solidarity with the U.S.¹⁰ The subsequent invasion of Afghanistan brought the rivals closer in shared enmity to the Taliban. Indeed, Tehran's antagonism was older and more deeply-rooted than Washington's. In 1988, the Taliban had killed eight Iranian diplomats and a journalist in Mazar-e Sharif, bringing the two countries to the brink of war. The Afghan Islamists evinced visceral hatred for Shiites, fuelling Iranian fear and anger. Ousting them from power, increasing Iranian influence on its neighbour and returning the many Afghan refugees living in Khorasan province were the Islamic Republic's barely concealed wishes.¹¹ As a result, Iran cooperated with U.S. military forces, providing substantial assistance to Operation Enduring Freedom. In particular, it allowed U.S. transport aircraft to stage from eastern Iranian airfields and an American freighter packed with humanitarian supplies to off-load its cargo in the Iranian port of Chabahar.¹²

⁴The U.S. missile that mistakenly destroyed an Iranian Airbus on 3 July 1988, killing 209 civilians, heightened anti-American animus. The tragic incident remains prominent in the minds of Iranian officials.

⁵According to a recent survey, 69 per cent of the population favours direct talks between Iran and the U.S. World Public Opinion (WPO) opinion poll, February 2008, www.worldpublicopinion.org. In September 2003, a poll published by the Iranian press agency suggested that three quarters supported resuming relations.

⁶The Irangate or Iran-Contra affair refers to the attempt by the Reagan administration to offer weapons to the Islamic Republic in exchange for the release of U.S. hostages held in Lebanon by Islamist groups including Hizbollah; the scheme also was intended as a funding mechanism for the Nicaraguan Contras, in effect an end-run around U.S. Congressional restrictions. See Kenneth Pollack, *The Persian Puzzle: The Conflict between Iran and America* (New York, 2004), pp. 208-216; "Excerpts from the Tower Commission Report", at www.presidency.ucsb.edu/PS157/assignment_files_public/tower_excerpts.htm.

⁷See *The New York Times*, 16 May 1995. Executive Order 12957 barred U.S. firms from developing or participating in the development of Iran's oil industry. On 5 August 1996, President Clinton signed into law the Iran-Libya Sanctions Act (ILSA) which imposed extraterritorial penalties on non-U.S. companies investing in Iran's oil sector (which, for the first time since the revolution, the Islamic Republic had opened to foreigners).

⁸Secretary Albright said, "in 1953 the United States played a significant role in orchestrating the overthrow of Iran's popular Prime Minister, Mohammed Mossadegh. The Eisenhower Administration believed its actions were justified for strategic reasons; but the coup was clearly a setback for Iran's political development. And it is easy to see now why many Iranians continue to resent this intervention by America in their internal affairs". See www.aghayan.com/alb031700.htm.

⁹The administration also removed Iran from its list of major states engaged in the production or transit of narcotics and approved the sale of safety-related aircraft spare parts by Boeing to Iran.

¹⁰President Khatami said at the time, "we wholeheartedly believe that the sad 11 September incidents were a big crime committed against humanity". <http://former.president.ir/khatami/eng/cronicnews/1380/8011/801110/801110.htm>.

¹¹Located in eastern Iran, Khorasan borders Afghanistan and has hosted as many as two million Afghan refugees during the Taliban's rule. The massive refugee influx has generated significant tension with Iranians and triggered a demographic shift toward Sunnis.

¹²See Pollack, *The Persian Puzzle*, op. cit., p. 346. These were not the only steps. Iran ensured support of a local ally, Hizb-i Wahdat, the principal party representing the Shiite

America's subsequent response confounded and scarred the regime. From partner in the war against the Taliban, Iran suddenly became one of Washington's prime targets. A U.S. analyst said:

From Iran's perspective, it was the ultimate reversal and betrayal. Tehran had worked with America to get rid of a dangerous adversary. Then, without warning, Washington turned around, branded it a member of [what President Bush called] "the axis of evil". In the meantime, the U.S. closed ranks with a country, Pakistan, that did precisely what Washington accused Iran of wishing to do: acquire a nuclear bomb, harbour terrorists and provide support to militants in a neighbouring country, Afghanistan.¹³

Tensions worsened with the newly uncovered information about Iran's covert nuclear program, the imposition of UN and additional U.S. sanctions¹⁴ and, in the wake of the occupation of Iraq, suspicion that Tehran was supporting militant groups and thus bore indirect responsibility for the death of U.S. soldiers.¹⁵

Washington's policy had a paradoxical, unintended effect. With the fall of the Taliban and Saddam Hussein's regime, the U.S. could be seen as having militarily encircled Iran. At the same time, though, it neutralised Tehran's two most hostile neighbours. After a period during which the Islamic regime worried about the consequences of America's regional military presence – and reportedly sent out feelers to the Bush administration¹⁶ – the Iraqi quagmire and growing U.S. diffi-

culties in Afghanistan emboldened Iran to project its power region-wide. The attempt to isolate Syria and marginalise Hamas (which compelled both to turn more decisively toward Iran), heightened polarisation in the Arab world between so-called moderates and radicals and together with the Bush administration's neglect of the Arab-Israeli peace process, further consolidated Tehran's strategic position. In short, the U.S. unwittingly paved the way for renewed Iranian influence just when its revolutionary fervour was exhibiting signs of exhaustion.

By 2006, it was increasingly clear that America's Iran policy was not producing its desired effect. In December, a prominent bipartisan committee headed by former Secretary of State James Baker and former Congressman Lee Hamilton released the Iraq Study Group Report. Among its key recommendations was the need to talk to all Iraq's neighbours, Iran and Syria included. Although the administration flatly rejected both the report's advice and similar entreaties, its policy began to shift. By March 2007, it had initiated several (for the most part fruitless) bilateral discussions with Iran on Iraq. In July 2008, it dispatched for the first time a senior diplomat, William Burns, to attend multilateral talks with Tehran on the nuclear file (the format, known as the P5+1, includes France, the UK, Russia, China, the U.S. and Germany).

Whatever hopes the Bush administration had of destabilising Iran collapsed. Despite clear popular dissatisfaction with important aspects of its policy, especially among the youth, the regime remains stable, and few Iranians appear to want foreign-inspired domestic change.¹⁷ The military option of attacking Iran or its nuclear facilities presents serious risks for uncertain gain, a fact recognised by key U.S. officials.¹⁸ Although Iranian officials could not rule out a U.S. or, more likely, Israeli strike, worry was on the decline. A senior official said, "an attack on Iran will condemn the region to more confusion and more risks. It will unify

Hazara minority in Afghanistan, which fielded a militia during the 1990s civil war. See, eg, www.janes.com/extracts/extract/jwit/jwit0545.html. In 2001 Tehran expelled Gulbuddin Hekmatyar, a radical Sunni leader who, from Iranian exile, had called on Afghans to take up arms against the U.S. Iran also offered technical help, including recovery of American pilots who had fallen on its soil. See Pollack, *The Persian Puzzle*, p. 346.

¹³ Crisis Group interview, Washington, April 2009.

¹⁴ See Crisis Group Middle East Report N°51, *Iran: Is There a Way Out of the Nuclear Impasse?*, 23 February 2006.

¹⁵ See Crisis Group Middle East Report N°60, *After Baker Hamilton: What to Do in Iraq*, 19 December 2006.

¹⁶ In May 2003, an Iranian proposal was faxed by the Swiss government, representing U.S. interests in Iran, to the U.S. State Department. The three-page document, a framework for the normalisation of Iranian-US relations, dealt with topics such as cooperation in combating terrorism (particularly in Iraq); possible Iranian acceptance of a two-state solution to the Israeli-Palestinian conflict; the end of economic sanctions and Iranian guarantees to "abstain from WMD [weapons of mass destruction]", while being allowed "full access to Western technology". See <http://kristof.blogs.nytimes.com/2007/04/28/irans-proposal-for-a-grand-bargain/>. What happened next is the source of considerable contro-

versy. Senior U.S. officials denied having seen it, though a former aide contended they had. According to other reports, the administration chose to ignore it, questioning both its status (the degree to which it had the Supreme Leader's imprimatur) and the desirability of reaching out to Tehran at a time of perceived maximum U.S. strength. See testimony by Suzanne Maloney, House Committee on Oversight and Government Reform National Security and Foreign Affairs Subcommittee, at www.brookings.edu/testimony/2007/1107_iran_maloney.aspx. See also below.

¹⁷ Crisis Group interviews, Tehran, August 2008, February-March 2009.

¹⁸ Robert Gates, the U.S. defence secretary, said, "even a military attack will only buy us time and send the program deeper and more covert". Associated Press, 30 April 2009.

our humiliated people. Don't try to imagine what Iran's reaction might be. Just look back in time and remember the sacrifices that were made during the war with Iraq".¹⁹

Their views on the regime or the revolution's balance sheet notwithstanding – and criticism is widespread – many Iranians regard as undisputed achievements the affirmation of national independence together with their nation's growing power and technological advancement.²⁰ The Bush administration's confrontational approach eroded sympathy for the U.S. among arguably one of the region's rare pro-U.S. public opinions (Israel and Iraqi Kurdistan are two others); empowered the regime's more radical wing; and provided a ready-made rationale for accelerating the nuclear program. As an analyst put it:

Of all the justifications the regime could invoke to pursue its nuclear program, those provided by the Americans were the most effective by far. Aside from Iran, two countries belonged to Bush's "axis of evil": Iraq and North Korea. The former did not possess a nuclear weapon; the latter did. Iraq was invaded, its regime overthrown, its territory occupied. Meanwhile, the U.S. is seeking to negotiate with North Korea. What conclusions do you think the Iranian regime would have drawn from this?²¹

Sanctioning, isolating and pressuring the regime backfired in other ways. Tehran strengthened its regional role, while economic pressure failed to yield its intended consequences. Sanctions notwithstanding, the regime pursued a vast nuclear program, continued its uranium enrichment and made significant technological progress in areas as varied as aeronautics, defence and space exploration, in cooperation with different countries. Washington's policy offered greater manoeuvring room to its rivals, chiefly Russia and China, which invested in Iran and sought to incorporate it in their longer-term strategic competition with the U.S. Likewise, the Islamic Republic gained leverage in Iraq and Afghani-

stan, where U.S. objectives were more difficult to achieve without Iran's assistance.

President Obama's proposed approach is a direct refutation of this legacy and a reflection of lessons learned. As he stated both during the campaign and after he assumed the presidency, he is ready to engage Iran in a broad-ranging dialogue. But is Iran equally predisposed, and does it see dialogue in the same light? At one level, the regime's evolution on the question of engagement has been remarkable. Whereas public advocacy of dialogue with the U.S. had once been deemed off limits, the Supreme Leader himself signaled a fundamental shift in a landmark 2008 speech in Yazd. Engagement, he said, is acceptable as long as it serves Iran's interests – adding that at that specific moment, it did not.²² Renewed dialogue, in other words, became a function of political circumstance rather than ideological purity. As he put it, "we never said that severing relations would be forever".²³

The result is striking: for the first time since the 1979 revolution, every candidate in the June 2009 presidential election agrees that talking to America is desirable. The most "radical" among them, President Ahmadinejad, arguably has been the most energetic and visible in this respect. By 2008, he had ordered the creation of an office within the foreign ministry specifically devoted to the U.S.;²⁴ as soon as Obama was elected, he sent a congratulatory message, an unprecedented step in the Islamic Republic's history and one that – to the dismay of many Iranian officials – has gone unanswered, the president's Iranian New Year message, discussed below, being considered an inadequate substitute.²⁵ On 10 February 2009, the 30th anniversary of the Islamic Republic, Ahmadinejad reiterated readiness for dialogue.²⁶

In its first 100 days, the Obama administration sent its own messages. Its first concrete step was inviting Tehran to a 31 March multilateral meeting on Afghanistan. A

¹⁹ Crisis Group interview, Tehran, August 2008.

²⁰ Crisis Group interviews, Tehran, August 2008, February-March 2009. According to a poll, some 89 per cent of the population supports the nuclear program and believes Iran should master the uranium enrichment process. World Public Opinion (WPO), February 2008, www.worldpublicopinion.org. An Iranian economist, otherwise highly critical of the regime, said, "we are experiencing a technological revolution. Ten years ago, we had 200,000 computers; today, there are some 25 million. We were last in the region in terms of scientific publication. Now, we are first". Crisis Group interview, Tehran, 27 February 2009.

²¹ Crisis Group interview, Tehran, February 2009.

²² In his words, "the day such a relationship will benefit the Iranian people, I will be the first to applaud it". Under current circumstances, however, renewal of diplomatic relations would "create the possibility of U.S. influence and allow the coming and going of its spies". Yazd speech, op. cit.

