

DIRECTORATE-GENERAL FOR EXTERNAL POLICIES
POLICY DEPARTMENT



**An EU strategy for
relations with
Iran
after the nuclear deal**

AFET



IN-DEPTH ANALYSIS

An EU Strategy for relations with Iran after the nuclear deal

ABSTRACT

This report outlines the potential for a more structured and strategic relationship between the European Union and the Islamic Republic of Iran following the Joint Comprehensive Plan of Action (JCPOA). To both address areas of disagreement and complaints, as well as pursue common interests and matters of mutual benefit, the EU needs to put in place an institutional framework that can withstand the various setbacks that have, to date, derailed all previous efforts of political dialogue. There are a number of areas where both actors can benefit from cooperation; trade, environmental and sustainability issues, education, and combatting drug trade. Even when pursuing more contentious issues such as human rights, having a strategic and fully-fledged multilevel relationship will be helpful. There are also a number of political crisis in the region (ISIS, migration) where reaching a solution without Iranian involvement will either be unnecessarily costly or near impossible.

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1 Introduction

The purpose of this paper is to assess the present EU relationship with Iran and examine how to improve this relationship to make it more strategic and less transactional. In the last two decades, the EU's relationship with Iran was fraught. Regardless of the issue of contention; human rights, regional conflicts or Iran's nuclear programme, the interaction was tense and the relationship never grew strong enough to manage the periodic downturns efficiently. But periodic re-engagement of the EU-Iran dialogue is an indication that, despite their differences and conflicts, they are either deeply invested (EU) or embedded (Iran) in the region. Some individual EU member states have had a long history of relations with Iran and maintained these relationships almost uninterrupted, regardless of the occasional turmoil in Iran. This tenacity, combined with the historically strong Iranian ambition to have good relations with Europe, confirms that the EU as a community is an actor of consequence for decision-makers in Tehran.

Both the nuclear issue and regional turmoil highlighted that for the EU not to have a functioning relationship with Iran is politically very costly. Iran is too big and too important of a regional actor for it to be ignored: the EU must engage with Tehran and make it a stakeholder for regional dialogue and stability to occur. Iran has its own policy objectives in much the same way as any other state. It is not always responsible in ways that we would like it to be, nor does it always make calculations of what is prudent policy in ways we can comprehend. While Tehran's decision-making process is multi-layered¹ and ambiguous at times, it is not suicidal or in search of a religiously-inspired Armageddon; rather it owes a lot to a revolutionary legacy of post-colonial Third-Worldism (for example consider the high importance Tehran bestows to the Non-Aligned-Movement), where major Western powers are viewed with deep suspicion.

In essence, Iran may not be an indispensable interlocutor, but it is in many regards an unavoidable one: the cost for the EU to pursue its policies vis-à-vis the region will be much higher and less effective with Iran absent from the table. Neither does the absence of an EU-Iran relationship mean that such a relationship void will remain empty. If Europe is not present on the Iranian scene, be it in trade or politics, other actors (China, Japan, India etc.) will claim that space. As a result, in order for the EU to make any headway in addressing issues of concern and build a more stable relationship with Iran, the EU must devise a medium to long-term strategy for regular, sustained dialogue with Iran. In other words, the EU must have a clear notion of what a structured and strategic relationship with Iran can and should look like. Such a rethink is not about rewarding or punishing the Islamic Republic of Iran, but rather, about the role and position of the EU in the Middle East in general and how it can pursue its interests most effectively.

¹ See chart p. 8 for an outline of the how major formal Iranian institutions relate to one another.

2 Background

Iran and Europe have a long history together and individual Member States all have their own specific relationship with Iran. The country which has had the most stable relationship (sustaining the conversation and exchange) with the Islamic Republic of Iran is Germany. This has been particularly important during times when the general EU relationship with Iran has been frosty. For some time the EU's overall policy towards Iran became a function of its relationship with the US, especially following the US invasion of Iraq in 2003. Iranian policy towards the EU, in turn, carried the weight of its lack of a relationship with the U.S.²

The engagement with Iran has gone through several phases.³ Between 1992-1997, the EU and Iran established a *Critical Dialogue* to address several issues, including the human rights concerns. After a year long crisis relating to political assassinations in Germany, the process was re-commenced under the heading *Comprehensive Dialogue* (1998-2002) to signal a broader approach. While the human rights component became more prominent over time, the Comprehensive Dialogue also addressed areas of cooperation and mutual interest with the long-term ambition to sign a Trade and Cooperation agreement between the EU and Iran.

The Comprehensive Dialogue stalled with the onset of the nuclear crisis in 2002. Between 2003-2006, the EU tried to negotiate with Iran through the E3 (Germany, France, Britain) and the High Representative Dr. Javier Solana. In 2004, an agreement (the 'Paris agreement') was reached by which Iran would voluntarily suspend its nuclear enrichment activities while further negotiations took place. While some progress was made the process eventually failed for several reasons; the George W. Bush administration in Washington D.C. refused to participate in any negotiations let alone be party to any agreement, and the newly elected Iranian President Mahmoud Ahmadinejad (2005-2013) chose a much tougher and more confrontational line on this issue than his predecessor.

After further failed attempts at talks, the 'Iran file' was referred to the UNSC. Beginning with UNSCR 1696 in July 2006, a number of UNSC resolutions (UNSCRs 1737 and 1747 in 2007; 1803 and 1835 in 2008; and 1887 in 2009) constituted the legal basis for sanctions against the Islamic Republic. But sanctions were still a means to an end, not an end in itself, and a new offer of dialogue was made by Javier Solana in 2008.

