

Iran

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Iran's security is affected by a broad region that includes the Caspian Basin, Central Asia, Afghanistan, the Persian Gulf states, Pakistan, Turkey, and the Middle East. However, an increased focus on the countries of the Economic Cooperation Organization (ECO), as well as Iraq, on the one hand, and with members of the Gulf Cooperation Council (GCC) (including Yemen) on the other, provides a natural starting point in the search for building blocks of a future regional security mechanism.

Historical Background

Throughout history, except for the two most recent centuries, Afghanistan was part of various Iranian empires. The British Empire in India forced Iran to withdraw from the eastern part of Afghanistan and Herat. To recapture the city, the British Navy attacked the port of Bushehr in the Persian Gulf. Iranian troops withdrew from Herat. Afghanistan then served as a buffer between the British and Russian empires until it won independence from British control in 1919. Following Afghan independence Iran and Afghanistan maintained good relations. Iran sponsored cultural activities in various cities of Afghanistan and built a pipeline for sending petroleum from Mashad to Afghanistan's Herat. A brief experiment in democracy ended in a 1973 coup and a 1978 Communist counter-coup. The Soviet Union invaded in 1979 to support the tottering Afghan Communist regime and Iran hosted millions of Afghan refugees for decades. The Taliban, a hard-line movement sponsored by Pakistan that emerged in 1994, seized Kabul and most of Afghanistan except for the Northern Alliance's strongholds by 1998.

There was a serious risk that Iran might be drawn directly into the conflict, especially following the murder of ten Iranian diplomats when the Taliban took Mazar-i-Sharif in August, 1998. Even aside from this danger the conflict was costly to Iran, which gave expensive but covert support to Shi'ia and other anti-Taliban groups, coped with a large number of refugees, and found itself in the front line of the difficult struggle against drug trafficking. Such trafficking caused the spread of drug abuse within Iran itself.¹

The tragic event of 11 September 2001 and the US military campaign against the Taliban regime in Afghanistan relieved Iran of the Taliban threat but did not improve its security overall.² U.S. forces and the Northern Alliance that benefited from Iranian military support, eventually toppled the Taliban. Iran supported the state-building process defined by the United Nations Bonn Conference. On 9 October 2004 Hamid Karzai became the first elected president of Afghanistan, while a National Assembly was inaugurated on 19 December 2005. Iran pledged \$580 million for Afghan reconstruction.

Regionalism as a Priority in Iran's Foreign Policy

The combination of strategic location and rich energy resources made Iran a focus of great power competition throughout the modern period. This fact has profoundly affected Iranians' perceptions of the world and of international relations.³ Iran is situated at the heart of the world's most important petroleum hub and also controls crucial transportation routes entering the landlocked countries of Central Asia with the high seas⁴. Its geographic diversity, skilled and semi-skilled workforce, and domination

¹ Herzig, Edmund, "Regionalism, Iran and Central Asia"; *International Affairs*; vol. 80 no. 3, 2004, 503-517.

² Hunter, Shireen, "Iran's Pragmatic Regional Policy"; *Journal of International Affairs*, vol. 56 no. 2, spring 2003.

³ Fuller, Graham, *the Centre of the Universe: the Geopolitics of Iran*; Boulder, CO: Westview Press, 1990, pp. 17-23.

⁴ Acemuglu, Murat, "Iran key state in Caucasian and Central Asia", *Armenian Reporter International*; vol. 32 no. 19, 1999.

of strategic and communication routes all contribute to this country's central role in regional affairs.⁵

Since the end of the war with Iraq (1988) and the death of Ayatollah Khomeini (1989), the Islamic Republic of Iran has accorded regional relations and coalition building an increasingly important place in its foreign policy. The prospects for regional cooperation, whether with Saudi Arabia, Turkey or Pakistan, or with the small and vulnerable states of the Persian Gulf coast were limited. Prospects for Iranian engagement in multilateral regional cooperation with its new northern neighbors following the dissolution of the USSR in 1991 were hardly more promising.

Regionalism first began to assume prominence in Iranian foreign policy during the presidency of Akbar Hashemi Rafsanjani (1989–97). Following the Iranian war with Iraq, the urgent need for reconstruction and, more generally, for social and economic development to meet the needs of a young population, forced policy-makers to focus on material needs in all areas. In foreign relations this was expressed in an emphasis on expanding trade and attracting investment through the development of mutually beneficial state-to-state relations and through closer integration into the global economy.

In time the change in emphasis led to improvements in Iran's relations with a number of countries but not, crucially, with the United States. In spite of a number of tentative moves towards rapprochement, this relationship deteriorated further. By the end of the Iran–Iraq War the significantly reinforced U.S. Navy in the Persian Gulf was involved in direct confrontations with Iranian forces, exposing the latter's weakness and vulnerability. Following the 1990–91 Persian Gulf War, Washington adopted a policy of 'dual containment' towards Iraq and Iran, which it branded as the region's two 'rogue' states. The collapse of the Soviet Union coincided with this shift, depriving the Islamic Republic of its

⁵ Meshkini, Qadir Nasri, "Challenges and Imperatives of the Iranian Policy in Central Asia", *Amu Darya: The Iranian Journal of Central Asian studies*, vol. 4 no. 5, 2000; pp. 73–101.

main potential counterbalance to the threat posed by US global pre-eminence.⁶

To counter Washington's efforts to isolate Iran became an important objective for Tehran in its own right. In search of ways to frustrate Washington's policy of containment Tehran looked towards cooperation with nearby and Muslim states and with possible alternative major centers of power (Russia, China, Europe, India). It also sought to use those regional and international organizations that were not susceptible to western domination - for example, the Non-Aligned Movement, the Organization of Islamic Conference (OIC), and the Organization of Petroleum Exporting Countries (OPEC)-for the same purpose. More recently Tehran has gained observer status in the Shanghai Cooperation Organization. The constant themes of Iranian statements on regionalism have been self-reliance among regional states and the exclusion of extra-regional powers, specifically the United States.