²³ Ibid.

²⁴ Until then, affairs related to the American continent were dealt with together with Europe.

²⁵ "This letter is important as many don't understand why the U.S. president has not yet answered. It's a question of respect". Crisis Group interview, Nasser Saghafi-Ameri, senior fellow, Centre for Strategic Research, Tehran, 29 February 2009.

²⁶ Iran, he said, is ready for discussions based on "equality and mutual respect". IRNA, 10 February 2008.

more important milestone was Obama's 20 March Iranian New Year's message, which he simultaneously addressed to the Iranian people and the Islamic Republic – a sharp break from the Bush administration's decision to clearly distinguish between the two in order to delegitimise the latter.²⁷ The Supreme Leader's response was not devoid of criticism – he called Obama's words mere “slogans” and noted the absence of any concrete change in policy – but did not close the door. He made clear Iran stands ready to reciprocate if the U.S. modifies its approach toward Iran and the region. For all their limitations and caveats, such official pronouncements reflect the end of a taboo. The question of engagement is no longer one of whether but of how – and to what end?

III. WHAT DOES IRAN WANT?

Seen from Tehran, changes in U.S. rhetoric and attitude are important but both insufficient and insufficiently clear. Officials and analysts with close ties to the regime assert these are born of necessity – namely, growing recognition in Washington of its predicament in Iraq, Afghanistan and elsewhere – rather than of a new strategic vision. They suspect that the administration is proposing a series of tactical arrangements aimed at rescuing its damaged posture in those arenas but not a fundamentally new relationship or partnership. Conversely, as Ali Larijani, the powerful speaker of parliament, said, “if Iran feels that the U.S. wishes to resolve regional problems, if it feels that America's shift is strategic rather than tactical and if talks could help the region's vital interests, then Iran could take a close look at the proposal”.²⁸

An analyst explained:

The Bush administration's wars – toppling the Taliban and Saddam Hussein – are rich in irony from our standpoint. The U.S. was compelled to eliminate regimes that had been their objective allies in efforts to contain Iran. America spent as much militarily and financially in overthrowing these regimes as they had in creating them. This new situation forces the U.S.

to find a new regional posture, but it is not enough to define a new relationship with Iran. Washington faces its failure and is in the position of *demandeur*. It realises Iran's importance and its own strategic fiasco. But does it really have an alternative strategy in mind for its relationship with Iran?²⁹

What Iran is awaiting is precisely such a new overarching U.S. strategic framework.

A. IRAN'S EXPECTATION: A FUNDAMENTAL SHIFT IN U.S. PERCEPTIONS

Tehran's most oft-repeated, basic demand also is its most abstract: that the U.S. change the way it sees and treats Iran, its regional role and aspirations. Because it is hard to define and generally devoid of a tangible dimension – what exactly would it mean for Washington to acknowledge Iran's regional influence and role? – the request often is dismissed as mere rhetoric. That is a mistake.

Kazem Sajjadpour, vice president of the School of International Relations, which is affiliated with the foreign ministry, put it this way:

Any positive initiative must be founded on a new understanding of Iran, in other words on relinquishing the tenets on which the West up until now has built its approach. This is not a matter of misunderstanding but of an utter lack of understanding, of intellectual laziness. The West sees Iran exclusively as a threatening power. It has built an entire industry on the basis of such fear and on its promotion. The first issue to tackle is to correctly answer two fundamental questions: what is Iran and what does it want?³⁰

From the regime's perspective, dialogue, in other words, is not enough. It can take place; indeed it already has: that was the model of the three rounds of Iraq-related negotiations and, earlier, of the talks on Afghanistan. Another analyst, Khalil Shirgholami, researcher at the Centre for Euro-American Studies of the Institute for Political and International Studies, described them as follows: “Washington simply asked us to take specific steps without seeking to understand Iran's overall position, as if it were possible to isolate the things we can do to help the U.S. from Iran's broader regional role”.³¹ He added:

²⁷ In Obama's words: “So in this season of new beginnings I would like to speak clearly to Iran's leaders. We have serious differences that have grown over time. My administration is now committed to diplomacy that addresses the full range of issues before us, and to pursuing constructive ties among the United States, Iran and the international community. This process will not be advanced by threats. We seek instead engagement that is honest and grounded in mutual respect”. <http://news.bbc.co.uk/2/hi/americas/7954211.stm>.

²⁸ Crisis Group interview, Tehran, 9 February 2009.

²⁹ Crisis Group interview, Tehran, 3 March 2009.

³⁰ Crisis Group interview, Tehran, 4 March 2009.

³¹ Crisis Group interview, Khalil Shirgholami, Centre for Euro-American Studies, Institute for Political and International Studies, Tehran, 25 February 2009.

For us, that kind of dialogue symbolises the unequal relationship the U.S. has sought to impose under cover of mutual respect. Iran was invited to participate only to the extent it had something to offer to the U.S. – not because it had something to say.³²

In the absence of reciprocity and treatment of Iran as a full-fledged regional actor, officials assert, engagement cannot achieve durable results. Worse, as they experienced with the Afghan precedent, it might not even shield Tehran from a sudden reversal in U.S. policy.³³ In a senior official's words, "Iran has nothing to gain from a pseudo-dialogue. We could sit forever around a table but nothing will come of it if the U.S. chooses to ignore our point of view, doubts and interests. You can't have a productive dialogue while insulting and seeking to destabilise us".³⁴ Accordingly, officials insist that real engagement must be built on four pillars:

1. Respecting Iran's sovereignty and territorial integrity

This issue is particularly sensitive for a regime that believes the country's independence historically has been flouted by the West;³⁵ is persuaded that Western demands are but thinly veiled attempts to dominate their nation and the region as a whole; and is convinced that the U.S. has, even recently, sought to sow ethnic divisions. It is particularly concerned by, and suspects a U.S. hand in the rise in Sunni radicalism in the tribal

region of Balochistan.³⁶ Specifically, Tehran accuses Washington of backing an Islamic group, Jundallah.³⁷ An analyst with close ties to the regime claimed: "We have witnessed a powerful American desire to exacerbate divisions among Iran's communities and ethnic groups. This strategy is both offensive and futile. Iran is a nation-state; to split it would be to undermine the region as a whole. In so doing, the U.S. is harming its own interests".³⁸

On the eve of Iran's presidential elections, the Supreme Leader reiterated these accusations, blaming the U.S. for promoting terrorism in border areas³⁹ and, on 29 May, officials accused Washington of being behind a

³² Ibid.

³³ The need for reciprocity is an Iranian leitmotif, reflecting insistence on concrete steps to benefit Tehran as much as a more abstract, intangible demand for respect and recognition. An analyst said, "all the missed opportunities between the U.S. and Iran have a common denominator: absence of reciprocity despite what at times has been extremely close cooperation entailing genuine risk-taking on the part of Iranian officials. The release of American hostages held in Lebanon did not prompt a change in U.S. policy despite earlier promises. Rafsanjani's offer to open the Iranian market to Conoco – which, as he later indicated, was meant as an important political signal toward Washington – was followed by increased sanctions. Intense intelligence sharing on Afghanistan and Iranian-trained rebel forces played a significant part in helping to topple the Taliban. The end result was a policy aimed at overthrowing our own regime! Finally, the dialogue on Iraq has not opened up any new prospects. From now on, when we hear Washington urge cooperation, our instinct is to be wary". Crisis Group interview, Tehran, March, 2009.

³⁴ Crisis Group interview, Tehran, August 2008.

³⁵ In a senior official's words, "Iran used to be America's vassal. No more. Our independence is non-negotiable. Nobody will dictate our policy any more. Since 1979, Iran speaks with its own voice". Crisis Group interview, Tehran, August 2008.

³⁶ Iran's ethnic Persian, Farsi-speaking population is only a slight majority of its 70 million population, which includes sizeable Azeri, Kurdish, Arab, Turkmen and Balochi communities. There are somewhere between one and four million Baloch, nearly all of whom are Sunni Muslims. Balochistan is one of Iran's most destitute and underserved provinces; its poverty, porous border with Pakistan and growth of Sunni radicalism make it a cause of considerable regime concerns. Tehran's security and intelligence forces regularly conduct crackdowns that have exacerbated tensions. www.jamestown.org/programs/gta/single/?tx_ttnews%5Btt_news%5D=34479&cHash=252e582264.

³⁷ Jundallah (Soldiers of God) is a radical Sunni Islamist group operating in Balochistan. Led by Abdulmalek Rigi, it first came to public attention in 2003 with a series of attacks against high-profile security and intelligence officials. On 28 December 2008, it conducted a suicide attack in Saravan, killing four security officers. This followed the abduction of sixteen police officers, whom the group subsequently executed. The group also has been implicated in several strikes on infrastructure both in and outside Balochistan. Officials believe Jundallah has ties to Sunni Islamist militants associated with al-Qaeda and the Taliban who operate across the border in neighboring Pakistan and Afghanistan, although the existence of such ties never has been established. Indeed, and notwithstanding its Sunni Islamist rhetoric, the group (which recently adopted the name of the People's Resistance Movement of Iran) must be understood in the context of Balochi nationalism, which extends to communities in Afghanistan and Pakistan. Iran has suggested that Jundallah is a CIA creation. The regime appears convinced that any future U.S. attack will be preceded by a spike in foreign-inspired domestic unrest; it regularly denounces foreign meddling as the cause of ethnic incidents in Balochistan.

³⁸ Crisis Group interview, head of Iranian research institute, Tehran, 3 March 2009.

³⁹ During his visit to Iran's Kurdistan province, Ali Khomeini declared: "I say this firmly that unfortunately across our borders, our western borders, the Americans are busy making a conspiracy, they are busy fostering terrorism Money, arms, and organisation ... are being used by the Americans directly across our western borders in order to fight the Islamic Republic's system. We should be awake". See Reuters, 19 May 2009.

suicide bombing at a Shiite mosque in Balochistan.⁴⁰ The claims appear wholly unfounded and have been roundly denied by the U.S.⁴¹

2. Respecting the Islamic regime

As officials see it, U.S. policy consistently has sought to drive a wedge between the regime and its people or, alternatively, between various factions of the regime itself. President Obama's decision to address his message to both leaders and people was – from the former's perspective – a step in the right direction, although concerns remain.⁴² Virtually all Iranian analysts and officials interviewed by Crisis Group – reformist and conservative alike – criticised what they perceived as the current administration's calibration of U.S. actions based on Iran's electoral calendar and in particular, as mentioned above, the president's decision not to respond to Ahmadinejad's congratulatory message.⁴³ This, they say, has put unnecessary hurdles on the path toward normalisation and provided the Iranian president with a reason to ratchet up his rhetoric; Obama's New Year message was not considered an adequate substitute.

Political calculations aside, the Iranian system appears far too opaque for the U.S. to fine-tune its actions, strengthening those it wishes to bolster or weakening those it aims to undermine. A prominent analyst warned:

One should be humble when seeking to master the complexities of our political system and avoid projecting Western categories of right-wing, left-wing, conservative and progressive. Iranian actors and political forces do not neatly fit into such groupings. Rather than waste time trying to game the system, a more useful strategy would be to propose a serious

dialogue. If the offer is fair, and if it acknowledges our regional role, Iran will respond, regardless of the identity of our president.⁴⁴

Several officials point to the terms of the 19 January 1981 Algiers accord between Iran and the U.S. pursuant to which, “the United States pledges that it is and from now will be the policy of the United States not to intervene, directly or indirectly, politically or militarily, in Iran's internal affairs”.⁴⁵ From their vantage point, reaffirmation of this commitment by the Obama administration would be an important signal.

3. Acknowledging Iran's regional role

Of all Iran's demands, recognition of its regional influence is the most imprecise but also, arguably, one of the more central. Officials repeatedly bring it up without defining exactly what it means. Pressed, a senior official offered the following explanation:

Dealing with Iran cannot be separated from understanding Iran as a major regional actor – not merely political, but also cultural and historical. Iran is not one file among others that must be dealt with. We are a civilisation, a proud people and independent nation that have a legitimate regional role.⁴⁶

Iranian leaders are all the more insistent today that their role in regional affairs be acknowledged because they are convinced that they have essentially reached regional strategic parity with the U.S.⁴⁷ and that this balance will persist regardless of the Obama administration's decisions:

Whatever Washington does, it will help us. If they stabilise Iraq and Afghanistan, modernise their economies and invest in their infrastructure, we will be pleased, because this serves our interest through stabilising the region. If, on the other hand, they opt for continued confrontation, the U.S. will grow weaker, becoming gradually less of a threat to Iran.⁴⁸

⁴⁰The deputy provincial governor of Sistan-Balochistan province said, “according to the information obtained [from interrogating suspects], they were hired by Americans and the agents of the arrogance”. Agence France-Presse, 30 May 2009. The Supreme Leader said that “no one can doubt” that “some interfering powers and their spying services” were involved, while even the more reform-minded presidential candidate, Mir Hossein Mousavi, blamed “foreign forces”. *The New York Times*, 30 May 2009. A total of 25 persons perished in the attack.