This offer was a concerted effort under the E3+, the US, China and Russia (also referred to as P5+1) model. After subsequent negotiations in 2009 failed, UNSCR 1929 (June 2010) - the most comprehensive UN-led sanctions effort - was passed. The EU added its own set of sanctions and restrictions, which were regularly updated. In 2012, the EU took restrictions one step further with an EU-wide import boycott on Iranian oil, implemented in July 2012.

In sum, as of 2003, the nuclear crisis overshadowed all other aspects of the EU-Iran relationship and by 2005, this issue had effectively sucked up all the oxygen in the room. Notions of cooperation and dialogue on any other topic were no longer on the agenda as the confrontation between the EU/US and Iran on this issue heated up. While the European Union insisted on a dual track policy of nuclear negotiations and diplomacy, in reality, all energy and focus was spent on the nuclear issue and the

² Rouzbeh Parsi "That Other Track, That Other Partner: The EU and Iran" in *Iran: Turmoil at Home, Assertiveness Abroad?*, Woodrow Wilson Centre Occasional Paper series Winter 2011, <https://www.wilsoncenter.org/publication/iran-turmoil-home-assertiveness-abroad-winter-2011>

³ For a brief overview see Walter Posch, "Iran and the European Union", Iran Primer, USIP, <http://iranprimer.usip.org/resource/iran-and-european-union>, and "INFORMATION NOTE: The European Union and Iran", EEAS, 17/4/2015, http://eeas.europa.eu/statements/docs/2013/131219_04_en.pdf

occasional criticism of Iran's human rights record. Increased use of sanctions as a tool of pressure to force Iran to negotiate and give up its nuclear enrichment programme left little room for manoeuvre between American and European positions vis-à-vis Iran.⁴

The EU, through the work of High Representative Catherine Ashton, sustained a diplomatic track for negotiations between the E3+3 (Germany, France, Britain, Russia, China and the United States) and Iran. The breakthrough came with a change in approach by the Obama administration in 2012 and the election of a new Iranian President, Hassan Rouhani, in June 2013. The Obama administration acknowledged that the goal of making Tehran abandon its nuclear enrichment programme was unrealistic. In addition, with the new tone set by the new Iranian negotiating team under Foreign Minister Dr Javad Zarif, the negotiators made headway. In November 2013, the P5+1 and Iran agreed to the Joint Plan of Action, which outlined the future negotiation process and the possible end goal of a comprehensive agreement on Iran's nuclear programme. In July 2015, the intensive negotiations led to the Joint Comprehensive Plan of Action, which details how the Iranian nuclear programme is capped and reduced in exchange for sanctions relief by the UN, EU, and eventually the United States (in 2023 according to the stipulations of the JCPOA).

In April 2016, the EU High Representative visited Tehran together with several Commissioners and officials in order to pursue a more vigorous and broadened exchange and relationship with Iran.⁵

3 Iranian perspectives

In order to assess how a new relationship can be built we must have a better grasp of what the internal Iranian political discourse on Europe looks like. For the purpose of this report, it is sufficient to consider the two main perspectives in the debate of the political establishment of the Islamic Republic. Often in foreign policy discussions, this duality is reduced to 'hawks' and 'doves', but as we will see a more accurate description would be 'hawks' and 'owls' as both sides agree on the importance of national security (domestic as well as external). Where they at times diverge is the method and manner through which this security is achieved. They also agree that in the various attempts to reach out to Europe over the past 20 years, their offers of dialogue and cooperation, all involving taking political risks domestically, have not been reciprocated.

This common narrative of the sequence of events is then read differently by the two groups. The owls are keenly aware of the post-revolutionary challenges facing Iran while the hawks primarily perceive existential dangers to the country. The latter group believe that Western attacks and rejections of cooperation are an indication of a deep seated repudiation of the Islamic Republic as such - in short the EU will never truly acknowledge the legitimacy of the Islamic Republic and therefore interact with it on an equal footing. Western sanctions and threats of war strongly reinforce the validity of this interpretation. For the hawks, the logical conclusion is to pursue maximum independence and self-reliance, which also involves a constant vigilance against proximity and cooperation that might lead to dependence. Here we also find the somewhat paranoid scepticism against calls for liberalisation of the Iranian societal atmosphere as this creates vulnerabilities of foreign manipulation and influence.