Iran's geographical position, size, economic stature, and military muscle give it the potential to play a leading or pivotal role in the Persian Gulf, Greater Central Asia and the Caspian Basin. The collapse of the Soviet Union gave rise to a new awareness in Iran of the possibilities presented by the country's strength relative to other regional states and its geographical location at the heart of the Eurasian continent. The perception of Iran's natural role as a major regional power has increased not only in government but across a wide spectrum of elite and popular opinion. Participation in groupings that exclude extra-regional powers enables Iran to fulfill its proper role in a way that it cannot currently do within the international system, given the nature of its relations with the United States.

Iran's conversion to regionalism can best be understood as the response of a relatively weak state to the external challenge posed by the strong, in circumstances when the balancing option was taken out of play by the end of the Cold War. President Rafsanjani and his successors,

⁶ Herzig, Edmund, "Regionalism, Iran and Central Asia"; *International Affairs*, vol. 80 no. 3, 2004, 503-517.

Muhammad Khatami, and President Ahmadi Nejad, have all placed a strong emphasis on regional relations. Khatami's foreign minister, Kamal Kharrazi, stated in his first address to the UN General Assembly in 1997 that "Iran's highest foreign policy priority ... is to strengthen trust and confidence and peace in our immediate neighborhood." The present Foreign Minister of Iran, Manouchehr Mottaki, has stated that priority of Iran's foreign policy is to strengthen its Asian identity as opposed to its Middle Eastern identity.

This debate turns on through a conception of the world as a set of interlinked and overlapping regions. The emergence and reinforcement of these regions and their internal and mutual linkages is held to be a part of a benign globalization process that will limit the capacity of any single power to dominate the system. Iranian conceptions of regionalism attach great importance to culture, both as a defining feature and as a basis for cooperation.⁷

Iran's Economy

Over the past ten years Iran's annual economic growth averaged 4.3 percent, while the unemployment rate – which has been the basic headache for every Iranian president – remained above 10 percent. During this time, the growth rate was as high as 7.5 percent (in 2002), while the unemployment rate peaked at 14.2 percent (in 2001). In U.S. dollar terms, GDP increased from \$100 billion to \$150 billion during Mr. Khatami's presidency.⁸ The other headache – the inflation rate – averaged 15.8 percent, partly reflecting the high growth of bank liquidity, itself due to large government budget deficits.

Iranians' per capita income increased during these eight years, thanks to economic expansion and declining rates of population growth. Domestic and foreign investment also increased. Domestic investment's annual growth rate averaged 8.8 percent. Foreign direct investment was nil in

⁷ Herzig, Edmund, "Regionalism, Iran and Central Asia", *International Affairs*, vol. 80 no. 3, 2004, 503-517.

⁸ Pourian, Heydar, Iran Economics: from Mr. Khatami to Mr. Ahmadi Nejad, *Iran Economics*, Dec. 2005.

1997 but increased to \$1.5 billion by 2004, above all in energy. The oil sector's share of the gross domestic product (GDP) increased from 9.26 to 13.2 percent. Had oil prices remained at 1997-98 levels, Iran's economic development would have ceased.

During 1997-2005 the growth rate of exports (including oil, gas and petrochemicals) was 12.5 percent, while non-oil exports averaged 12.3 percent. Imports grew at 12.5 percent annually. There are pockets of critics who argue that excessive imports during this period damaged Iranian industries and increased unemployment rate. And since some of the imports were consumer goods, it is claimed that the country wasted its potential savings. In the meantime, the smuggling of commercial goods into Iran has exacerbated the situation.

Other accomplishments during this time include the expansion of road networks and agricultural improvements (including levels of wheat productions that transformed Iran from the largest importer of wheat in the world to self-sufficiency). Meanwhile, a new tax law lowered corporate rates from 64 percent to 25 percent. Revisions in the law on foreign direct investment, modern securities law, lowered tariffs, the establishment of an Oil Stabilization Fund (OSF), exchange rate unification, and discipline in foreign debt have all helped strengthen the Iranian economy.

Nonetheless, the ratio of the governmental budget (including state-owned enterprises and state-sponsored entities) to GDP increased from 67 percent to 88 percent, reflecting the growing governmental share of the economy, despite government plans to promote privatization.

Finally, in 2001, for the first time since 1989, banking licenses were issued to private groups. In spite of some progress and development, Iran's status in the region has lagged. During 1997-2005, a total of \$170 billion was earned as oil revenues. Critics argue that this amount (more than one-year's GDP) could have renewed the engine of industry had it been spent wisely. Observers also point out that foreign boycotts are continually hurting Iran and increasing the cost of doing business.

In social environment, while number of marriages has increased from 512,000 to 680,000, (a 32 percent increase) during this period, the number of divorces has expanded by more than 70 percent, from 42,000 to 72,000.

Cooperation in the Framework of ECO

The Economic Cooperation Organization (ECO) is the only major regional grouping of which Iran is a member. The ECO is a regional intergovernmental organization consisting of Pakistan, Iran, Turkey, Afghanistan, Azerbaijan, Turkmenistan, Uzbekistan, Tajikistan, Kyrgyzstan, and Kazakhstan. ECO may not be able to develop a soft security dimension for some time, but the organization can promote cooperation in trade liberalization, energy, migration issues and other “soft” security issues.

ECO is the successor organization to the Regional Cooperation for Development (RCD), which was established in 1964 by the triumvirate of Iran, Turkey, and Pakistan as an agent against Soviet Communism. Abandoned by Iran after the 1979 revolution, RCD was nonetheless revived and transformed into the present SCO.