⁴¹See *The New York Times*, 30 May 2009.

⁴²Vahid Karimi, head of the Centre for Euro-American Studies at the foreign ministry's Institute for Political and International Studies, noted: “If the goal is to restore trust, the key is to convince Iran that there is no attempt to divide the people from their rulers”. Crisis Group interview, Tehran, 25 February 2009.

⁴³Crisis Group interview, Khalil Shirgholami, Tehran, 25 February 2009.

⁴⁴Crisis Group interview, Mohammad Marandi, head of Tehran University's North America Research Centre, Tehran, 26 February 2009. He added: “Obama should avoid repeating Clinton's mistakes. Despite some positive steps, Clinton was trying to influence the nature of Iran's regime, in particular by tightening sanctions. Obama can mark a real policy change by respecting the Islamic regime”.

⁴⁵www.parstimes.com/history/algiers_accords.pdf.

⁴⁶Crisis Group interview, Tehran, August 2008.

⁴⁷Crisis Group interview, Kayhan Barzegar, Centre for Strategic Research, Tehran, 1 March 2009.

⁴⁸Crisis Group interview, Mohammad Marandi, Tehran, 26 February 2009.

Ultimately, Iranian leaders and advisers contend they aspire to a situation in which their country enjoys two types of power: soft, based on the region's growing acquiescence in its role and multifaceted influence; and hard, albeit (they claim) essentially as a defence mechanism to protect vital national interests.⁴⁹ As for the latter, an analyst at the influential Centre for Scientific Research and Middle East Strategic Studies – a think tank whose head enjoys close ties to the Supreme Leader's office – said:

If Iran faces threats, it adopts a confrontational strategy designed to safeguard its fundamental interests. That was the case in Iraq, when the U.S. harboured aggressive aims toward us. Our Iraq policy reflects the imperative of national security. Our doctrine is perfectly clear in this respect and is built around a non-negotiable principle: regional stability cannot be achieved at Iran's expense. But once our security interests are met, Iran's foreign policy sheds its more ideological trappings and reverts to a pragmatic form of realpolitik.⁵⁰

Hence the regime's irritation and anger when it is asked (as it was by the Bush administration, among others) what it is doing in Iraq, as if it had no role in that country other than to police and secure the border. "Our influence is intrinsic, inbuilt", the same analyst stated. "It is political, cultural, religious and economic. The natural starting point of any discussion with the U.S. should be to recognise that we have to be there and that we inevitably will exercise influence in this region. [But] we are not trying to expand, we are not planning to rebuild Iran of the Safavids".⁵¹ He added:

Iran is engaged in a process of economically-driven normalisation. We are helping build highways and railway tracks; we are exporting cement and building material. All of which is meant to establish long-term strategic ties to stabilise our relationship.⁵²

⁴⁹ Crisis Group interview, Kayhan Barzegar, Tehran, 1 March 2009.

⁵⁰ Ibid. Barzegar added: "The regime's fundamental demand was not that Iraq be ruled by Iranian-dominated Shiites; rather it was that the new government in Baghdad be friendly and non-threatening".

⁵¹ Ibid.

⁵² Ibid; also Crisis Group interview, Ali Biniiaz, head of the Centre for Energy and International Economy Studies, Institute for Political and International Studies, Tehran, 4 March 2009.

4. The nuclear file as test case

In the coming period, the U.S. and the West as a whole likely will judge Iran on the basis of its nuclear activities; Tehran can be expected to assess the new U.S. administration through the same lens. Because Iran's nuclear aspirations embody virtually all the leadership's core demands – as a guarantor of national independence and self-sufficiency, as an instrument of regime legitimacy and as a symbol of the state's regional standing – it will consider U.S. policy in this respect a test of whether the administration has adopted a genuinely new approach.

From the regime's standpoint, a key in this respect will be whether the U.S. eventually accepts Iran's right to enrich uranium on its soil and the extent to which it breaks from its predecessor's approach – namely, threatening increased sanctions or worse in the event of continued enrichment. When, in his implicit reply to Obama's New Year message, Ayatollah Khamenei stressed the need for concrete U.S. steps and demanded that it renounce a policy of "threats and inducement", he clearly had nuclear negotiations in mind, making it a gauge of the administration's goodwill.⁵³

This is not to say that Iran's ambitions necessarily will stop at a civilian enrichment capacity; doubts remain about its ultimate intent and have been deepened by the recent test of a new generation of longer-range surface-to-surface missiles, the Sejil 2.⁵⁴ There is reason to believe that the leadership itself has not yet decided how far it will go but that, at a minimum, it

⁵³ Supreme Leader's speech in Mashhad, 21 March 2009, www.msnbc.msn.com/id/29810371/. Some Iranian officials suggest and many analysts assert that the regime could accept a solution under which enrichment is undertaken on Iranian soil under strict international monitoring and under the auspices of an international consortium. Crisis Group interviews, Iranian officials, July 2008-April 2009; Mohammad Hadi Semati, researcher at the Centre for Strategic Research, Tehran, 28 February 2009. There are serious indications the U.S. administration recognises that any solution ultimately will have to entail allowing at least a pilot enrichment program on Iranian soil, perhaps under the auspices of an international consortium, though this is unlikely to satisfy Tehran's requirements. Crisis Group interview, U.S. official, Washington, May 2009. The nuclear crisis will be discussed in greater detail in a subsequent Crisis Group report.

⁵⁴ The Sejil 2 demonstrates that Iran has crossed an important threshold in its ballistic program by mastering solid-fuel technology; it also indicated likely technological improvements in terms of precision. This has further raised concern among experts that it seeks a military nuclear program. See *The New York Times*, 20 May 2009.

seeks mastery of the entire nuclear cycle with a break-out capability.⁵⁵

Based on conversations with senior Iranian officials over several years in Tehran and other capitals, Crisis Group has concluded, and maintains the view, both that the leadership is very conscious of the military, economic and further reputational downsides of weaponisation, and that an acceptable negotiated outcome remains possible.⁵⁶ In the interviews conducted for this report, Iranian analysts and officials again claimed to be aware of the high costs associated with crossing that threshold – heightened risks of a U.S. or Israeli military strike; greater isolation; and a probable regional nuclear arms race.⁵⁷ They also pointed to likely consequences on the internal situation. The head of a research centre said, “a nuclear bomb would be under the control of the Revolutionary Guard Corps and therefore would significantly alter the domestic political balance of power in their favour. This could change the very nature of the Islamic Republic”.⁵⁸

B. REGIONAL COOPERATION: IRAQ AND AFGHANISTAN

Even as Iran’s leaders insist on the need for a U.S. paradigm shift, their eyes are more immediately fixed on prospects for regional cooperation, notably on Iraq and Afghanistan, where they see potential common ground.

On Iraq, officials and analysts argue that Tehran and Washington have shared interests: maintaining the

country’s stability and territorial integrity (its fragmentation being seen in Iran as a worst-case scenario, with possible spill-over effects, especially among Iran’s Kurds); pursuing its electoral process (which, from Iran’s standpoint, has meant political power for the Shi’ite majority); and strengthening its economy. Likewise, each is determined to prevent the growth of Sunni extremist groups. Iran arguably also will be amenable to a residual U.S. presence – not so much to help Iraq as to increase Tehran’s leverage vis-à-vis Washington and minimise risks of a U.S.-led or condoned military strike, since U.S. forces will be vulnerable to Iranian or Iranian-inspired retaliation. On that basis, Iran’s leaders claim they can establish a *modus vivendi* with the Obama administration on condition that it acknowledges the inevitability and legitimacy of Tehran’s role and continued influence, given the extended common border and shared history.

Officials and others also maintain that the two countries can work together on Afghanistan. They have precedent on their side: Tehran backed the anti-Taliban Northern Alliance well before the 11 September attacks and played a significant role in the post-war period, helping to fortify new state institutions.⁵⁹ With a 930-kilometre common border, close to a million Afghan refugees on Iranian soil⁶⁰ and persistent narco-trafficking from Afghanistan into Iran, the status of Tehran’s neighbour is an issue of vital national concern. Drugs constitute, in many ways, the most urgent issue: Iran has one of the world’s highest consumption rates,⁶¹ trafficking poses a security threat at the border, and proceeds fund the Taliban, viewed by Tehran as a dangerous foe. Officials believe they could assist international efforts to provide Afghan farmers with alternative crops.⁶²

Significantly, in early informal messages conveyed to the Obama administration, Iranian officials made clear that, even more so than Iraq or the nuclear question,

⁵⁵ See Crisis Group Report, *Is There a Way Out of the Nuclear Impasse?*, op. cit.

⁵⁶ President Gareth Evans summarised Crisis Group’s position in these terms in December 2007: “What the international community really wants is for Iran to never produce nuclear weapons. The red line that matters is the one at the heart of the Non-Proliferation Treaty, between civilian and military capability. If Iran’s neighbours, including Israel, and the wider world, could be confident that that line would hold, it would not matter whether Iran was capable of producing its own nuclear fuel That line will hold if we can get Iran to accept a highly intrusive monitoring, verification and inspection regime that goes well beyond basic Non-Proliferation Treaty safeguards, which already apply, and includes both the optional additional inspection measures available under that treaty as well as tough further measures. Iran would also need to build confidence by agreeing to stretch out over time the development of its enrichment capability and to have any industrial-scale activity conducted not by Iran alone but by an international consortium”. “The right nuclear red line”, *The Washington Post*, 5 December 2007.

⁵⁷ Crisis Group interviews, Tehran, March 2009.

⁵⁸ Crisis Group interview, Tehran, March 2009.

⁵⁹ During the Bonn negotiations that led to the formation of the new Afghan government, Iran pledged \$560 million in grants and loans, with a focus on road reconstruction and power supply projects mainly in western Afghanistan. See Crisis Group Asia Report N°145, *Afghanistan: The Need for International Resolve*, 6 February 2008.

⁶⁰ See www.unaids.org/fr/KnowledgeCentre/Resources/FeatureStories/archive/2009/2009024_UNODC.asp.

⁶¹ Experts believe there are roughly 2 million Iranian habitual drug users. See, eg, Agence France-Presse, 23 May 2007.

⁶² Crisis Group interview, Tehran, March 2009. The commercial attaché at Iran’s Kabul embassy claimed his country has had extensive involvement in conducting seminars and workshops in coordination with Afghanistan’s agriculture ministry, reportedly peaking in 2007. Crisis Group interview, Kabul, 19 May 2009.

Afghanistan is where they are looking for swift results – due to shared interest in combating the resurgent Taliban but also to nagging worries that Washington could be playing a double game.⁶³ In particular, they are perplexed by perceived U.S. acquiescence in Pakistan's dealings with its own Taliban (at least prior to Islamabad's recent military offensive) and fear that Washington – perhaps under Saudi influence – might at some point decide to negotiate directly with their Afghan counterparts as a means of extricating itself from the Afghan quagmire.⁶⁴

An analyst said:

This would be a serious mistake. Today, the fight against the second generation of Sunni fundamentalism which is gaining ground in Afghanistan is a shared Iranian and American priority. We should be on the same side in the struggle against resurgent fundamentalism – with common interests and the same enemy.⁶⁵

Understanding Iran's threat perception in this regard is of crucial importance. It informs the regime's frustration at what it perceives as the international community's – and specifically the United States' – delayed reaction to the Taliban threat and refusal to directly cooperate with Iran. For Mohammad Nahavandian, the influential head of the Iran Chamber of Commerce, Industries and Mines:

Iran was the only country that highlighted the threat presented by Saddam Hussein. It took the United States twenty years to understand this. It then took Washington ten years to take our warnings about the Taliban into account. How long will it take them this time to heed our admonitions about the new Taliban?⁶⁶

Iran has reason for concern. It fears Sunni extremism spreading to its own Balochistan region on the border of Pakistan, which has seen mounting tension of late. Iran lost some 3,000 men over the past decade in fighting with smugglers and militants,⁶⁷ and the worsening security situation is cause for alarm.⁶⁸ In recent months, officials claim, Pakistan's military has reduced

its presence at the Iranian border;⁶⁹ as noted above, on 28 December 2008 Jundallah mounted an unprecedented suicide attack in Saravan, on the Iranian side of the border, killing four security officers. This followed the June 2008 kidnapping, detention in Pakistan's own Balochistan region and then murder of sixteen Iranian police officers by the same group. Finally, a suicide bomb attack killed 25 on 28 May 2009.