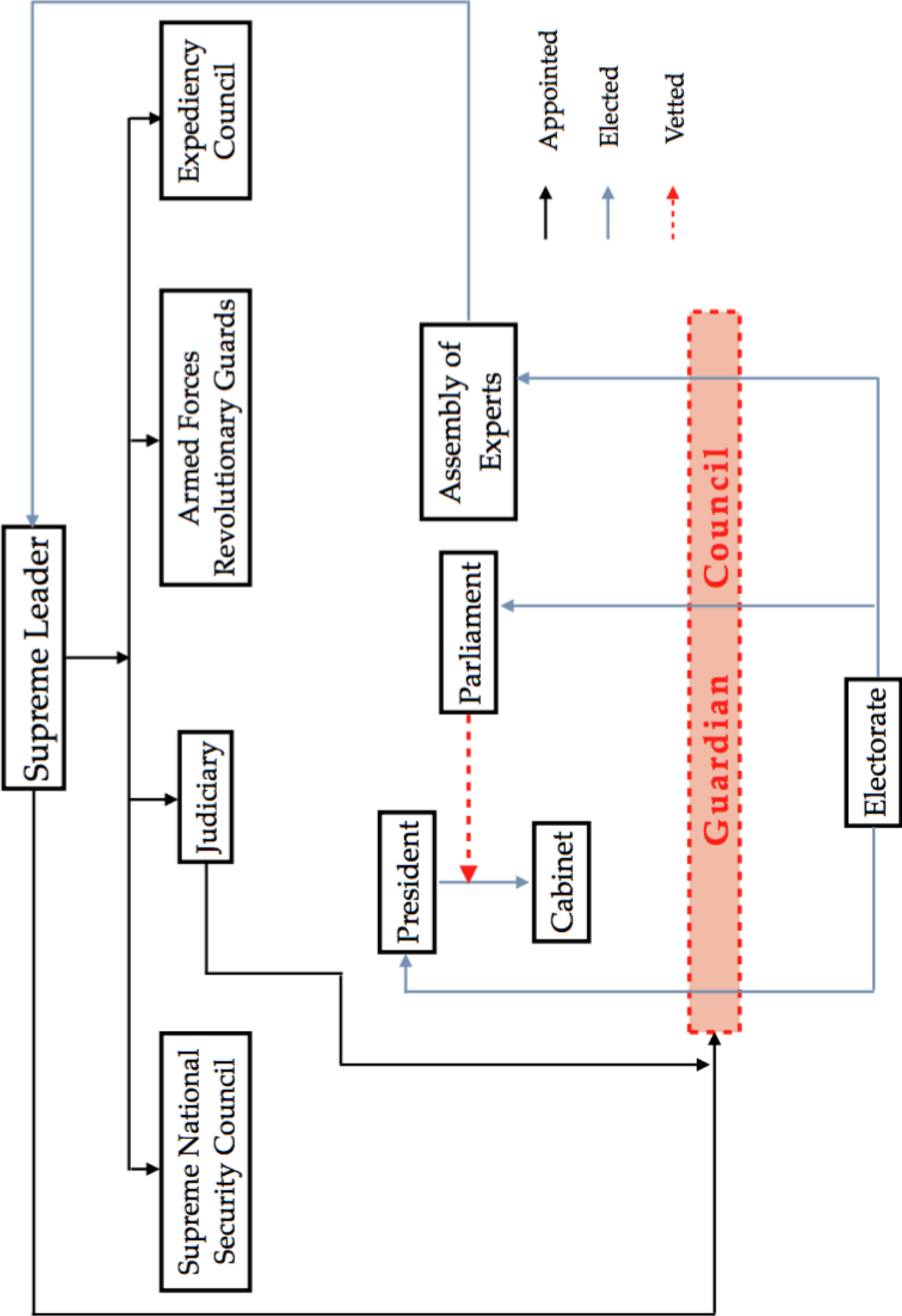
⁴ Dina Esfandiary, "Assessing the European Union's Sanctions Policy: Iran as a case study", EU non proliferation papers, no.34, December 2013, <http://www.sipri.org/research/disarmament/eu-consortium/publications/nonproliferation-paper-34>
Parsi, R. "Stereomoronophonic: Iran and the West", EU ISS Analysis June 2012.

⁵ Joint statement by the High Representative/Vice-President of the European Union, Federica Mogherini and the Minister of Foreign Affairs of the Islamic Republic of Iran, Javad Zarif, http://eeas.europa.eu/statements-eeas/2016/160416_01_en.htm, 16/4/2016, and "EU-Iran relations", European Commission Fact Sheet, 13/4/2016, http://europa.eu/rapid/press-release_MEMO-16-1368_en.htm

The owls on the other hand believe that more domestic democratic developments will strengthen the legitimacy and resilience of the Islamic Republic. Similarly they believe that a deepened relationship with Europe will be beneficial for the Islamic Republic, allowing it to offset its historically problematic neighbour Russia and its eastern behemoth China. Crucially, the owls make a distinction between the EU and the United States - whatever they may think of the desirability (or not) of mending fences with the United States, they believe that a better relationship with the EU is possible and needed by itself. The hawks in general do not make this geopolitical distinction.

In many ways the owlish 'reaching out' approach has been driving Iranian foreign policy towards the EU in the past 20 years. In the Iranian narrative, this was not sufficiently reciprocated by its European counterparts. While, as mentioned before, the hawks believe this to be an inherent Western enmity towards the Islamic Republic, the owls consider the cause to be European inability to be less reactive and more imaginative in how to pursue a deepened relationship with Iran. In their narrative, the EU repeatedly misunderstood the situation and miscalculated its response. Whether hawk or owl, the previous attempt at a structured dialogue with the EU (critical and comprehensive dialogue of the 1990s and early 2000s) is in hindsight considered a failure and a humiliation. The inconclusive nature of that dialogue cost the owls dearly in Iranian domestic politics and set back the argument that a better relationship with the EU would benefit Iran. The critical exchange of human rights was at the forefront of these attempts and was quite controversial in Iran while often criticised in the West as being ineffective. These complaints notwithstanding the exchange on human rights with the EU coincided with a renewed interest and debate inside Iran on citizen's rights and the socio-political development of the country in the wake of the Iraq-Iran war (1980-1988). In this regard, the dialogue was useful and the constructive elements of this legacy should not be underestimated.