The first ECO summit in Tehran and a subsequent extraordinary meeting of the ECO Council of Ministers in Islamabad (November 1992) culminated in the accession to ECO of five Central Asian republics as well as Azerbaijan and Afghanistan.⁹ ECO member states work to promote intra-regional trade and took significant steps to improve regulatory frameworks and remove tariff and non-tariff barriers. The regional trade situation, however, is far from satisfactory when compared to earlier years and prospects of an imminent change do not seem likely unless private initiatives, backed by the political will of the member states, are given momentum. So far, the scope and depth of trade linkages served as the main channel for the transmission of external shocks between the member states. The total intra-regional trade volume of

⁹ Afrasiabi, K & Pour Jalali, Y. The Economic Cooperation Organization: Regionalization in a competitive Context; *Mediterranean Quarterly*, Fall 2001.

ECO region increased to \$16.7 billion in 2004 (excluding Afghanistan) compared to \$10.2 billion in 2002.¹⁰

According to 2004 statistics, the share of Iran's intra-regional export was just 2.7 percent, with Kazakhstan at 5.7 percent, and Pakistan and Turkey at 6.7 percent and 3.5 percent, respectively; Azerbaijan amounted to 15 percent of the total, Kyrgyzstan to 22.0 percent, Tajikistan for 13.3 percent, and Turkmenistan and Uzbekistan for 23.7 percent and 15.8 percent, respectively. In most ECO countries the governments are moving ahead to reduce or remove trade barriers, deregulate internal markets, and privatize and liberalize investment flows. In some cases liberalization has been extended to such service industries as telecommunications, transportation and power generation and distribution, previously closed to foreign investors. Most of the countries have concluded bilateral treaties to protect FDI and avoid double taxation. Despite a global decline in FDI, several transition economies of ECO continued to see strong capital inflows. The resource inflows were uneven, however, with the oil and gas sectors in Azerbaijan, Kazakhstan, and Turkmenistan remaining the most attractive areas for FDI.

The short-term outlook remains favorable for countries of the region. ECO countries as a group are growing faster than the global economy, as well as some other groups of countries. This progress is providing greater stability in exchange rates and a more stable environment for investment, both domestic and foreign. However, institutional progress has been slower and more uneven, especially in the financial sector.

The region's short- and medium-term prospects depend critically on the implementation of structural reforms. The recent improvement in the region's growth performance has not made a significant dent in unemployment or brought about a sizable reduction in poverty. Yet the good macroeconomic performance of the last few years provides an opportunity to address these longstanding problems in the ECO region. And the favorable current economic outlook will present a timely

¹⁰ www.ecosecretariat.org, as March 15, 2006.

opportunity to strengthen policies aimed at resolving macroeconomic imbalances, addressing the fragility of banking and financial systems, and implementing structural reforms.

Assuming robust growth in ECO countries over the next years, and in the absence of major unforeseen shocks, aggregate GDP growth for the ECO region should have been 6.4 percent in 2006. Although economic growth in ECO region is projected to settle to more sustainable rates after 2006, the oil and gas sector and intraregional trade and strong consumer demand will remain a major driver of growth in the ECO region over the coming years. Such regional trade promises to benefit the entire region.

Iran and Greater Central Asia

Iran has 8731 kilometers of territorial and water borders with fifteen countries. Links between Iran and countries of Greater Central Asia include territorial border with Afghanistan and Turkmenistan and with Kazakhstan via the Caspian Sea. The Iran-Afghanistan border includes 945 kilometers of mountainous terrain that greatly assists drug traffickers.¹¹ Iran should be playing a major role in Central Asia and Afghanistan. Geography favors Iran's relations with the Greater Central Asian states, since all these states are landlocked, and some of them (Uzbekistan) double-landlocked. Their shortest and most natural route to the open seas is through Iran¹².

Iran's approach to Greater Central Asia is remarkably free of ideological influences.¹³ The best example is the role of Iran during the civil war in Tajikistan (1992-1997) when it mediated between the Tajik government and the Tajik Islamic Renaissance Party. No Greater Central Asian country has ever complained of support by Iran for Islamic groups in the

¹¹ Nasri, Ghadir, "Iran, Challenges in Persian Gulf", *Nameh Defaae*, Strategic Center for Defense Studies, No. 3, 2002.

¹² Dannreuther, Roland, "Bridging the Gulf? Iran, Central Asia and the Persian Gulf"; *The Review of International Affairs*, vol. 2 no. 4, Summer 2003, pp. 32-46.

¹³ Hunter, Shireen, "Iran's Pragmatic Regional Policy", *Journal of International Affairs*, vol. 56 no. 2, spring 2003.

region. Iran highest priority in regard to Greater Central Asia is to safeguard its security and its territorial integrity.¹⁴

The functional dimension of Iran's orientation towards the Central Asian region has been well received by neighboring states, forming the basis for the development of both bilateral and multilateral regional relations. Iran easily finds partners for the construction of roads, railways, pipelines and power grids to link its infrastructure with that of the countries of Central Asia and Afghanistan, for programs to remove barriers to trade, and for environmental protection in the Caspian Sea. So far, the new regionalism of Greater Central Asia has not reached the point at which states are required to pool sovereignty to any significant degree, and has therefore been more or less cost-free in political terms, but even this amount of regionalism implies the existence of a level of interaction and governance that lies between the global and the national.

Iran is a key player in the development of the new Afghanistan. Many prefer to consider Iran a Middle-Eastern country because of its role in oil production, as well as its tendentious relations with Iraq and Lebanon. Yet in reality Iran is preeminently a part of Greater Central Asia. Although its identity as the largest Shi'ia Muslim nation is important to Iran, and its first interest in Afghanistan is to protect Shi'ia (Hazara) groups there, when it comes to its relations with Central Asia Iran tends to define its policies in terms of the long-term intents of a Nation-State (Iran or Persia) rather than the short term interest of the current government. Iran sees itself as having been part of the Greater Central Asia for a millennium and as having always played a leadership role in the region.