Officials fear that Jundallah will carry out similar operations in major Iranian cities, including Tehran, as well as attacks against the energy infrastructure. The Iranian-Pakistani-Indian pipeline⁷⁰ is due to run through Balochistan, further enhancing the area's strategic importance and deepening the risks presented by Sunni radical activism. According to Iranian security experts, Islamist websites contain growing references to the situation of Iran's Sunni minority, especially in Balochistan.⁷¹

In dangling the prospect of partnership with the U.S., officials point to the fact that Iran is one of Afghanistan's top ten donors,⁷² a major commercial partner and a vital access route for the landlocked nation. In particular, and although officials are clear that they want to see U.S. troops eventually depart, they also highlight possible use of its Chabahar port as the most convenient and secure means for the U.S. and its partners to send civilian logistical assets – two thirds of which currently run through Pakistan – into Afghanistan.⁷³ Iran reduced tariff rates for trade with Afghani-

⁶³ Crisis Group interviews, senior Iranian officials, Tehran, March 2009.

⁶⁴ Ibid.

⁶⁵ Crisis Group interview, Tehran, March 2009.

⁶⁶ Crisis Group interview, Mohammad Nahavandian, Tehran, 6 March 2009.

⁶⁷ See <http://english.aljazeera.net/news/middleeast/2008/06/200862620538368661.html>.

⁶⁸ Crisis Group interview, Tehran, March 2009.

⁶⁹ Crisis Group interview, Tehran, 1 March 2009.

⁷⁰ Construction is due to begin sometime in 2009, with completion expected by September 2012. Gas for the pipeline will come from Iran's South Pars Field. Plans to develop the \$7.4 billion pipeline have faced repeated delays due to security concerns along the Pakistani route, controversy over pricing mechanisms and poor relations between Islamabad and New Delhi. Western governments have balked at any deal that could economically benefit Iran. Iranian officials expect a visit from a Pakistani delegation to finalise details of the 2,775-kilometre gas pipeline. See www.daily.pk/business/businessnews/9825-iran-expecting-pakistani-moves-on-iran-pakistan-india-pipeline.html. On 24 May 2009, President Ahmadinejad and his Pakistani counterpart Asif Ali Zardari signed a 25-year deal pursuant to which Iran will export gas to Pakistan via the Iranian-Pakistani-Indian pipeline. www.huliq.com/1/81367/iran-pakistan-inc-gas-pipeline-deal.

⁷¹ Crisis Group interviews, Tehran, March 2009.

⁷² Crisis Group interviews, Tehran, March 2009.

⁷³ The worsening situation in Pakistan has enhanced the appeal of alternative transit routes, particularly after the February 2009 closing of the U.S. air base in Kyrgyzstan.

stan by some 90 per cent,⁷⁴ and commercial exchanges reached \$600 million in March 2009.⁷⁵

None of this is meant to suggest full convergence of Iranian and U.S. interests on Iraq or Afghanistan. Officials do not deny the persistence of conflicting views and of a tug-of-war for influence between Washington and Tehran; still, they insist this is overshadowed by mutual need to stabilise both countries. In Afghanistan, despite periodic reports of Iranian help to rebel groups and the seizure of weapons purportedly originating from Iran,⁷⁶ Tehran maintains it backs President Hamid Karzai's government and expresses puzzlement at why the U.S. typically has played down Pakistan's problematic role while highlighting Iran's far less harmful one. As Crisis Group described elsewhere:

Iran has pursued a multi-pronged approach, including public assistance to the Karzai administration and development initiatives particularly in the West of the country; support to the Northern Alliance (Karzai's opposition), its traditional non-Pashtun, non-Taliban allies as well as the minority Shia community; and possibly covert support to the Taliban, not out of a desire to see them win but to ensure that U.S. forces remain mired in the region.⁷⁷

⁷⁴ Crisis Group interview, Tehran, March 2009.

⁷⁵ Crisis Group interview, Tehran, March 2009. According to the Iranian commercial attaché in Kabul, trade between the two countries in 2008 amounted to roughly \$600 million (\$590 million in Iranian exports, \$10 million in Afghan exports). Crisis Group interview, Kabul, 19 May 2009.

⁷⁶ In June 2007, the U.S. claimed it had uncovered Iranian-origin weapons in the hands of Taliban fighters in western Afghanistan. Secretary of Defense Robert Gates said, "I haven't seen any intelligence specifically to this effect, but I would say, given the quantities we are seeing, it is difficult to believe that it is associated with smuggling or the drug business or that it is taking place without the knowledge of the Iranian government". www.rferl.org/content/article/1077356.html. Afghan President Hamid Karzai, however, said, "we don't have any such evidence so far of the involvement of the Iranian government in supplying the Taliban We have a very good relationship with the Iranian government. Iran and Afghanistan have never been as friendly as they are today". www.rferl.org/content/article/1077356.html. Tehran strongly denied it was aiding the Taliban. Foreign Ministry Spokesman Mohammad-Ali Hosseini said, "our policies in Afghanistan, our support for the Afghan government and our contribution to the country's reconstruction are perfectly clear". *South Asia News*, 5 August 2007.

⁷⁷ Crisis Group Asia Briefing N°89, *Afghanistan: New U.S. Administration, New Directions*, 13 March 2009, p. 7. Crisis Group concluded: "Dialogue between Washington and Tehran is essential to ensuring that Iran does not feel threat-

Analysts further point out that, with only a 20 per cent Shiite population, Afghanistan is not seen as a candidate for significantly deeper Iranian influence.⁷⁸

If anything, the Iraqi case is more complex and ambiguous. Tehran aspires to a unitary Iraq, powerful enough to withstand the shock of a future U.S. troop withdrawal yet not so strong as to some day pose a renewed threat to Iran or again serve as a buffer against Iranian influence. This means an Iraq under a measure of Iranian influence, dependent on it for trade, investment and political support; Iraqi leaders who share as much as possible the Islamic Republic's outlook; a country bereft of a strong air force and – of utmost importance – without the capacity to develop weapons of mass destruction. Although Tehran has few genuine ideological or political allies in Iraq – and although suspicion of Iranian intentions runs high – from 2003 onwards it has successfully extended its influence through extensive trade relations, reciprocal pilgrimage to Shiite holy sites in both countries and the purported placement of intelligence operatives in Iraqi parties and institutions.

Iran also can make use of historical relations with former exile parties currently in power, including the Islamic Supreme Council in Iraq, the Patriotic Union of Kurdistan and the Democratic Party of Kurdistan.⁷⁹ Its focus has been on both the northern, Kurdish areas and predominantly Shiite and historically underdeveloped south-eastern regions, where it has developed a variety of channels for extending its influence, playing on the diversity of Iraq's Shiite society more than a presumed common Shiite identity.⁸⁰

In this case, too, however, there are limitations of which at least some Iranian officials are aware. To begin, common religious identity is no guarantee of allegiance. A large majority of Iraq's infantry during its war with Iran was Shiite, yet the army proved loyal. Iraqi Shiism historically has followed a trajectory differing from its Iranian counterpart's; the dominant trend has tended to espouse a form of political quietism that contrasts

ened by the presence of U.S. troops in Afghanistan; that it plays a responsible role in stabilising Afghanistan; and that its relationship with its Afghan neighbour is not impeded by third parties". See also Crisis Group Asia Report N°145, *Afghanistan: The Need for International Resolve*, 6 February 2008.

⁷⁸ Crisis Group interview, Tehran, March 2009.

⁷⁹ See Crisis Group Middle East Report N°38, *Iran in Iraq: How Much Influence?*, 21 March 2005; Crisis Group Middle East Report N°70, *Shiite Politics in Iraq: The Role of the Supreme Council*, 15 November 2007.

⁸⁰ See Peter Harling and Yasin Hamid, "Iraq's Diverse Shiites", *Le Monde Diplomatique*, September 2006.

sharply with the Khomeinist notion of a Shiite theocracy. Moreover, a strong sense of nationalism runs through the Iraqi body politic, emphasising common national and ethnic identity over religious affinity. Even assuming it were possible, any Iranian attempt to fully back the Shiite Islamist parties in Baghdad would be a double-edged sword, heightening risks of sectarian confrontation and territorial break-up that would threaten the Islamic Republic's core interests.

For some Iranian analysts, therefore, the most promising starting point for dialogue with the U.S. is the common objective of stabilising Iraq and Afghanistan and ensuring their territorial integrity. Some go further, acknowledging that Tehran's regional influence has peaked, that the U.S. never will wholly desert the region and that it is better for Iran to consolidate gains than to risk them. In the words of one, "the fluctuating and unstable nature of Middle East politics means that Iran cannot assume its current power will last forever or that it will continue to influence states and factions that look upon it favorably today".⁸¹

C. AN ABIDING REGIONAL RIVALRY

When Iranian leaders speak of partnership and cooperation on regional issues, they mean it – but within bounds. They are equally quick to point out genuine differences on a host of Middle East issues on which they evince little if any willingness to compromise and on which they expect similar U.S. inflexibility. In other words, the dialogue contemplated by the Islamic Republic would take place against the backdrop of enduring competition.

At the core of this rivalry stands the question of Israel. In conversations with Crisis Group, and even as they discuss readjustment of some policies, Iran's leaders exclude any softening of their anti-Israeli rhetoric and practice which – together with their close embrace of the Palestinian cause – they see as pivotal to their growing regional influence.⁸² The Islamic Republic long ago concluded that its uncompromising hostility toward Israel and support for groups such as Hamas, Hizbollah and Islamic Jihad enabled its significant inroads among Arab and Muslim public opinion and pro-

vided it with the means to pressure (and undermine) pro-Western Arab regimes. For them, these are tools that, at this stage at least, are too precious to forsake.

Some interlocutors pointed to the 2003 Iranian offer to the U.S., suggesting the Islamic Republic was prepared to shift policy toward the Israeli-Palestinian conflict. In May 2003, in the aftermath of the Iraqi invasion, Iran used its Swiss channel⁸³ to send a letter to the State Department asserting that in the context of normalised relations, Tehran might cease providing material support to militant groups and accept a two-state solution.⁸⁴ As discussed above, the degree to which the letter reflected the Supreme Leader's views is disputed.⁸⁵ But regardless of its status at the time, the situation has changed significantly since 2003. U.S.

⁸³ Since Iran and the U.S. broke diplomatic relations, the Swiss embassy has represented American interests in Tehran. Pakistan performs this function for Iran in Washington.

⁸⁴ According to the fax sent by the Swiss government, "Iran accepts a dialogue in mutual respect and agrees that the U.S. puts the following aims on the agenda: WMD: full transparency for security that there are no Iranian endeavors to develop or possess WMD, full cooperation with IAEA [International Atomic Energy Agency] based on Iranian adoption of all relevant instruments... Terrorism: decisive action against any terrorists (above all Al Qaida) on Iranian territory, full cooperation and exchange of all relevant information. Iraq: coordination of Iranian influence for activity supporting political stabilization and the establishment of democratic institutions and a non-religious government. Middle East: 1) stop of any material support to Palestinian opposition groups (Hamas, Jihad etc.) from Iranian territory, pressure on these organizations to stop violent action against civilians within borders of 1967. 2) action on Hizbollah to become a mere political organization within Lebanon. 3) acceptance of the Arab League Beirut declaration (Saudi initiative, two-states-approach)". Full text available at www.mideastweb.org/iranian_letter_of_2003.htm.

⁸⁵ According to Iran's then ambassador to France, Sadegh Kharrazi, the Supreme Leader knew of and approved the document's content. U.S. officials questioned that account. A State Department spokesman said, "this document did not come through official channels but rather was a creative exercise on the part of the Swiss ambassador The last 30 years are filled with examples of individuals claiming to represent Iranian views. We have offered to Iran a chance to sit across the table from us and discuss their nuclear issue and anything else they would like, should they simply, verifiably suspend their uranium-enrichment activities". *The Washington Post*, 14 February 2007. Then Secretary of State Condoleezza Rice said, "I have read about this so-called proposal from Iran We had people who said, 'The Iranians want to talk to you', lots of people who said, 'The Iranians want to talk to you'. But I think I would have noticed if the Iranians had said, 'we're ready to recognise Israel' I just don't remember ever seeing any such thing". *The Washington Post*, 8 February 2007.

⁸¹ Crisis Group interview, Kayhan Barzegar, Tehran, 1 March 2009.