But the question of what a better relationship with the EU could mean (e.g. technology transfer for vital industrial sectors and cooperation in areas of sustainable development) and whether it could be achieved never died away. Today, it is once again at the forefront of Iranian foreign policy. The owls have learnt their lesson from previous mistakes and are more cautious in their approach. The JCPOA yielded the best opportunity in a decade to rebuild the relationship and go beyond what it was in the early 2000s. The agreement also vindicated the strategic interpretation of the owls that diplomacy can resolve complex national security conflicts. As a result, from an Iranian perspective, it is vital that the JCPOA marks the beginning of a qualitatively different, and much improved, EU-Iran relationship specifically, but also in the EU approach to the Middle East in general. A new, deeper relationship based on reciprocity, rather than implicit tutelage, must be built in a concerted effort by both parties. This requires an institutional framework for regular exchange between political representatives as well as civil servants in various areas, addressing both common interests as well as issues of contention. For the owls, the investment in the JCPOA was existential in a political sense. As a result, its success is absolutely vital for their ability to play a role in Iranian politics in the foreseeable future.



4 Building a relationship

4.1 Iran's strategic position in the Middle East

Iran is a dominant state in the region. It is large, resource rich and a potentially powerful partner in an unstable region. It is the largest country in the Middle East with the capacity to pursue a serious international agenda. Iran is also located in a strategically significant area in the Middle East. It shares border with seven countries: Afghanistan, Armenia, Azerbaijan, Iraq, Pakistan, Turkey and Turkmenistan. Its long coastline on the southern edge includes the Persian Gulf waters and beyond the Straits of Hormoz, across from the Arab states of the Gulf Cooperation Council (GCC): Qatar, Saudi Arabia, UAE, Bahrain and Oman. This gives Tehran strategic control over the waterways through which the majority of the world's oil travels. Iran also sits on the Eastern edge of the Middle East region, closer than its neighbours to trade partners in Asia. Consequently, an amicable relationship with Tehran, who could be convinced to act in the common interest of the region, would be highly beneficial for all parties involved.

At over 79 million, Iran is the largest Shia country in the world. Iran is by virtue of its long and eventful history, home to a variety of ethnic, religious and linguistic groups.⁶ The average age of its population is 30; a youthful population that is educated⁷ and tech-savvy, and consequently, curious about the Western world in particular.

Iran's strategic position in the region cannot be ignored. As a bridge between the west and the east, the Iranian plateau provides an alternative for the transit of goods and oil through to Europe; one that does not pass through Russia. It also allows Iran to turn east to Asia for trade; particularly appreciated during the height of unilateral sanctions against Iran from 2010-2013. As a result of this involuntary pivot, China became Iran's biggest trading partner. In 2012, it overtook the UAE as the biggest source of Iranian imports.⁸ In 2013, Iran sent 47% of its exports to China, amounting to \$22.9 billion.⁹ Indeed, Iran is an integral part of China's "One belt, one road" policy, essentially an effort to revive the ancient Silk Road.¹⁰

On its southern coast, the straits of Hormoz allow Iran to project power in the Gulf and give it strategic control over the bottleneck through which the majority of the world's oil is transported. Tehran is keenly aware of its advantageous position in this regard and has repeatedly threatened to close the straits following the ramping up of unilateral sanctions against it. In 2012 a bill was introduced in the Majles allowing it to close the straits until the annulment of sanctions.¹¹ But Tehran never made good on its threats, likely for fear of provoking US intervention to protect the waterways.¹²

⁶ While the overwhelming majority of the population is Muslim, and predominantly belong to the Shi'a sect, there are also Christians, Jews, Zoroastrians etc. Linguistically roughly 60-65% speak Persian as their first language, followed by Azeri, Kurdish, Arabic, etc.

⁷ According to the World Bank, Iran has a 98% youth literacy rate (15-24 years old) compared to an 83% literacy rate among all adults over 15 (2012). See "Adult literacy rate, population 15+ years, both sexes (%)", World Bank Data, <http://data.worldbank.org/indicator/SE.ADT.LITR.ZS/countries/IR?display=graph>

⁸ 21% of Iranian imports in 2011 came from China. See The Observatory of Economic Complexity - a project of MIT, Iran page, <http://atlas.media.mit.edu/en/profile/country/irn/>