In Afghanistan, Iran has multiple goals. In addition to ensuring that Hazara interests are accommodated, Iran wants an Afghanistan that is stable enough to permit the two million refugees now in Iran to return home. A longer-term goal is to prevent Russia, Pakistan, or Turkey from dominating the region and its resources. Iran's perspective is complicated

¹⁴ Atal, Subdoh, "Central Asian Geopolitics and US policy in the Region: The Post-11 September Era", *Mediterranean Quarterly*, Spring 2003.

by the fact that Central Asian energy producers are competitors to Iran. The Iranians have plans to build oil and gas pipelines to Pakistan and India via Baluchistan that will compete directly with proposed pipelines from Turkmenistan. Finally, Iran, like Russia, wants to ensure that the United States is not a dominant player in whatever new order emerges in the region.

Iran sought and attained observer status of the Shanghai Cooperation Organization (SCO) in an effort to escape from the dilemma of military and security threats from both East and West, as well as from the threats of Al Qaida and the Taleban. The SCO also seeks to reduce America's military pressure in the region.

Iran has for centuries considered itself the first neighbor of Central Asia and Afghanistan. Its strategic objectives there include:

- Developing positive political relations with the states of the region, including expanded trade and investment, particularly with Turkmenistan, Kazakhstan, Kyrgyzstan, Tajikistan and Afghanistan. Its relations with Uzbekistan are likely to remain correct but strained.
- Protecting open access to energy supplies, including the development of energy-based industries that complement rather than compete with Iran's domestic industry.
- Building relationships that helps it escape from international isolation, which it sees as enforced by US global hegemony.
- Maintaining close and professional, if not necessarily cordial, relations with Russia.¹⁵

In the economic sphere Iran aims to accomplish the following in Central Asia:

- Expand its infrastructure, especially its railway network;

¹⁵ Charles Fairbanks, Frederick Starr, Richard Nelson, and Kenneth Weisbrode, *Strategic Assessment of Central Eurasia*; Washington: The Atlantic Council of US & SAIS, Johns Hopkins University, Jan. 2001, pp. 73-77.

- Gain political and economic influence in Greater Central Asia through the Economic Cooperation Organization (ECO);
- Acquire shares in a number of Caspian oil and gas development and export ventures.

Iran seeks Central Asian and Afghan markets for its non-oil exports. It is also actively interested in developing transport infrastructure in Central Asia that will enable it to take advantage of its strategic location between Turkey and the Arab states in the west and South Asia in the east, and between the Caucasus, Caspian and Central Asia region to the north and the Persian Gulf to its south.

Iran has participated in the establishment of several free trade zones intended to stimulate regional trade. In Greater Central Asia it established the Sarakhs Free Zone between Iran and Turkmenistan, the Anzali Special Zone on the Caspian Sea, and the Dogharoon special Customs Zone with Afghanistan. For the first time in modern Iranian history, it has delegated to provincial authorities the power to establish relations with their regional counterparts in other states. As a result, the Province of Khorasan Razavi is working closely with Afghanistan, Golestan Province with Kazakhstan, and Mazandaran Province with Turkmenistan. It is hoped that the development of interdependent economic, social and cultural relations with other countries in the region will contribute to peace and stability by generating shared interests, mutual understanding, and trust.

Bilateral Relations

Iran's closest relationship in Greater Central Asia is with Turkmenistan. This is due to geographic proximity and their mutual interests in the exploitation and export of Turkmenistan's oil and gas resources. The Iran-Turkmenistan border extends 1200 kilometers and includes four highway border crossing points and a railroad border crossing at Sarakhs-Tejan. An important project was the construction of the 200-kilometer pipeline between Korpedzhe in Turkmenistan and Kord-Kuy in Iran,

allowing the export of 8 billion cubic meter of Turkmen gas annually into the Iranian gas network. Iran financed the \$160 million project, which is envisaged as the first step towards the export of Turkmen gas to Turkey and Europe via Iran. A connection between the Iranian and Turkmen electricity grids was completed in 2000.

Iran has recently been engaged in road-building projects in north-west Afghanistan, providing new routes to Uzbekistan and Tajikistan. These highways will eventually be of significant economic value, even though they have yet to be exploited to full capacity. Their symbolic significance in linking Iran to the Greater Central Asian states has been emphasized by politicians and commentators alike.

Railroads are an important element of Iran's transportation strategy. When eleven regional heads of state gathered at the opening of the Mashhad to Tejen rail link, they heard Iran's President Rafsanjani extol the wider significance of the project: 'The world is moving towards greater regional cooperation. Sustained and regionally-coordinated economic growth and development will consolidate peace and stability and pave the way for the enhancement of international relations.'¹⁶ This 300-kilometer rail link from Mashhad, the capital of Iran's Khorasan province, to Tejen in Turkmenistan was opened in May 1996, providing the first direct connection between the Iranian and Central Asian rail networks. More recently, efforts to extend and integrate the ECO rail network have continued, with the first journeys of both passenger and goods trains along the route from Almaty via Tashkent, Ashgabat and Tehran to Istanbul taking place in 2002. This rail link was developed after the United States' 1997 sanctions preventing the construction on international oil and natural gas pipeline projects that pass through Iranian territory from the Caspian region. Iran has also strongly supported the construction of the Turkmenistan-Iran-Turkey-Europe gas pipeline project, and signed oil swap agreements with both Turkmenistan

¹⁶ <http://international.rai.ir/Site.aspx>.

and Kazakhstan.¹⁷ Iran also has close energy sector relations with Turkmenistan. A pipeline between Korbeje in Turkmenistan and Kordkuy in Iran sends annually 8 billion cubic meters of gas to Iran. In July 2006, Iran's Minister of Petroleum Kazem Vaziri Hamaneh and Turkmenistan's Gas Minister Qurban Atayov agreed to increase gas exports to Iran to 14 billion cubic meters per annum.