⁸² Ayatollah Khamenei described Israel as a "cancerous growth" at the opening ceremony of a 4 March 2009 conference on Palestine held in Tehran and during which President Obama was accused of "defending [Israeli] state terrorism". www.cbsnews.com/blogs/2009/03/04/world/worldwatch/entry4842425.shtml.

military and political power in the Middle East was then on the ascent, and many in Tehran feared Tehran could follow Iraq as the target of choice. Today, neither U.S. standing nor Iran's threat perception is remotely comparable.

The Islamic Republic's basic outlook on Israel and the Arab-Israeli conflict is unlikely to change in the foreseeable future, regardless of how relations with the U.S. evolve. Indeed, the regime will see its belligerent anti-Israel posture as an effective tool to mitigate the impact of a rapprochement with Washington. Reversing three decades of anti-U.S. dogma undoubtedly would face strong resistance and could undermine regime legitimacy;⁸⁶ the blow arguably would be softened by steadfast adherence to its other governing tenet, hostility toward Israel (conversely, a shift on both fronts simultaneously would call into question the regime's ideological foundation). By the same token, continued denunciation of Washington's support for Israel provides the Islamic Republic with a useful instrument to manage the pace of normalisation and regulate both the degree of bilateral tensions and the scope of engagement according to domestic and international calculations.

D. A CONFLICTUAL PARTNERSHIP?

The Islamic Republic's conception of a future relationship with the U.S. comprises three distinct, at times seemingly contradictory dimensions: wide-ranging strategic dialogue covering both bilateral and regional issues; targeted cooperation on specific regional files; and the persistent reality of deep-seated political and ideological differences within the context of an overall strategic competition.

Under this view, neither side will fundamentally shift its regional approach: the U.S. because it is unwilling to alter its policy toward Israel and must take into account Arab concerns about its dialogue with Tehran; Iran because of ideological principles and its aspiration to lead the Muslim world's struggle against Israel and defence of the Palestinians. An Iranian analyst underscored that the parties possess only narrow margins of manoeuvre: "This is a dialogue into which each side will enter for its own reasons: the U.S. because it needs help in Iraq and Afghanistan; Iran in order to minimise any strategic threat. But both are aware of the risks, and so they will move cautiously and within bounds".⁸⁷

It is, in many ways, a modest approach – which, for that very reason, could turn out to be unrealistic in that it does not fit Washington's expectations of a more radical Iranian policy shift.⁸⁸ It stems from the perspective that Iran's relationship with the U.S., however important, ought to be viewed as one among many and that its principal benefit will be to strengthen Tehran's overall independence. In the words of one official:

The Islamic Republic wants balanced relations with all international actors, the U.S. included. This won't be like it was in the past – it won't be an exclusive or unequal relationship. Iran has no privileged strategic partner that can guarantee its security or economic development. These can only be ensured by a multiplicity of partnerships and by balancing one against the other.⁸⁹

Echoing this view, an analyst said:

The basic problem is not that Iran is a superpower eager for recognition. It is that Iran lacks the means of becoming a superpower; that it cannot be wholly self-sufficient; and that it does not have a single, reliable strategic partner that can ensure its economic prosperity and strategic security. Iran is too small to be a superpower and too big to be a mere follower.⁹⁰

Europe is an important commercial partner – but it cannot provide security assurances and, from Tehran's perspective, has followed Washington's lead in adopting a hostile policy on the nuclear question. China provides diplomatic support and sees value in maintaining close ties because of its need for external sources of energy; so far at least, however, it has not displayed any willingness to jeopardise its international credibility by siding with Iran when others do not – specifically on the nuclear issue.

Likewise, the relationship with Russia is close, particularly in military and civilian nuclear domains, and strengthening those ties appears to be a regime prior-

⁸⁶ See Section V below for discussion of the domestic hurdles rapprochement likely would face.

⁸⁷ Crisis Group interview, Tehran, March 2009.

⁸⁸ A U.S. official partially echoed this view: "Iran wants tactical cooperation on certain matters and better, more strategic management of the rest. They are not looking to fundamentally 'redefine' the relationship. In fact, that would scare the regime. They want something more modest that makes the relationship more workable". Crisis Group interview, Washington, May 2009. He added that beginning with a narrow, focused discussion might not be an insuperable obstacle. "The important thing is to begin a process. Once that happens, who knows where the discussions might lead". Ibid.

⁸⁹ Crisis Group interview, Tehran, March 2009.

⁹⁰ Crisis Group interview, Saeed Leylaz, independent analyst, Tehran, 26 February 2009.

ity.⁹¹ But relations are complex, and marked by energy competition: the only way for energy-rich Turkmenistan and Kazakhstan to bypass Russia with its hydrocarbon exports is through Iran. As a result, Moscow has little interest in Iran expanding its energy potential and seeks to check any initiative that might threaten its ambition to exercise a quasi-monopoly over European hydrocarbon imports.⁹² And, like China, Russia appears concerned about a nuclear armed Iran and has joined in relevant UN Security Council sanctions.

Bereft of a single, reliable ally, Iran is seeking to diversify and balance its relationships, both as a means of maximising gains and as insurance policy. Its interest in improving relations with the U.S. is a natural corollary: in theory, this would lessen any security threat; legitimise Tehran's role in its immediate neighbourhood (Iraq and Afghanistan); and, through the eventual lifting of sanctions, pave the way to full use of its energy potential despite Russian opposition. But, at least as its leaders currently view it, the partnership with

countries such as Russia or China is not a temporary stopgap as Iran awaits restored relations with the U.S. and the end of sanctions; it reflects, rather, a strategic decision aimed at bolstering independence vis-à-vis the West. Accordingly, they put considerable weight on working through regional institutions, such as the Economic Cooperation Organisation,⁹³ the D-8 group⁹⁴ and the Shanghai Cooperation Organisation.⁹⁵

Asked how the U.S. and Iran can manage and sustain a relationship characterised by targeted areas of cooperation against the backdrop of pervasive competition and antagonism, Iranian officials and analysts pointed to three examples that are revealing less for their relevance than for what they say about Tehran's ambitions and worldview:

- U.S. relations with the Soviet Union during the Cold War, when progress on specific questions and ever-widening political and economic relations went hand in hand with irreconcilable ideological differences and an overall strategic struggle;⁹⁶
- Iran's relations with some European countries where "diplomatic and commercial relations take place amidst daily accusations".⁹⁷ Specifically, Tehran repeatedly criticises them for alignment with U.S. views and interference in its domestic affairs, while at the same time engaging in complex, chaotic but nevertheless regular diplomatic and economic relations; and
- perhaps most surprisingly, they mention Washington's relations with Saudi Arabia, which are portrayed as both close and inherently conflictual, insofar as the Kingdom allegedly backs radical Islamist groups seen

⁹¹ The Supreme Leader thus repeatedly has come out in favour of an OPEC-like gas organisation involving Russia since "half of the world's gas reserves are in Russia and Iran". Ayatollah Khamenei, quoted in the *International Herald Tribune*, 29 January 2007.

⁹² For example, Russia was successful in limiting the export capacity of the Iran-Armenia pipeline to ensure it would not provide Tehran with the future means to export gas to Georgia or the Black Sea area. In 2006, Armenian President Kocharian and Russian President Putin agreed that control over the section of the pipeline that crossed Armenian territory would be assumed by Gazprom via the ArmRosGaz company. Gazprom took measures to minimise Iran's role, for example by reducing the Iran-Armenia pipeline's diameter from the originally planned 1,420 millimetres (the size of major gas export pipelines) to 700 millimetres. This undermined Iran's ability to export gas beyond Armenia, in particular to Europe. See www.caucas.com/home/depeches.php?idp=1132 and www.huliq.com/15899/iran-armenia-gas-pipeline-more-than-meets-the-eye. In turn, the U.S. is dangling the prospect of Iran becoming a major alternative route for the export of Caspian oil and gas – assuming relations improve. The Obama administration hinted at such a possibility: its envoy for Eurasian energy, Richard Morningstar, did not rule out Tehran's possible involvement in the Nabucco project, a 3,300-kilometre-long pipeline from the Caspian Sea to Austria via Turkey which would reduce EU dependence on Russian energy resources. He suggested that Tehran stood to gain significantly given the U.S.'s deep commitment to Europe's energy security. *Asia Times Online*, 26 April 2009. In part in reaction, Moscow has sought to appeal to Tehran by massively investing in the South Pars Field and promoting Iranian exports to Asia. See *Asia Times Online*, 21 December 2007. On 27 May 2009, Gazprom announced its interest in the Iran-Pakistan-India pipeline with the barely concealed aim of lessening Iranian interest in the Nabucco project. See *Agence France-Presse*, 27 May 2009.

⁹³ Founded in 1985 by Iran, Pakistan and Turkey, the Economic Cooperation Organisation (ECO) is an intergovernmental body involving ten Eurasian nations dedicated to improving development and promoting trade as well as investment opportunities. Its stated objective is to establish a single market for goods and services. Its secretariat and cultural department are located in Tehran; its economic bureau is in Turkey and the scientific bureau in Pakistan.

⁹⁴ The Developing 8 Countries Organisation for Economic Cooperation, also known as the D-8 group, aims at promoting economic and technical cooperation between eight Muslim countries. Its members are Bangladesh, Egypt, Indonesia, Iran, Malaysia, Nigeria, Pakistan and Turkey.

⁹⁵ The Shanghai Cooperation Organisation is an intergovernmental mutual security body founded in 2001 by China, Kazakhstan, Kyrgyzstan, Russia, Tajikistan and Uzbekistan. Iran has observer status and applied for full membership in March 2008.

⁹⁶ Crisis Group interviews, Tehran, March 2009.

⁹⁷ Crisis Group interview, Saeed Leylaz, Tehran, 26 February 2009.

by Iran as far more dangerous in the long term to the U.S. than any Iranian-supported movement.⁹⁸

In some ways, Iran's overall conception is more akin to a grand dialogue than to a grand bargain. Even as officials insist on the need for a clean break in Washington's approach, argue for broad strategic engagement on a range of issues and reject the notion of an exchange limited to bailing out the U.S. in Iraq and Afghanistan, they put forward restricted objectives of their own. The implicit outcome is a better managed, regulated and respectful rivalry.

IV. IRAN IN THE FACE OF CONTINUED U.S. PRESSURE

Although it has said little publicly, the Obama administration's strategy toward Iran is increasingly apparent: full U.S. participation in the multilateral nuclear talks; initiation at some point of a wider-ranging bilateral dialogue; continuation of sanctions as an instrument of leverage; and intense regional as well as international diplomacy to solidify a consensual approach and maximise support for intensified pressure in the event Tehran rejects what the West considers a fair offer on the nuclear question.⁹⁹ President Obama suggested an end-of-year deadline to assess whether engagement has yielded results, though other officials have referred to a shorter timeframe before pushing for heightened multilateral sanctions – the UN General Assembly meeting in late September. Bravado notwithstanding, this has some Iranian officials worried, although not to the point of changing policy.¹⁰⁰

⁹⁸ Crisis Group interviews, Iranian officials and analysts, Tehran, February-March 2009.

⁹⁹ Crisis Group interview, U.S. official, Washington, May 2009. In remarks delivered after his meeting with Israeli Prime Minister Netanyahu on 18 May, Obama said, "we are engaged in a process to reach out to Iran and persuade them that it is not in their interest to pursue a nuclear weapon and that they should change course. But I assured the prime minister that we are not foreclosing a range of steps, including much stronger international sanctions, in assuring that Iran understands that we are serious". www.whitehouse.gov/the_press_office.

¹⁰⁰ In the words of Saeed Leylaz, an independent political analyst, "the Islamic Republic has become apt at concealing its concerns, but they are real. Economic difficulties combined with strategic uncertainty are taking their toll". Crisis Group interview, Tehran, 26 February 2009.

A. IRAN'S ECONOMIC PREDICAMENT

Despite a relatively rapid growth rate (currently averaging roughly 6 per cent annually), the Islamic Republic faces tremendous economic challenges. Its most glaring weakness is its excessive reliance on energy resources, which constitute over 80 per cent of its gross domestic product¹⁰¹ and are key to ensuring social stability. Energy-related revenues help subsidise the price of basic necessities¹⁰² and finance the bulk of public sector jobs,¹⁰³ which in turn helps curb the unemployment rate (officially, 10 per cent, in all likelihood far higher).¹⁰⁴ The oil price collapse hit Iran hard, threatening to unravel the implied social contract through which the regime has purchased domestic peace with generous subsidies.