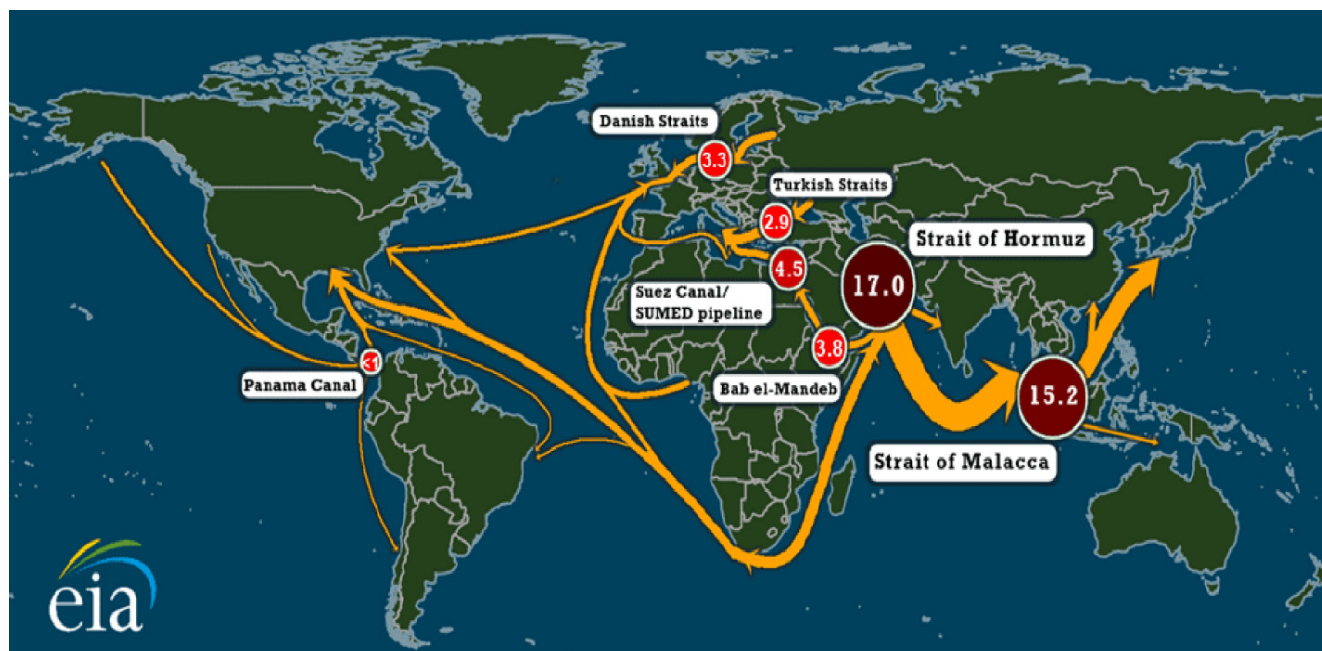
⁹ See The Observatory of Economic Complexity - a project of MIT, Iran page, <http://atlas.media.mit.edu/en/profile/country/irn/>

¹⁰ For Iran's trade development see International Trade Center: Islamic Republic of Iran, <http://www.intracen.org/layouts/CountryTemplate.aspx?pageid=47244645034&id=47244652056>

¹¹ "Iran threatens to block Strait of Hormuz oil route", BBC News, 28 December 2011, <http://www.bbc.co.uk/news/world-middle-east-16344102>, and "Iran renews Hormuz closure threats", Reuters, 15 July 2012, <http://www.reuters.com/article/us-iran-hormuz-idUSBRE86E0CN20120715>.

¹² For more on the Iranian threat to close the straits, see Caitlin Talmadge, "Closing Time: Assessing the Iranian Threat to the Strait of Hormuz", International Security, volume 33, issue 1 (Summer 2008) pages 82-117

Figure 1 - Oil tanker shipping routes and chokepoints (2013)



Source: US Energy Information Administration¹³

Iran sits on the world's fourth largest crude oil reserves and largest natural gas reserves.¹⁴ But its potential remains underdeveloped following years of international sanctions. Today, Iran is hopeful that foreign investors will pour money into its energy sector and revitalise its infrastructure and technology.¹⁵

By virtue of its size and location, Iran is also a major regional player, albeit a relatively isolated one. It is a reactive power, which is adept at responding to changing and difficult circumstances. Iran has a sizeable military force but it is in many respects out-dated in terms of technology and military tactics and capabilities. With the exception of Special Forces, such as the Islamic Revolutionary Guard Corps (IRGC) Quds force, this restricts Tehran's ability to project significant military power. But Tehran has focused on developing its ballistic missile capability and rocket systems, and relies instead on a variety of proxy groups to project power in the region. Today, Iran is heavily involved in Iraq, spearheading the fight against ISIS through its Hashd-Al Shabi, Shia militias and the advisory, training, and material support it offers to the Iraqi army.¹⁶ It is also heavily involved in the crisis in Syria: directly through military advisors, funding and weapons, and recently, with special forces, and indirectly, through the support it offers its proxy Hezbollah and other Shia militia groups.¹⁷ While present, Iran's involvement in the Yemen conflict is not as straightforward; it advises the Houthis, but the group does not respond to Tehran like its other allies do.¹⁸

¹³ "World Oil Transit Chokepoints", US Energy Information Administration, Report, 10 November 2014

¹⁴ "Iran – International Energy Data and Analysis", US Energy Information Administration, Report, updated 19 June 2015, and BP Statistical Review 2015.

¹⁵ "Iran seeks to reassure oil investors", Financial Times, 9 March 2016

¹⁶ For more on Iraq's importance to Iran and Tehran's ISIS policy in Iraq, see Dina Esfandiary and Ariane Tabatabai, "Iran's ISIS policy", International Affairs, January 2015, Volume 91, Number 1

¹⁷ "Four Iran army special forces troops killed in Syria: agency", Reuters, 11 April 2016

¹⁸ See Dina Esfandiary, Ariane Tabatabai, "Yemen: the lowest hanging fruit for dialogue between Iran and Saudi Arabia?", Washington Quarterly (forthcoming) or for a shorter version see, Dina Esfandiary, Ariane Tabatabai, "Sana'a: Iran's Fourth Arab Capital?", Lawfare Blog, 10 January 2016, <https://www.lawfareblog.com/sanaa-irans-fourth-arab-capital/>; Parsi, R., "The Middle East and the Deal: In Search of a New Balance" in Magri, P. and Perteghella, P., *Iran after the deal: the road ahead*, ISPI Report September 2015, <http://www.ispionline.it/en/articles/article/iran-after-deal-road-ahead-ispireport-13904>

Iran is skilful at using soft power to gain influence. Iranian influence is visible throughout Lebanon, where Tehran helped build parts of the country's infrastructure. In Iraq, the country's Shia majority is an important constituency for Iran, which it maintains close ties with. Iran also focused on developing trade ties with Iraq, especially during sanctions, and Tehran encourages Iranian companies to invest in Iraqi infrastructure.¹⁹ As a result, the Gulf Arab countries perceive Iranian influence throughout the region, often overestimating actual Iranian strength.