Iran's ethnic and cultural ties to Tajikistan are strong and now extend to energy and transportation issues. On a September 2004 trip to Tajikistan former President Khatami pledged to cover half of the \$500 million cost of a hydroelectric plant on the Vakhsh River and promised investment of more than \$700 million into the impoverished Tajik economy over the next five years. A road link from Tajikistan to Iran via Herat in Afghanistan also features prominently in Iran's plans for boosting trade.

The World Bank has acknowledged Iran's significant role in stabilizing and strengthening Tajikistan's economy:¹⁸ "The construction of Tajikistan's Sang-Toudeh II and Raqoun power plants relying on Iranian and Russian capital depends on the atmosphere that the projects' managers provide, which also lowers risk for investors." Iran has also invested in the Anzab hydro tunnel. Tajikistan's Sang-Toudeh I and Raqoun power stations will be constructed by Russia, but Iran will construct its Sang-Toudeh II Power Plant. The construction of the 220 megawatt Sang-Toudeh II Power Plant is scheduled to take around four years at an estimated cost of \$300 million.

Relations with Kazakhstan are also developing well, particularly in the oil sector. Uzbekistan, too, has recently opened its door to economic and commercial relations with Tehran. Iranian heavy trucks now use Uzbek roads to reach Kazakhstan, Tajikistan and also the north of Afghanistan.

¹⁷ Efezil, E. & Stone, L., "Iran and Turkey in Central Asia: Opportunities for Rapprochement in the post-cold war era", *Journal of Third World Studies*, vol. 20 no. 1, 2003, pp.58-62.

¹⁸ World Bank's Economic Affairs Expert in Tajikistan Utker Omarev, March 2005, <http://payvand.com/news/06/mar/1063.html>.

Despite their differing views on political and security issues in the region, Iranian traders are working actively with their Uzbek counterparts. Uzbek roads are essential if Iran is to have access to other Central Asian states and northern Afghanistan. In the energy sector Iran's Oil Exploration Operations Company (OEOC) has signed an agreement with Malaysia's Petronas to carry out seismic operations in Uzbekistan at a costly \$30 million.¹⁹

Iran's Private Sector in Greater Central Asia

Iranian products are well known across Central Asia thanks to the historical ties between Iran and the region. They are relatively cheap since the transportation costs are the lowest in the region. Also, Iranian products are less complex than those from the West.

Several studies by Iranian and other specialists have identified the main barriers to Iran's exports to Greater Central Asian countries.²⁰

One of the main issues in this regard is that huge demand inside of Iran for goods and products, which discourages Iranian firms from exporting. They are also inhibited by the lack of staff who are familiar with exporting and by weak governmental programs for encouraging export policies. There also exist external barriers to export from Iran. These consist largely of tariffs, but also to an inadequate knowledge in some countries of existing commercial agreements, and so forth.

Continental Trade

Iran is carefully shifting its economic strategies to affirm its Asian identity. This has already led to closer relations with Asian countries. For instance, the trade volume between Iran and its major partners over the first four months of 2006 hit \$6.25 billion. Iran's main trading partner is China, then Japan, which together have replaced Europe; France, Germany, Britain, and Italy have fallen to third to fifth place, with

¹⁹ Mehr News Agency, May 18, 2006.

²⁰ For example, Ghazi Zadeh, Mostafa, Analysis of attractiveness of Central Asian region for Iranian Companies, presented at Third Management Conference, Tehran, Dec. 2005.

Russia, and South Korea a low sixth and seventh. Iran's revenue from the export of crude oil, oil products, and condensates surpassed \$18 billion during the second quarter of 2006, most of it from sales to Asian countries like China, Japan, Turkey and India.²¹

For the countries of Greater Central Asia, Iran is the major link to international markets. All the states of the region have requested Iran to expand its links to the rail system of Turkmenistan, so that the other countries in the region can gain access to Iran's railways to the Persian Gulf. In March, 1995, the Iranian and Central Asian presidents opened the 700 km railroad connecting the Iranian city of Bafq to the Iranian Persian Gulf port of Bandar Abbas. The construction of this line completed the rail link between the Iranian city of Mashad and the Persian Gulf. The line that connects Iran with Turkmenistan (the Tejen-Sarakhs-Mashad line) was completed in March, 1996. It is 140 km long and enables the countries of Greater Central Asia and Russia to access Europe via Turkey and also to reach the Persian Gulf, Pakistan, and India by a shorter and more time-efficient route than formerly. This transport link also provides an alternative rail link to the Russian railway system.

Another major project under way is the Trans-Asian Railway (TAR), which will connect Singapore with Istanbul. The United Nations Economic and Social Commission for Asia and the Pacific (ESCAP) initiated the TAR in the 1960s. The main direct route will have a length of 14,000 km. Currently the total length of unbuilt sector is 1550 km, of which 1400 km extends between Bangladesh and Thailand. Iran strongly supports the completion of this project.

Oil and gas are keys to the economic prosperity of the region but they must first be delivered to high-income importing countries. Iran plays an important role in both the exploitation and export of these resources. It has the world's second largest proven oil and natural gas reserves,²² and an extensive pipeline network to which pipelines from the Greater

²¹ *Jahaane Sanat*, August 4, 2006.

²² http://www.gasandoil.com/GOC/marketintelligence/primevistas/iran_oil_report.

Central Asia could be connected. In contrast to the east-west pipelines which the US supports, Iran, Russia and China are looking to other routes to the north, east and south. A Kazakhstan-Turkmenistan-Iran pipeline is already under study. The swapping of oil via the Caspian Sea is growing steadily and the capacity of the Neka-Ray pipeline inside Iran has been expanded to 170 000 b/d.