Burdened with ageing refineries and infrastructure, Iran imports between \$5 billion and \$7 billion of gasoline per year and, oil reserves notwithstanding, the general public experiences both petrol rationing (since 2007) and a daily average of roughly four hours of electricity cuts. Daily oil production, which reached 6 million barrels in 1974, currently stands at 3.7 million and – due to technological shortcomings and investment shortages – is declining by roughly 5 per cent per year.¹⁰⁵ Iran holds 15 per cent of the world's hydrocarbon reserves, yet accounts for only 2 per cent of global energy production, and things could get worse. In April 2009, U.S. senators introduced legislation targeting Iran's importation of refined petroleum products, including foreign companies supporting its energy sector or ensuring fuel shipments.¹⁰⁶ Regardless of the bill's ultimate fate, the international crisis sparked by Iran's nuclear program has discouraged crucial foreign investment in the oil and gas sectors, without which

¹⁰¹ 90 per cent of Iran's export revenues and 75 per cent of its budget derive from the oil sector.

¹⁰² According to official data, these subsidies account for some 20 per cent of GDP. Iran's deputy oil minister said that petrol subsidies cost some \$85 billion per year. Agence France-Presse, 8 June 2008.

¹⁰³ About one third of the workforce is employed in the public sector. Crisis Group interview, Tehran, August 2008.

¹⁰⁴ Crisis Group interview, Tehran, February 2009.

¹⁰⁵ Crisis Group interview, Tehran, February 2009.

¹⁰⁶ The bill would extend sanctions detailed in the Iran and Libya Sanctions Act of 1996 to persons who have "with actual knowledge, made an investment of \$20 million or more (or any combination of investments of at least \$5 million which in the aggregate equals or exceeds \$20 million in any 12-month period) that directly and significantly contributed to Iran's ability to develop its petroleum resources". www.thomas.gov/cgi-bin/bdquery/D?d111:2:./temp/~bd5jNo:@@D&summ2=m&/bss/111search.html.

the government will be unable to meet growing domestic demand.¹⁰⁷

Other economic clouds are on the horizon. President Ahmadinejad's policy of income redistribution and subsidies reportedly have cost between \$180 billion and \$200 billion since his 2005 election¹⁰⁸ – roughly equivalent to the Oil Stabilisation Fund established in 2001 to insulate the economy from fluctuating oil revenue. Added to this has been Ahmadinejad's heavy public spending – it rose by some 40 per cent under his presidency – and the resulting projected \$45 billion 2009 budget deficit.¹⁰⁹ All this has led to a rapid growth in liquidity,¹¹⁰ which in turn has spurred inflation (rising from 10.2 per cent in 2005 to 17 per cent in 2007 and 30 per cent a year later) and exacerbated social tensions.¹¹¹ According to Iran's central bank, approximately 14 million of Iran's 70 million citizens live beneath the poverty level and unemployment has risen, even as more affluent classes reap important benefits through speculation, particularly in real estate.¹¹² Social inequality has grown, as illustrated by the visible presence in north Tehran's more affluent neighbourhoods of Western luxury brands of cars and clothing.

The regime is aware of the attendant social and political risks¹¹³ but so far at least, has no ready-made answer.

¹⁰⁷ In the absence of such investments, Iran will become a net oil importer by 2015. It needs approximately \$15 billion in annual investments merely to maintain its current oil production. In 2008, the oil minister stated that Iran would need to invest \$500 billion by 2024 in order to develop its oil sector. See www.iran-daily.com/1387/3109/pdf/i4.pdf. Since 1980, growth in energy demand (6.4 per cent) has exceeded growth in energy supply (5.6 per cent). See www.eia.doe.gov/emeu/cabs/Iran/Oil.html.

¹⁰⁸ Crisis Group interview, Saeed Leylaz, Tehran, 26 February 2009.

¹⁰⁹ See Majlis Research Centre (Iranian parliament's research centre) website, at www.majlis.ir.

¹¹⁰ Since Ahmadinejad's 2005 election, the monetary mass reportedly has grown by 36 per cent. Crisis Group interview, Ali Rashidi, head of the Industrial Engineers Society and former Central Bank governor, Tehran, 2 March 2009.

¹¹¹ Iran's currency, the rial, was devalued by 50 per cent in four years. *Ibid.* On 4 November 2008, 200 Iranian economists published a letter to the president in *Kargozaran*, claiming that average purchasing power had dropped by some 60 per cent in three years. In January 2007, more than half the members of the parliament signed a letter blaming Ahmadinejad's economic policy. www.rferl.org/content/article/1074152.html.

¹¹² The cost of a square metre of property in Tehran has more than doubled since Ahmadinejad assumed the presidency. Crisis Group interview, Tehran, February 2009.

¹¹³ The most acute social tensions in the recent past have been related to economic problems. In June 2007 the government

To combat inflation, the government announced on 29 December 2008 its intention to cancel \$90 billion worth of subsidies on essential goods, energy products and electricity.¹¹⁴ However, fearful of alienating its lower class constituency, it coupled this with the promise of cash handouts that, according to Iran's Parliament Research Centre, could bring the inflation rate to as high as 50 per cent.¹¹⁵ For Moussa Ghaninejad, one of Iran's top economists:

It is as if the government were instituting a reverse value added tax. Up until now, Iranians paid less for basic goods than they should have thanks to subsidies. But this was not apparent to your average citizen. Now, Ahmadinejad's goal appears to be to make the money visible and distribute it to the people. So prices will increase but the president will give out the difference between yesterday's and today's prices in the form of cash. It's a dangerous scam that will significantly augment the amount of liquidity in circulation. Its timeframe is three to four months – just long enough to last through the elections. Afterwards, inflation will neutralise any potential gains.¹¹⁶

All this is occurring against the backdrop of a precipitous decline in oil prices. According to an independent analyst, "by mid-2008, Iran collected roughly \$10 billion in oil revenues monthly; that amount has since declined to about \$3 billion. It's not that easy to reduce one's appetite after it has been so dramatically increased".¹¹⁷ The Central Bank governor, Mahmud Bahmani, cautioned, "If this rate continues until the end of the year, we will have generated \$54 billion less than expected in oil revenue"¹¹⁸ – a warning only slightly tempered by the more recent rise in the cost of oil.

For the most part, Iran's economic predicament results not from sanctions but rather from longer-term structural weaknesses, some predating the revolution (such

faced unrest after it sought to ration oil; likewise in October 2008 when merchants (*bazaris*) went on strike – their first since the Islamic revolution – following a government decision compelling them to turn over 3 per cent of their profits to the state.

¹¹⁴ In March 2009, parliament amended the government's proposal on the ground that it would stoke inflation, but the issue has not been fully resolved and likely will be debated over coming months.

¹¹⁵ See Majlis Research Centre website at www.majlis.ir; www.nioclibrary.ir/latin%20articles/090368.pdf.

¹¹⁶ Crisis Group interview, Tehran, 1 March 2009.

¹¹⁷ Crisis Group interview, Saeed Leylaz, Tehran, 26 February 2009.

¹¹⁸ Quoted in *The Washington Post*, 4 December 2008.

as the tendency to spend oil revenues on imports rather than infrastructure development), but many made worse by three decades of mismanagement. The result has been insufficient investment, corruption, nepotism,¹¹⁹ a bloated public sector and a disproportionate role for Islamic foundations.¹²⁰ Slogans extolling the Islamic Republic's self-sufficiency aside, the country remains highly dependent on imports, including of refined oil products. A businessman said, "if we really were self-sufficient, what would these \$60 billion-\$70 billion worth of imports mean?"¹²¹

The stunning growth of the already high level of imports vividly illustrates Iran's economic paradox. On the one hand, it underscores the regime's flawed macroeconomic decisions, which have stunted growth and increased dependency. But it also demonstrates the system's remarkable adaptability to external constraints. As commercial relations with the U.S. dried up and Washington's sanctions intensified, trade with others expanded. With China, it grew from \$200 million to \$25 billion in the last decade, as Tehran increasingly looked eastward for alternatives.¹²² The regime also has used UAE-based dummy corporations to circumvent American prohibitions.¹²³

¹¹⁹ Since 1979, the number of employees at the National Iranian Oil Company has grown tenfold, even though the oil sector suffers from under-investment, and production has dropped from 6 million barrels a day in 1974 to 3.7 million.
¹²⁰ Islamic foundations (*bonyads*) are charitable organisations that own a large sector of the Iranian economy. The income of the two wealthiest, the Foundation for the Disabled and Oppressed and the Imam Reza Foundation, reportedly are \$10 billion and \$20 billion respectively. The former is said to own some 1,200 businesses, 15,000 buildings and 400 agricultural properties, as well as 2.5 million square metres of offices; some 150,000 employees reportedly are on its payroll, and its activities allegedly account for between 4 and 5 per cent of Iran's GDP. Crisis Group interview, Tehran, March 2009. The Imam Reza Foundation controls an economic empire in the eastern region of Khorasan, on the Afghan border. It owns an airline company and, among other things, exclusive rights to Iran's popular soft drink, Zam-Zam Cola. It also is establishing a free trade area on the border with Turkmenistan and has sizeable real estate holdings.

¹²¹ See *Middle East Business Information*, 21 February 2009.

¹²² Crisis Group interview, Saeed Leylaz, Tehran, 26 February 2009.

¹²³ Crisis Group interview, Mohammad Nahavandian, Tehran, 6 March 2009.

B. DEALING WITH SANCTIONS

Understanding the regime's adaptation skills and sense of priorities is critical for assessing the impact of sanctions and tempering the impression of an impending economic catastrophe that could force Iran into political concessions. History – in particular the far more dire circumstances faced during and after the war with Iraq – should serve as a guide. The head of a research institute said:

After the Iraq war, we experienced a far more serious situation. Inflation had reached 50 per cent, and there was zero economic growth. We also witnessed periods when a barrel of oil cost \$6 or \$7. Today, we have economic growth, we've fulfilled our pledge to educate our youth, and we are working to ensure our country's technological independence.¹²⁴

Others mention Iran's accomplishments throughout this period, from regional influence to political independence, as of far greater importance than any transient economic crisis.¹²⁵

At their roots, the Islamic Republic's economic choices are predicated on non-economic variables – the relationship with the West; regime preservation; pride and dignity. In Moussa Ghaninejad's words, "the state does not think in economic terms but strictly in political ones. Iran's economy is dominated through and through by politics. There is no political economy. There is a politicised economy".¹²⁶ An Iranian economist put it that:

One must take Ahmadinejad seriously when he asserts that economics is not a science. That should not be read as a symptom of his economic incompetence, but rather a sign that he remains loyal to Ayatollah Khomeini's famous slogan according to which the revolution had not been fought over the price of watermelons. In other words, achieving the Islamic Republic's political objectives is more valuable than any concrete costs this might entail.¹²⁷

As a result, the regime tends to interpret economic indicators based on its political goals. Hadi Semati, an analyst at the Centre for Strategic Research noted,

¹²⁴ Crisis Group interview, Mohammad Marandi, Tehran, 26 February 2009.

¹²⁵ Crisis Group interview, 1 March 2009.

¹²⁶ Crisis Group interview, Moussa Ghaninejad, Tehran, 1 March 2009.

¹²⁷ Crisis Group interview, Tehran, 28 February 2009.

The best way to understand our economy is not to ask what level of prosperity we can reach but rather what political goals our economy allows us to achieve. The regime assesses the economic situation in terms of whether it can ensure political independence as well as military and diplomatic regional supremacy. Through that lens, whatever costs have been incurred over the past 30 years are deemed more than acceptable. What this means is that the current situation will not suffice to smother Iran and will not be enough to force it to shift its position vis-à-vis the U.S.¹²⁸

From a purely economic standpoint, improving relations with the U.S. and relaxing sanctions would make perfect sense, providing a windfall of heightened investment and unrivalled technology. But Iran's decision-making, particularly on matters affecting the strategically vital energy sector, have less to do with optimising productivity and profit than with buttressing its political stature and independence. This is the case, for instance, with Iran's decision to replace the French company Total by its Russian counterpart, Gazprom, to develop phases eleven and twelve of the South Pars project,¹²⁹ despite Total's clear technological edge.¹³⁰ Ultimately, Tehran chose Gazprom because it allowed Iran greater control over its own resources. By the same token, inarguable U.S. technological superiority in the energy sector will not necessarily impact Iran's decision.¹³¹ Using such criteria "may cost Iran about 10 to 15 per cent more, but they guarantee its energy independence" and, notably, free Tehran from having to count on American goodwill.¹³²

For Nahavandian:

The argument that Iran needs U.S. hydrocarbon technology was valid fifteen or twenty years ago.

¹²⁸ Crisis Group interview, Tehran, February 2009. Saeed Leylaz echoed that view: "In our system, petrodollars are principally aimed at ensuring the Islamic Republic's regional supremacy, not the greatest possible individual prosperity". Crisis Group interview, Tehran, 26 February 2009.