Following the 2015 nuclear agreement, political space for dialogue with Iran has emerged. The country's participation in the talks on Syria in Vienna in October-November 2015 and negotiations to free the US sailors captured by Iran in its territorial waters January 2016 are evidence of this. But the deal has had a mixed impact on Iranian regional policy. While Tehran states it aims to mend the divide between itself and its neighbours, it has not scaled back its disruptive activities in the region. This is partially the result of the responsibility for foreign policy decisions in Iran. Traditionally, foreign policy is not the remit of the President, rather, it belongs to the Revolutionary Guards and the Supreme Leader, who both have more hawkish views on Iranian regional policy than the Rouhani administration²⁰.

In addition, for most of the GCC states, Iran's nuclear programme is a secondary concern; what matters is Tehran's perceived expansionist regional policy. They believe that the JCPOA will provide Iran further means to fund its proxies and destabilize the region and see the agreement as the first step towards a US-Iranian rapprochement at their expense. This is especially the case in Riyadh. With the agreement, the need to counter Iran and its influence has become further entrenched in Riyadh's mind. This will likely further inflame sectarian conflicts in the region in the near future, as was seen following Saudi Arabia's beheading of Shia Sheikh Nimr al Nimr in January 2016. As a result, it is likely the region will continue to witness a heating up of the intra-regional cold war in the medium term, increasing the need for foreign mediation between Iran and the GCC states.

4.2 EU interests in the region

When trying to understand the EU's relationship and role in the region, we must remember that the Middle East states are our neighbours. Events in the region will inevitably have repercussions on the EU by virtue of geographical proximity, economic relationships and European citizens of Middle Eastern origin living in Europe.

War and instability generate refugee flows and hardship that may result in violence and ideological extremism. As the developments in the Middle East repeatedly show failure of governance of state elites and subsequent societal breakdowns favour groups and political actors willing to use extreme and radical 'solutions'. The latest example is the fall out of the Arab spring where states and other political actors often have resorted to ostracising minorities and framing conflicts in ethnic or religious terms. The ripple effects result in more refugees that neighbouring countries do not and cannot be expected to cope with on their own.

It is in the European Union's general interest that the Middle East be stable; an environment where positive societal and economic development occurs and where violence and repression does not. Here the interests and values of the EU coincide quite well if a strategic perspective is adopted where long term prosperity and development is not exchanged for short term stability. Trade, people to people

¹⁹ Dina Esfandiary and Ariane Tabatabai, "Iran's ISIS policy", *International Affairs*, January 2015, Volume 91, Number 1, <http://www.chathamhouse.org/publication/iran%E2%80%99s-isis-policy>

²⁰ On the complicated nature of decision making in Iran see for instance Lim, K. "National security decision-making in Iran", *Comparative Strategy*, v.34 no.2 2015

contact, and a fostering of peaceful tools for conflict resolution are vital means applied within the European Union, and should be increasingly applied in interactions with neighbouring states and regions. The spread of sectarianism and violent religiously inspired extremism has plagued the Middle East for several decades but has spread to an unprecedented level since the September 11, 2001 attacks in the US and the subsequent American invasion of Afghanistan and Iraq. This extremism also spread to disaffected groups living in the European Union and added a dangerous element to an already difficult and complex fight against violent subversive groups across Europe and the Middle East.

Iran is a vital player in the Middle East region. As a result, Iran; a relatively stable state in the region, with a vibrant society that includes elements of democratic rule, is a potential partner in creating a more stable and harmonious Middle East which will benefit the European Union in the above mentioned aspects. Conversely the EU as a political entity is highly regarded in Iran and has an institutional relationship through its role as facilitator for the JCPOA negotiations and as the Coordinator of the Joint Commission that will oversee the implementation of the agreement. In its discussions with Iran the EU has also consistently brought up human rights concerns. This has not always been received well in Tehran but does, nonetheless, constitute a credible track record for the European Union. It would however yield better results if this subject was integrated into a good governance approach and pursued as a range of issues were cooperation and exchange with various relevant ministries could be undertaken (see policy recommendations chapter 5).

It is in the interest of both parties to develop closer cooperation in areas such as environment, climate change, migration management, transport and energy, education and humanitarian issues. In the following sections we will explore some of these areas further. It is also important to remember that until the breakdown of relations due to the nuclear issue in 2005 there were discussions about a future Trade and Cooperation Agreement (TCA) between the EU and Iran. The TCA:s have been replaced by Partnership and Cooperation Agreements (PCA) and such an agreement should be a medium term goal for EU-Iran relations. A significant and practical step in this direction would be to create an EU wide Investment and Protection Agreement that would provide a more robust legal protective framework for trade with Iran. This would instil greater confidence in European businesses that are interested in trading with, and investing in, Iran. Similarly the EU should continue its support for Iran's accession to the WTO as part of the effort to integrate Iran into the world economy.