Iran supports also the following possible pipelines:

- A Tabriz-Ankara pipeline from Tabriz (Iran) to Ankara (Turkey);
- A Baku-Tabriz pipeline from Baku (Azerbaijan) to Tabriz (Iran);
- A Tehran-Kharg Island pipeline from Tehran (Iran) to Kharg Island (Persian Gulf);
- An Iran-Pakistan-India gas pipeline via Baluchistan.

Impediments

Despite the many opportunities for expanding continental trade across Eurasia and beyond, there are several impediments that are equally formidable.

Not the least of these is the absence of a clear conception of the opportunities that continental trade presents. The long-term Soviet domination of Central Asia, prolonged warfare in Afghanistan, and the United States' sanctions against Iran combine to prevent a full appreciation of the potential benefits of commerce and trade on a continental scale.

Beyond this, the existing infrastructure is inadequate for continental trade. Most of the road and rail networks in Central Asia and Afghanistan are badly deteriorated as a result of poor construction and the lack of maintenance. Existing networks must be upgraded and expanded to meet the demands of future economic growth and activity.

Financial constraints on investment in infrastructure are also important, the more so because private investors usually are reluctant to invest in transportation infrastructure projects. Similarly, taxes, tariffs, and

regulations affecting border posts are archaic and poorly coordinated among the countries.

Recently the ECO secretariat has been trying to deregulate commerce among its members but so far with modest results.

Beyond this, corruption is a major impediment to trade. Local officials and governmental personnel in customs, transport and banking are poorly paid and unfamiliar with the modern business practices in the rest of the world, leaving them more prone to corruption. Other problematic issues include unscheduled closures of border crossing, inadequate border crossing facilities and procedures, capricious charges, and poor control by police and other authorities along the principal transit corridors.

o The Regional Economic Outlook

The economies of Iran and Greater Central Asia, despite many unfavorable elements, have displayed impressive resilience. After the downturn of 2001, GDP growth in the region picked up, thanks mainly to Iran and Kazakhstan, where the improved outlook was supported by substantial FDI in the oil and gas sector.

With a total population of 157,726,994 million (almost 2.45 percent of the world population), the aggregate GDP of the countries of Greater Central Asia amounted to \$ 805 billion in 2005. This made up only 1.36 percent of the world GDP. The economic recovery achieved by Iran and Great Central Asian countries as a group in 2005, with average real GDP growth at 6.5 percent, compared very favorably to the level of 1.1 percent in 2001. To be sure, this strong performance has been underpinned by robust global growth, high commodity prices, low international interest rates, and generally accommodative monetary and fiscal policies. Recognizing this, ECO countries nonetheless has achieved average GDP growth of 6.2 percent annually, compared to 4.1 percent for all developing

countries. Moreover, ECO countries have outpaced global growth since 2000.²³

The core development challenge within the region is to ensure sustainable economic growth, macroeconomic balance and price stability by the countries of Greater Central Asia and Iran. These are essential steps to achieving a much better quality of life for a population of almost 158 million. But while the countries have achieved notable progress in resolving fiscal, monetary, structural and other systemic difficulties, the remaining agenda for reform and restructuring is formidable.

○ North-South Corridor

Back in the 17th century Peter the Great had an ambition to establish trade contacts with India.²⁴

The Astrakhan Local Lore Museum provides information on Caspian navigation and fishing it shows also how Iranian and Indian merchants crossed the sea to settle in Astrakhan. The isolationism that came with Soviet power in 1917 closed this important route from Asia to Europe across the sea and along the Volga. Until the early 1990s the only international freight on the Caspian was about 2 million tons crossing the sea to Baku from Iran.

The new north-south corridor as the International North South Transport Corridor (INSTC), which was initiated by between Russia, Iran, and India reduces the cost of freight from Southeast Asia to Greater Central Asia to one third, eliminating the need to use the Suez Canal and thus omitting the Mediterranean. Multilateral forwarding systems will allow goods to be sent from India to Bandar Abbas, the Iranian port on the Persian Gulf, then by rail to Central Asia, or by ship from the Caspian Sea to Russia, or by highways to Afghanistan. Iran also intends

²³ World Bank, 2005.

<http://web.worldbank.org/WBSITE/EXTERNAL/EXTABOUTUS/EXTANNREP/EXTANNREP2K5/o,,menuPK:1397361~pagePK:64168427~piPK:64168435~theSitePK:1397343,00.html>.

²⁴ Mukhin, A. & V. Mesamed, "The North-South International Transportation Corridor: Problems and Prospects, *Central Asia Journal*, 2001, p.341.

to build a 511 km railway along Iran's Caspian Sea coast, as part of the North-South rail corridor being promoted by Russian Railways. The line would start at Astara, the southern part of Azerbaijan, near the Azerbaijan/Iran border and follow the coast to the port of Bandar-e-Anzali, turning south to the city of Rasht before joining the existing Tehran-Tabriz main line, which is part of the East-West route at Qazvin. The new route will restart the rail traffic between Russia and Iran that was broken fourteen years ago. At present, the traffic along the North-South corridor moves by train ferry between Olya and Bandar-e-Torkeman near the Turkmenistan-Iran border.

Other countries, including Belarus, Kazakhstan, Tajikistan, Oman, Armenia, Azerbaijan, Syria, Bulgaria, Ukraine, Turkey, and Kyrgyzstan have joined the project. This corridor links northern European countries and Russia with the Indian Ocean, the Persian Gulf and Southeast Asian countries. Goods will travel through the ports of Amsterdam, Hamburg, Copenhagen, Stockholm and Helsinki in Europe to St. Petersburg and Moscow in Russia. From here they can reach the Caspian Sea ports of Anzali and Amirabad, Central Asia, and the Persian Gulf and Southeast Asia.²⁵

At the same time Afghanistan has moved closer to its goal of becoming a major trade hub between Europe, the Middle East and Central Asia after signing favorable trade agreements with its neighbors. Commerce Minister Seyyed Mustafa Kazemi signed a deal with Iran that will give Afghan import-export merchants the right to use the port of Chabahar on the Indian Ocean with a 90% discount on customs and port fees for non-oil goods and a 50% discount on warehouse charges. India is participating in the development of a new port complex at Chabahar on the Iranian coast of Iran, which is linked by a highway with Afghanistan.