¹²⁹ The Iranian South Pars field is the northern extension of Qatar's giant North Field; it holds roughly 10 per cent of the world's total gas reserves and 60 per cent of Iran's. It is expected to go through 30 development phases, each of which requires an initial investment of approximately \$1 billion.

¹³⁰ See, eg, *Global Insight Daily Analysis* at www.globalinsight.com, 14 July 2008.

¹³¹ An Iranian oil consultant said, "the Chinese don't have LNG [liquefied natural gas] technology, but their technology is good enough". Crisis Group interview, Tehran, 28 February 2009.

¹³² Crisis Group interview, Hadi Semati, Tehran, February 2009.

It is not any longer. We have entirely replaced what once was our U.S.-based infrastructure; we now look elsewhere. Our technological dependence on the U.S. is a thing of the past. It is too late for Washington to play that card.¹³³

An Iranian energy expert added: "Incidentally, if we need American technology we can find it by ourselves", an unobvious reference to black market availability.¹³⁴

The current economic context undoubtedly heightens the cost of U.S. and other sanctions.¹³⁵ Of these, the measures targeting the banking sector have been the most biting, imposing additional costs to the tune of 5 to 20 per cent on Iranian business.¹³⁶ That said, regime officials maintain they have the capacity to withstand such pressure and even more. Nahavandian put it as follows:

The history of sanctions proves that such a policy can produce its intended effect only when several key factors are present. The targeted economy generally should be small; it should have only a small number of neighbours, and its population should be isolated from them; and there needs to be an international consensus as was the case with South Africa. None of these applies to Iran. Chances of altering Iran's behaviour as a result of sanctions are nil.¹³⁷

Officials also cite a number of potential shock absorbers, most notably the large oil and gas reserves,¹³⁸

¹³³ Crisis Group interview, Tehran, 6 March 2009.

¹³⁴ Crisis Group interview, Tehran, 28 February 2009.

¹³⁵ International sanctions against Iran are contained in UN Security Council Resolutions 1737, 1747 and 1803. Besides banning the export of any nuclear or ballistic missile materials, these resolutions contain financial restrictions on dealing with Tehran. The U.S. has imposed its own unilateral sanctions since 1987. Virtually all trade and investment activities with Iran by U.S. persons, wherever located, are prohibited, except the import of carpets and food items. The Iran and Libya Sanctions Act of 1996 also empowers the president to impose sanctions on any person or company (foreign or domestic) knowingly investing \$40,000,000 or more in a manner that directly and significantly contributes to the enhancement of Iran's ability to develop petroleum resources. www.un.org/sc/committees/1737/index.shtml; www.treas.gov/offices/enforcement/ofac/programs/ascii/iran.txt; www.fas.org/irp/congress/1996_cr/h960618b.htm.

¹³⁶ The U.S. has been most forceful in pushing for and enacting financial sanctions, though there are UN and EU actions in this area as well.

¹³⁷ Crisis Group interview, Tehran, March 2009.

¹³⁸ Iran's reserves are over 138.4 billion barrels of oil (10 per cent of the world total) and 28 billion cubic metres of gas. It possesses the world's third largest oil reserves and

which give Iran both a global economic role and the support of a number of important powers such as China, for whom the Islamic Republic is the second largest oil exporter.¹³⁹ In addition, while the global economic crisis has caused a significant drop in oil prices, it also has had some beneficial effects for the general population: real estate prices also have begun to drop, as has the inflation rate. Moreover, the government maintains a liquidity reserve on the order of \$90 billion.¹⁴⁰

Although the possibility of significant social unrest is present, officials and observers alike deem it remote. As one analyst put it, “political repression is effective. What is more, economic difficulties are in some respects the regime’s ally, as they make citizens more malleable. A more prosperous society would be far more difficult to manage”.¹⁴¹ A well-known political scientist made a similar point:

Granted, social tensions could increase. But there is little chance for them to become a danger to the regime. What opposition movement is sufficiently organised to threaten the regime? What realistic alternative is there? Developments in Iraq and Afghanistan have soured the Iranian people on the idea of a second revolution, which would be little more than a huge leap into the unknown.¹⁴²

Finally, it would be misleading to assess the economic crisis’s social impact strictly on the basis of official statistics. A former central bank governor said, “in Iran, official figures do not take into account over one third of the economy. We are talking about the universe of Islamic Foundations, the *bonyads*, which neither pay taxes nor publish accounts and whose real number remains unknown”.¹⁴³

All in all, most insiders appear convinced that neither the economic crisis nor U.S.-led sanctions will compel the regime to change course; it has weathered more serious economic storms and has lived with sanctions for three decades. Ghaninejad concluded: “Economic factors will not lead Iran to make diplomatic or political concessions”.¹⁴⁴

V. ENGAGING THE U.S.: A MAJOR DOMESTIC POLITICAL CHALLENGE

The prospect of dialogue with the U.S. presents substantial political risks to the regime. It challenges one of its ideological pillars and ultimately could mean loss of a convenient target of enmity that repeatedly has showed its usefulness for ensuring leadership cohesion.

A. A PERILOUS DIALOGUE

For engagement with Washington to proceed and yield results, the Islamic Republic will need to turn the page on one of its most important founding moments, the 1979 hostage crisis and all that it has come to signify; more broadly, it will have to break with that critical component of official discourse that relies on denunciation of U.S. imperialism and the notion of inherent U.S. hostility. To this day, the leadership’s rhetoric about the struggle for independence is predicated on and intermingled with the idea of continued U.S. attempts at domination. Economic adversity can be blamed on Washington’s sanctions, while every technological success can be hailed as a powerful symbol of resistance against Western powers opposed to Iran’s autonomy.¹⁴⁵ The greater tensions with Washington are, the easier it is for the regime to rally supporters, suppress dissent and invoke national unity against a common enemy. An analyst who favours regime liberalisation commented:

International sanctions are extremely useful for the regime. They provide it with an ideal alibi to justify economic difficulties. It’s America’s fault, according to the Islamic Republic and, in effect, the U.S. and much of the international community bear significant responsibility by imposing sanctions and openly acting against Iran. The greater external pressures, the more pertinent and solid is the official discourse. Opening the country frightens the more extreme forces who hope sanctions will remain in place.¹⁴⁶

second largest gas reserves. It is the world’s fourth largest oil producer and OPEC’s second. www.eia.doe.gov.

¹³⁹ Crisis Group interview, Ali Rashidi, Tehran, 2 March 2009.

¹⁴⁰ Ibid.

¹⁴¹ Crisis Group interview, Tehran, March 2009.

¹⁴² Crisis Group interview, Davoud Hermidas Bavand, Al-lameh Tabatabai University, Tehran, February 2009.

¹⁴³ Crisis Group interview, Ali Rashidi, head of the Industrial Engineers Society and former Central Bank governor, Tehran, 2 March 2009.

¹⁴⁴ Crisis Group interview, Tehran, March 2009.

¹⁴⁵ See the Supreme Leader’s 20 October 2008 speech before Basij students (a paramilitary force established in 1979 that operates under Iranian Revolutionary Guards command), as summarised in www.leader.ir: “Ayatollah Khamenei asserted that the resistance, the achievements and triumphs of the Iranian nation were admired and encouraged by all Muslim nations and added that the United States sought to use pressure to force the Iranian nation to renounce its independence and prestige”.

¹⁴⁶ Crisis Group interview, Moussa Ghaninejad, Tehran, 1 March 2009.

Echoing this view, another analyst said, “there is nothing like foreign pressure to buttress the official narrative. Thanks to it and to the West’s ultimatums, the nuclear program has become a national cause. Besides, officials believe that any confrontation with Europe – and most of all the United States – strengthens Iran’s regional position as leader of the Muslim world”.¹⁴⁷

By contrast, normalisation with Washington could entail serious political costs for the regime, possibly outweighing expected gains and triggering internal tensions within leadership ranks. Engagement likely would bring to the surface non-nuclear related issues where Washington’s stance might resonate more broadly with the wider public – including the human rights record or support for militant Arab groups that has been questioned by ordinary Iranians. Many citizens associate the launch of a U.S. dialogue with hope for internal liberalisation and could seize the opportunity to press harder for domestic reform.¹⁴⁸

All this led an analyst to comment: “Obama could present the Islamic Republic with one of the most difficult challenges of its history by asking it to remove a core pillar of its political edifice and relinquish one of its most trusted political tropes”.¹⁴⁹ Handled adroitly by Washington, it could put the regime before a vexing dilemma: to accept Obama’s dialogue offer, thus risking undercutting a central ideological tenet, or to reject it, thus risking being viewed as unreasonably inflexible by both domestic and international public

opinion. Obama’s popularity makes the latter scenario all the more challenging. A former vice president and chief of staff to ex-President Mohammad Khatami said, “if engagement does not succeed, President Obama will be far more dangerous than his predecessor. Bush had little credibility when he accused Iran of various misdeeds; even staunch U.S. allies told us privately they disagreed with him. Given Obama’s image, we could see the entire world rally against us”.¹⁵⁰ Iran has mastered the art of managing isolation. It has less experience dealing with international openings.

It follows that discussions between Tehran and Washington will be burdened by Iran’s ideological inertia and political apprehension (as well as by U.S. misperceptions and its own ideological preconceptions). Already, Obama administration officials lament that their efforts at engagement have been frustrated by the “absence of a real interlocutor. Iranian officials either don’t answer, or say they’ll answer later or claim we have to look for the answer elsewhere in the regime”.¹⁵¹ The Islamic Republic is unlikely to forsake its anti-American rhetoric even as the dialogue proceeds and notwithstanding achievements registered by a possible détente. In an October 2008 statement, the Supreme Leader suggested as much: “Hatred toward the U.S. is general and profound ... and disagreements [between Iran and the U.S.] are far deeper than a simple difference in political views”.¹⁵² Earlier, he had underscored that restoring relations “will not reduce the danger presented by the U.S.”, recalling that during the first Gulf War it had “attacked Iraq even though the two countries had diplomatic ties”.¹⁵³

That theme – that normalisation is not in and of itself a guarantor of Iran’s security – was sounded emphatically by the head of one of the country’s most influential think tanks:

Most governments of the former Soviet sphere that were toppled enjoyed very good relations with the U.S. Improved relations with Washington often ended up with “velvet revolutions”, political upheavals that were directly organised by the U.S. In hindsight, upgrading relations was a mistake. The real question regarding the possibility of a dialogue between the Islamic Republic and the U.S. is how it would benefit Iran – if at all.¹⁵⁴

¹⁴⁷ Crisis Group interview, Tehran, February 2009.

¹⁴⁸ Regime anxiety in this regard can be measured by heightened efforts to suppress any sign of protest and to label dissenters as U.S. collaborators. Officials increasingly accuse critics of seeking to destabilise the regime on America’s behalf and fomenting a “velvet revolution”. For instance, in January 2009 two renowned AIDS experts, Arash and Kamyar Alaei, were sentenced to three and six years of imprisonment respectively, on charges of participation in a U.S.-backed anti-government plot. On 12 January, the Supreme Leader’s representative in the influential Islamic Revolutionary Guards Corps (IRGC), Ali Shirazi, was quoted in the semi-official Fars News Agency as saying that “a velvet revolution in Iran” remains on the “enemy’s” agenda.

¹⁴⁹ Crisis Group interview, Saeed Leylaz, Tehran, 26 February 2009. Leylaz added: “Iran’s radical forces would have voted McCain without hesitation in the last U.S. presidential elections”. Crisis Group interview, Tehran, February 2009. Or, in Ghaninejad’s words, “George Bush unwittingly wore the clothes that the Islamic Republic for the past 30 years was hoping a U.S. president would wear. He was the ideal embodiment of the West as the regime wished it to be seen: arrogant, authoritarian, imperial. His principal impact will have been to give unprecedented credibility to the official discourse”. Crisis Group interview, Tehran, 1 March 2009.

¹⁵⁰ Crisis Group interview, Mohammad Ali Abtahi, Tehran, 28 February 2009.

¹⁵¹ Crisis Group interview, U.S. official, Washington, May 2009.

¹⁵² Supreme Leader’s 28 October 2008 speech to Basij students, op. cit.

¹⁵³ Supreme Leader’s January 2008 speech in Yazd, op. cit.

¹⁵⁴ Crisis Group interview, Tehran, 3 March 2009.