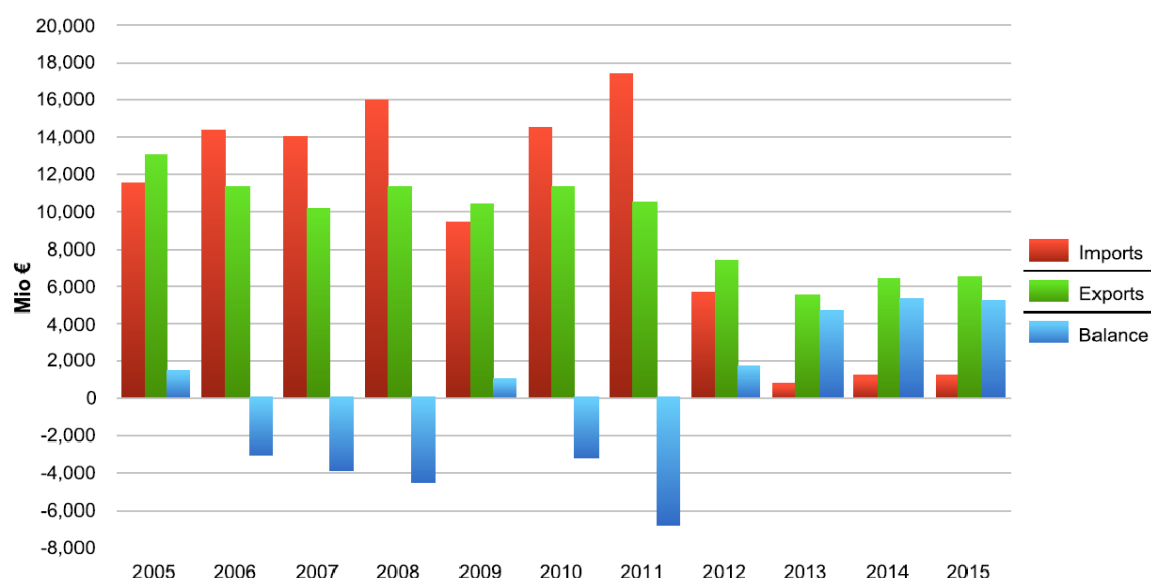
4.3 Economic, trade, and energy ties

The EU as a block used to be Iran's largest trading partner until 2008 when the two sides achieved a €27 billion trade volume. As the following graph indicates, sanctions and deteriorating relations led to a decline of the mutual trade volume to less than €7 billion in 2013. In 2014 and 2015, trade activities showed some marginal growth, but it is clear that the lifting of sanctions will produce a stronger increase in trade and present opportunities to the business communities of both sides. However, it is important to understand the dynamics on the Iranian side in order to shape future trade and investment relations in a manner that they will facilitate improved and a more sustainable EU-Iran relations.

European Union, Trade with Iran

Total goods: EU Trade flows and balance, annual data 2005 - 2015

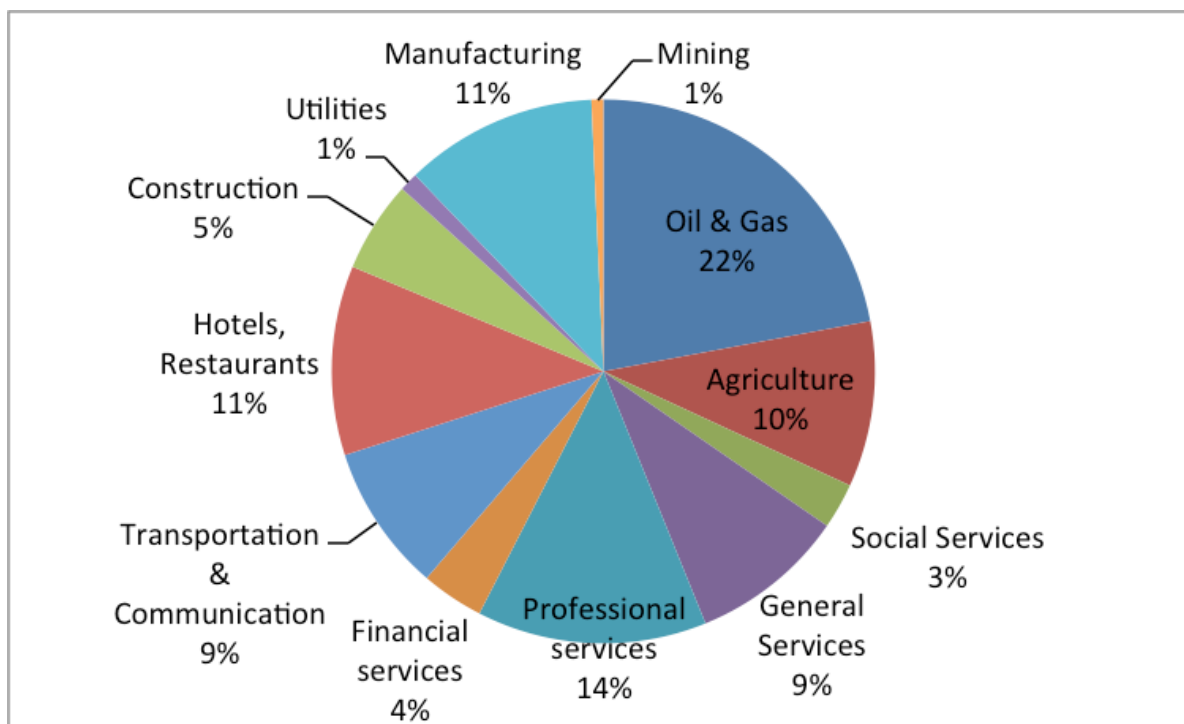
Source Eurostat Comext - Statistical regime 4