Afghan-registered vehicles, moreover, will be allowed full transit rights on the Iranian road system. Consumer goods and construction materials

²⁵ www.instc.org,
<http://www.instc.org/EArchive/EArchiveE/Item.asp?ParentID=47&ItemID=104&Doc=1>.

are likely to make up the bulk of the trade headed toward Afghanistan. In January, 2006, India, Iran and Afghanistan signed an agreement to give Indian goods destined for Central Asia and Afghanistan similar preferential treatment and tariff reductions at Chabahar. New Delhi, which is barred from trading with Afghanistan through Pakistan, agreed to finance the upgrading of the road linking the port with the southwest Afghan town of Dilaram via the border post of Zaranj. India is also building the Afghan sector of the 22 km Zaranj- Milak road. Existing road networks link Dilaram to Turkmenistan, via the western Afghan city of Herat, and to both Uzbekistan and Tajikistan via Kabul. The road through Zaranj will also open up one of the poorest and most isolated regions of Afghanistan. India, in a memorandum of understanding with Iran, also agreed to build a rail line linking Chabahar to the main Iranian railway network. Iran will then extend its railway to the western Afghan border town of Islam Qaleh. Afghanistan's growing ties with Iran have prompted the U.S. to designate Afghanistan as a preferential trading partner. Kabul is also moving swiftly to open trading routes and receive concessions from neighboring Central Asian republics.

The East-West Transit Corridor

The rapid economic development of the East and Southeast Asian countries in the last quarter of the twentieth century increased trade turnover with Europe and required new faster and cheaper trade routes. Early in the 1990s trade turnover between the two ends of the Eurasian landmass accounted for over a third of the world's total. This coincided with the radical political changes in Eastern Europe, Russia, Central Asia, and Afghanistan, which produced new independent states and new markets. In view of this, the U.N. and international financial institutions drew up several projects for possible transportation corridors between Asia and Europe.

A report from Asian Development Bank identifies fifty potential road corridors through Afghanistan connecting Tajikistan, Uzbekistan, and Turkmenistan with the five sea ports in Pakistan and Iran. Thirty-one of these roads would link to Pakistani ports and the other twenty-one would connect the region through Iranian ports. Most Afghan trading centers

are located along the east-west corridor to Iran. The benefits from developing the Central Asia transport corridors are significant for the Greater Central Asian countries, as well as for the neighboring regions. However, the benefits will only materialize with an engaged and close coordination and an effectively integrated policies among the participant countries.

In assessing the potential impact of the road corridors, the ADB found, that for example, once the corridors are built in 2010, total regional trade will increase by 160% and combined transit trade will be greater by 113%. Total exports among the participating countries will increase by 14% (or \$5.8 billion) and total imports will grow by 16% (or \$6.7 billion) over the period 2005 to 2010.

The potential impact of trade on overall GDP as a result of trade via the corridors is also noteworthy. The ADB estimates that the combined GDP of the participant countries in the region will increase by over 5% per year during the 5 year horizon for a total increase of \$5.9 billion. Based on ADB's estimates, these benefits come at a relatively low cost as the corridors requires a total investment of about \$5 billion for the entire region, but that this level of investment represents only less than 5% of the combined projected total national investments for the participating countries over the period.²⁶

The Central-South Asian Transport and Trade Forum (CSATTF) is an initiative to establish the road transport corridors discussed above. The aim is to promote economic growth and social development and to reduce poverty in the six participating countries—Afghanistan, Iran, Pakistan, Tajikistan, Turkmenistan and Uzbekistan. This will be done by strengthening regional transport and trade links and by opening up alternative routes for third country trade. The corridor initiative is expected to cost about US \$5.7 billion investment. It is expected that the funding will be a joint effort of the countries concerned, with assistance from the multilateral institutions and the international community.

²⁶ [www.adb.org http://www.adb.org/Documents/Books/CAREC-Comprehensive-Action-Plan/default.asp](http://www.adb.org/Documents/Books/CAREC-Comprehensive-Action-Plan/default.asp).

Iran's infrastructure in the transportation sector is the central axis of the East-West route. The highways which link Iran to Turkey in the West and Afghanistan in the East, and Azerbaijan and Turkmenistan in both sides of Caspian, are known as "RCD Roads." These national highways along with Iranian railroads, give Iran the capability of playing a major role in the transit of goods, products, and people to or from GCA states.

The link between Iran's railroads and Herat in Afghanistan is under construction. Ali Saeed Lou and Ahmad Zia Masoud, Vice presidents of Iran and Afghanistan, inaugurated the construction of the 191 km sector of railroad between Khawaf in Iran and Herat. With this project, Afghanistan's first railroad will be linked to the Persian Gulf and to European, Russian, and Central Asian railroad networks. Iran has also finished construction of a 60 km road between Herat and Faryab province in the north of Afghanistan.²⁷ Earlier, in January, 2005, Hamid Karzai and Mohammad Khatami inaugurated the Dogharoun-Herat highway. The 122 km road was constructed by Iran with \$60 million from the Iranian Support Fund for Afghan Reconstruction.

A shared language (Persian), ethnic, and cultural features bring Iran closely with both Afghanistan and Tajikistan. At a July, 2006, summit in the Tajik capital of Dushanbe, leaders of the three states signed several economic agreements, among them one establishing a "cultural cooperation commission" to promote closer economic and security ties. According to Iranian President Mahmoud Ahmadinejad, the commission will convene twice annually with the inaugural gathering in the fall of 2006 in the Afghan capital. In addition, the Iranian president advocated the creation of a television network that would "broadcast the Persian language and culture to the world," and promote the expansion of educational exchanges.