B. IRAN'S POLITICAL FACTIONS AND THE PROSPECT OF U.S. ENGAGEMENT

Although it is extremely difficult – and risky – to describe various leadership factions, even more so to ascribe clear political views to each, there is little doubt that the possibility of renewed contact with the U.S. has exacerbated intra-regime divisions. In contrast to what commonly is assumed, disagreements do not mirror a straightforward reformist versus conservative split, with the former arguing in favour of engagement and the latter against; rather, they cut across the political camps. Hadi Semati evoked three broad attitudes toward the U.S. that can be found within each faction:

The first approach sees in the U.S. a highly useful political instrument, a scapegoat that provides ready-made justifications to Iran's problems. The second considers the enmity between the Islamic Republic and the U.S. as ideologically rooted, a defining antagonism that simply cannot be overcome. The third acknowledges that, sooner or later, dialogue will resume despite existing obstacles and tries to assess costs and benefits to the Islamic Republic. The Supreme Leader balances between the second and third approach. He is the guardian of the revolution's dogmas but, at the same time, as a political leader, he is prepared to reassess them if required by the Republic's interests. Ahmadinejad's position is principally inspired by the third approach. He looks at the problem from a realist's standpoint and wants to maximise benefits of renewed contacts – both for Iran and for himself.¹⁵⁵

In other words, according to this analysis, the firebrand Iranian president would be among those “most eager to reestablish a channel of discussion”.¹⁵⁶ A well-connected analyst said:

It is one of the most misleading preconceptions about Iran. The revolution's anti-American evolution came principally from the Islamic Left, out of which have emerged Iran's reformists. The key figures behind the hostage crisis were also part of Khatami's government. They draw their roots in Marxism and a socialist economic conception; they are deeply suspicious about renewing relations with Washington. Mir Hossein Mousavi [the reformist presidential candidate and presumptively Ahmadinejad's most serious rival] fits this mould. As for the conservatives, don't forget that many

among them opposed the idea of breaking with the U.S. some 30 years ago.¹⁵⁷

This is not to say that the reformists – and Mousavi in particular – would prove less open to improved relations or that Ahmadinejad's provocative, inflammatory rhetoric and behaviour might not greatly complicate things.¹⁵⁸ But it suggests both that the current president might not be an insuperable obstacle to engagement and that a more reform-minded successor might prove less able to achieve it. The broader point is that attitudes toward the U.S. are not necessarily a function of political or even ideological positioning. Many other Iranian officials and analysts concurred that Ahmadinejad, paradoxically, might wish to renew contact with the U.S., notwithstanding the ideological predilections of some within his political camp. They cite letters he wrote to Presidents Bush and Obama,¹⁵⁹ as well as his three visits to the U.S. since assuming office.¹⁶⁰ They also underscored that, precisely due to his militant image and conservative pedigree, a Nixon-in-China syndrome makes Ahmadinejad well suited to break the taboo should he wish to.¹⁶¹ Unlike Khatami, who was handcuffed by conservative pressure and intimidation, the current president might, if reelected, have relatively free hands and the independence to move.¹⁶² Finally, and crucially, Iran's

¹⁵⁷ Crisis Group interview, April 2009.

¹⁵⁸ As a U.S. official said, “Who knows whether Ahmadinejad really wishes to engage. What we do know is that his outrageous statements about Israel and denial of the Holocaust will make engagement far more difficult, no matter what he really wants”. Crisis Group interview, Washington, May 2009.

¹⁵⁹ Ahmadinejad wrote an eighteen-page letter to President Bush in May 2006, recounting all the U.S. government's alleged “sins” and calling on its president to repent. On 6 November 2008, he sent a congratulatory letter to President-elect Obama.

¹⁶⁰ All three visits were related to UN General Assembly sessions, in 2006, 2007 and 2008.

¹⁶¹ Crisis Group interview Bahador Aminian, rector, School of International Relations, foreign ministry, Tehran, 4 March 2009.

¹⁶² An analyst who is not particularly sympathetic to the president noted: “Arguably for the first time since the Islamic Republic's birth, an Iranian president is in a position to escape from factional pressure. Ahmadinejad does not belong to any specific faction; in fact, he has built himself in part against the existing conservative camps. Tensions within his camp do not frighten him, and his position is exactly the opposite of Khatami's. He can, if he wants, avoid the paralysis that is caused by the ideological intimidation exerted by those who are ideologically opposed to the U.S. This time, the desire to talk to the U.S. also emanates from the most hardline faction of all”. Crisis Group interview, Tehran, March 2009.

¹⁵⁵ Crisis Group interview, Tehran, 28 February 2009.

¹⁵⁶ *Ibid.*

fundamental foreign policy orientation is determined by the Supreme Leader, not the president and therefore the future president's influence will be circumscribed.¹⁶³

A June electoral victory by a more reformist candidate thus would not automatically presage enhanced prospects for engagement. Whereas Ahmadinejad potentially could begin a dialogue and, because of his profile, effectively neutralise his opponents' spoiling capacity, his rivals would enjoy less manoeuvring room and might confront a determined conservative lobby (possibly even led by Ahmadinejad).¹⁶⁴ If faced with determined conservative opposition, the next president's attempted opening to the U.S. could well be stillborn.

VI. CONCLUSION

In the four months since Obama assumed the presidency, there has been much movement but little progress in U.S.-Iranian relations. The movement has included Ahmadinejad's congratulatory letter, Obama's Iranian New Year message, U.S. attendance at the P5+1 talks, its invitation to Iran to attend a meeting on Afghanistan and, overall, a more respectful U.S. tone, devoid of much of the bluster that characterised the preceding administration. In practice, however, there has been scant change. It is too early to reach any conclusions; U.S. officials say they are awaiting Iran's presidential elections for the situation to clarify. They attribute the absence of an Iranian response to the P5+1 nuclear proposal partly to political uncertainty in Tehran, partly to inherent slowness of Iran's complex decision-making process and partly to the regime's risk aversion.¹⁶⁵

Still, it is not too early to identify seeds of potential misunderstanding and try to neutralise them. Expectations appear mismatched. U.S. participation in the nuclear talks is highlighted in Washington but hardly noticed in Tehran, both because this began at the tail end of the Bush administration and, more importantly, because the gaps in substantive positions remain large. Even though U.S. officials suggest between the lines that they realise Iran, at the end of the day, will have to retain some enrichment capacity,¹⁶⁶ the maximum they contemplate – a small pilot program – falls short of the minimum Tehran seems willing to accept.

The U.S. administration's overall approach (coupling engagement with steps to bolster its leverage), though it can certainly be understood, also risks alienating the Iranian leadership. Washington is persuaded it has lost leverage over the past years because of Iran's growing regional might and America's mounting regional problems; it therefore believes it must recalibrate the balance of power if negotiations are to be successful. Hence the effort to convince European, Arab and other countries of the need to agree in advance on "crippling" multilateral sanctions if engagement does not yield results.¹⁶⁷ Hence, too, the suggestion of a deadline – the end of the year – to assess results of dialogue. Hence, finally, the repeated assertion that the best way to undermine Iran's regional posture is to move toward Arab-Israeli peace and forge an implicit alliance between so-called moderate Arab regimes and Israel. All this also is explained by the administration's desire to persuade U.S. sceptics that it is not naïve and that it will maintain a robust posture even as it talks to an arch-enemy.

Seen from Tehran, however, and in light of this briefing's conclusions, these steps cast the upcoming talks in a highly negative light. They could intimate that Iran's regional role is not viewed as legitimate and that the goal remains to minimise its power. When coupled with repeated hints of U.S. pessimism about prospects for successful engagement, they might lend credence to the theory that Washington in actuality is going through the motions simply to make the case to its allies that it has gone the extra mile – and that tougher sanctions will be required as soon as Iranian ill-will is exposed. In this sense, the leverage Washington believes it must acquire to maximise chances for successful talks could be what dooms them. Stated differently, the administration's concern that talks might fail could become a self-fulfilling prophecy, triggering the very Iranian reactions (denunciation of the U.S., acceleration of the nuclear program, a more belligerent approach to the Israeli-Arab conflict) that will torpedo the talks.¹⁶⁸

¹⁶³ Crisis Group Middle East Report N°18, *Iran: What Does Ahmadinejad's Victory Mean?*, 4 August 2005, pp. 11-14.

¹⁶⁴ See Frederic Tellier, "Dealing with Ahmadinejad", *Global Post*, 11 March 2009.

¹⁶⁵ Crisis Group interview, U.S. official, Washington, May 2009.

¹⁶⁶ Crisis Group interview, U.S. official, Washington, May 2009.

¹⁶⁷ On 22 April 2009, Secretary Clinton referred to the need for "crippling" sanctions if negotiations fail in before the House Foreign Committee. "We actually believe that by following the diplomatic path we are on, we gain credibility and influence with a number of nations who would have to participate in order to make the sanctions regime as tight and as crippling as we would want it to be". www.timesonline.co.uk/tol/news/world/us_and_americas/article6149692.ece.

¹⁶⁸ For the argument that the Obama administration's Iran policy has "in all likelihood, already failed", see Flynt Leverett and Hillary Mann Leverett, "Have we already lost Iran?", *The New York Times*, 24 May 2009. The Leveretts claim that the U.S. approach is convincing Iranian officials that

It would be foolish to profess blind optimism. As this briefing suggests, Iran's endgame vision (concerning its nuclear program and ties to militant Arab groups, for example) is at loggerheads with Washington's. Nor is there any certainty that Iran's domestic system will favour genuinely improving relations. But these difficulties make it the more important that U.S. efforts begin wisely and that, as much as possible, the administration seek to understand and take into account Iran's outlook and perceptions even if it does not accept them. And they make it all the more imperative that it discard well-worn illusions, such as that "moderate" Arab regimes will coalesce with Israel against Iran – when it is precisely those regimes' concern that Iran has gained credibility with their more militant publics that will deter them from improving ties to Israel.

A first step might be for President Obama to send a public letter to an Iranian counterpart – whether the Supreme Leader or the future president – expressing his desire for a broad strategic dialogue on the full range of issues as well as respect for Iran's territorial integrity, security and legitimate interests. The Iranian leadership would find such a message hard to ignore.

How the process is initiated, the degree to which the parties understand each other's psychology, how they try to overcome a legacy of mistrust – all these can have significant impact on the course of the dialogue. It is not too late to start on the right foot.

Tehran/Brussels, 2 June 2009

the administration intends to make them "an offer we can't accept' simply to gain international support for coercive action". They continued, "having a deadline for successful negotiations will undercut the perceived credibility of American diplomacy and serve only to prepare the way for more coercive measures". They describe as "delusional" the "the notion of an Israeli-moderate Arab coalition united to contain Iran".

APPENDIX B

ABOUT THE INTERNATIONAL CRISIS GROUP

The International Crisis Group (Crisis Group) is an independent, non-profit, non-governmental organisation, with some 130 staff members on five continents, working through field-based analysis and high-level advocacy to prevent and resolve deadly conflict.

Crisis Group's approach is grounded in field research. Teams of political analysts are located within or close by countries at risk of outbreak, escalation or recurrence of violent conflict. Based on information and assessments from the field, it produces analytical reports containing practical recommendations targeted at key international decision-takers. Crisis Group also publishes *CrisisWatch*, a twelve-page monthly bulletin, providing a succinct regular update on the state of play in all the most significant situations of conflict or potential conflict around the world.

Crisis Group's reports and briefing papers are distributed widely by email and made available simultaneously on the website, www.crisisgroup.org. Crisis Group works closely with governments and those who influence them, including the media, to highlight its crisis analyses and to generate support for its policy prescriptions.

The Crisis Group Board – which includes prominent figures from the fields of politics, diplomacy, business and the media – is directly involved in helping to bring the reports and recommendations to the attention of senior policy-makers around the world. Crisis Group is co-chaired by the former European Commissioner for External Relations Christopher Patten and former U.S. Ambassador Thomas Pickering. Its President and Chief Executive since January 2000 has been former Australian Foreign Minister Gareth Evans.

Crisis Group's international headquarters are in Brussels, with major advocacy offices in Washington DC (where it is based as a legal entity) and New York, a smaller one in London and liaison presences in Moscow and Beijing. The organisation currently operates nine regional offices (in Bishkek, Bogotá, Dakar, Islamabad, Istanbul, Jakarta, Nairobi, Pristina and Tbilisi) and has local field representation in eighteen additional locations (Abuja, Baku, Bangkok, Beirut, Cairo, Colombo, Damascus, Dili, Jerusalem, Kabul, Kathmandu, Kinshasa, Ouagadougou, Port-au-Prince, Pretoria, Sarajevo, Seoul and Tehran). Crisis Group currently covers some 60 areas of actual or potential conflict across four continents. In Africa, this includes Burundi, Cameroon, Central African Republic, Chad, Côte d'Ivoire, Democratic Republic of the Congo, Eritrea, Ethiopia, Guinea, Guinea-Bissau, Kenya, Liberia, Nigeria, Rwanda,

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