Conclusions

Iran's strategic geographical position allows it to be considered a country in the Middle East, Greater Central Asia, and the Caspian region. Iran's

²⁷ BBC Persian, July 28, 2006, http://www.bbc.co.uk/persian/afghanistan/story/2006/06/040819_v-heratsepanta.shtml.

foreign policy is therefore regionalist and takes advantage of its location at the crossroads of these three areas. A major change took place in this regionalist policy after the breakup of the Soviet Union. During the Cold War, Iran did not have relations with half of its neighbors.

Despite the great potential for cooperation in trade, Iran is not a dominant player in the region. Its internal economic and political problems, which are made worse by the U.S.'s effort to isolate Iran, hamper investment in the region as a whole.

Now, for the first time since 1979, Iran is positioning itself to be a regional economic power. Facing continued dependence on petroleum exports, corruption, and a brain drain, Iran believes that in order to survive it has to become a regional power. Iran has constructed a network of highways on its border with Afghanistan and Turkmenistan linking it to other Central Asian states. It conducts trade with Kazakhstan via the Caspian Sea, and has linked its power grid with the rest of Central Asia. Iran has also constructed a hydroelectric plant in Tajikistan to obtain energy from that country.

Iran is moving from an inward-oriented economy to a more liberalized and open market structure that welcomes interacting with the rest of the world. In fact, the Third Five-Year Plan was the first policy document since the 1979 Revolution to declare an "outward orientation" as a main policy objective. Challenges in Iran's domestic politics, as well as tensions caused by regional confrontations, suggest that some time will be required to implement this goal. It should also be stressed that the process of democratization and its related phenomena will create short-term complications in Iran's business environment, even though sustainable democratization will have positive long-term effects on the economy.

Iran's domestic dynamics will determine the success or failure of its policy toward trade and overall relations with Central Asia and Afghanistan. While Iran's role in the economic and political developments there should not be exaggerated, it is nevertheless fair to say that it has contributed to the economic development and political stability of the region and is likely to continue to do so in the future. On the economic level, though, Iran's activity and success have been modest.

This is partly because of the weakness of its own economy and also to the inexperience of Iranian firms in investing in foreign projects.

Tehran seems to be opting for continued ad-hoc cooperation with the states of Central Asia, avoiding collisions of interests with them. This follows the course of Iranian foreign policy in the region since the 1990s. Despite remaining differences, Tehran has managed to find its own niche of political and economic engagement with the Greater Central Asian states. Iran's policy is one of economic pragmatism and positive political engagement. But U.S. policy in Iraq and Afghanistan raises the question of how long Tehran will be able to sustain this course.

Since 1991, Iran has attempted to establish economic relations with the countries of Greater Central Asia, especially in trade, transport, and the construction of pipelines. It has also tried to strengthen cultural and scientific links with the region, emphasizing the historical Persian background of the common culture of the region. Despite this, Iran's economic involvement in Greater Central Asia is still limited, with the exception of its expanding ties with Turkmenistan. Iran's problematic relations with the West, especially the United States, pose an obstacle to its ambitions in Greater Central Asia. As Iran becomes more isolated because of its nuclear activities, Iran is turning its eyes more to the East, i.e. to Asian countries.

Given the international and domestic problems Iran faces in dealing with the Greater Central Asian countries, the record of Iran's performance has been relatively good. Iran should increasingly become a key bridge between Central Asia/Afghanistan and the Persian Gulf, facilitating the two regions' social, economic and cultural interconnection. Developing transport routes through Iran will be the most effective and efficient way to enable the countries of Central Asia and Afghanistan to break away from the Soviet legacy of dependence on transport corridors through Russia's territory.

One of the Iran's advantages in Greater Central Asia is its close relationship with Russia in several strategic and political aspects, while its chief failure is its lack of contact with Washington. Despite their historic rivalry, following the disintegration of the USSR Iran and Russia realized that their interests in Greater Central Asia were similar. The

Russo-Iranian alliance may turn into an important regional geopolitical fact in the post-Cold War era.

Regional economic integration between Greater Central Asia and Iran has been limited. The overall direction of Iran's economy is different from the economies of Central Asian countries. Economic ties between Central Asia and its eastern neighbor are growing, with Xinjiang province's cheap goods being very attractive to Central Asian traders. Thanks to this, Iran's bilateral relations with Afghanistan are far stronger than with the Central Asian countries.

Two pipeline projects involving Afghanistan will connect Central Asian energy exporters and South Asian markets. One is the projected Iran-Pakistan-India line (IPI) and the other is a Turkmenistan-Afghanistan-Pakistan-India line (TAPI). Naturally, these plans have spurred geopolitical maneuvering in the region. Given the U.S.'s goal of thwarting Iran's energy exports wherever possible, Washington opposes the IPI line and supports TAPI. The latter also could enhance Washington's new strategy of reorienting Central Asian energy to South Asian markets in order to steer Central Asian states away from Russia. Meanwhile it should be recalled that Iran is also trying to have access to China's energy market through a pipeline traversing Afghanistan and Tajikistan. It also looks increasingly on Afghanistan as a corridor to China's Northwest (Xingjian), and is eager to build a pipeline between the Caspian region and China. China, for its part, appears to welcome such a move as a means of decreasing its dependence on oil imported via maritime routes through the Indian Ocean.

Greatly facilitating Iran's position in the Greater Central Asia is the fact that its policy there is based not on ideology but on transport, trade, and cultural links between them. In short, Iran has not acted as a dragon breathing ideological fire across the region, but as a rather traditional entrepreneur and reliable trader.