In promoting closer economic ties, it would be a mistake to view Iran as a “consumer market” and try to focus on European exports to Iran. Iran needs to be seen as a partner on multiple levels, i.e. as a key player on the international energy market; as a source of economic and technological innovation and a potential partner for co-investments in the entire region. Top Iranian leaders have not left any doubt about the fact that creating qualitative employment opportunities is their top priority. To achieve that, Iran is offering a long host of projects to international investors including major projects in the energy sector. If EU companies take advantage of these opportunities, it will create value in the Iranian economy which can be a backbone for greater regional development that is needed to induce a degree of stability into an otherwise challenging region.

One fact that should facilitate the process of greater economic interaction is the sheer diversity of economic activity in Iran. Indeed, Iran has the most diverse GDP composition in the entire region (see graph below) and also has the resources (natural and human) to expand each of these sectors from agriculture to mining, industry and petroleum. EU companies and EU governments should consider this diverse economic base and the availability of resources as a huge potential for enhanced economic and investment relations.

Graph: Sectors' Contributions to GDP (%) (2014 figures)



Source: Statistical Centre of Iran (<http://amar.org.ir/english/>)

In fact, Iran's declared goals in the Vision 2025 Document, i.e. the country's desire to become the leading regional economic and technological power, will rely heavily on the country's ability to develop new technological solutions and to enhance its economic activities. Economic and technological collaboration between Iranian and EU businesses through the creation of joint ventures and continuous technology transfer processes will be a crucial element in this development. To reinforce this potential EU officials, as well as representatives of Member States' governments, should use every opportunity to remind all stakeholders that Brussels favours Iran's technological and economic progress as it would benefit the entire region. Here the EU Commission in particular plays a vital role in facilitating such developments as per its role in negotiating trade and investment agreements with non-EU countries.²¹

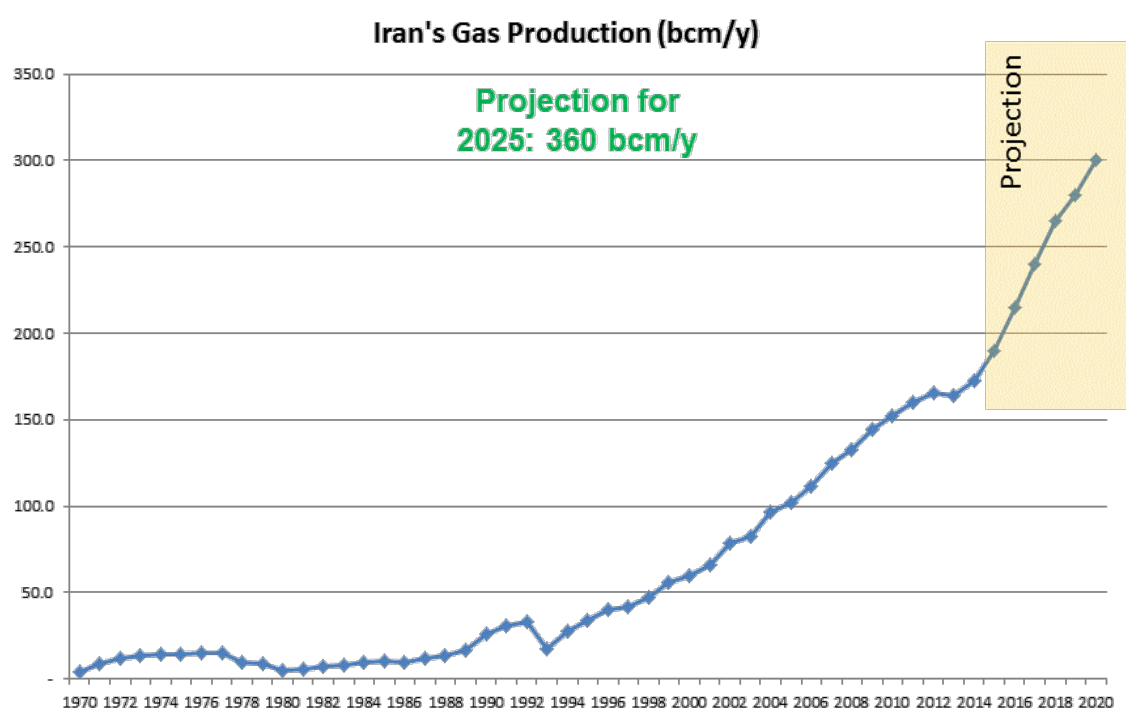
To help Iran achieve its own goal without antagonizing any of the other regional powers, the EU will have to proactively look for scenarios that will create win-win solutions for the regional players. Iran and the GCC countries would need to issue the required licenses to allow private sector players from their respective countries to partner with European companies and implement such projects. These could translate into creative regional investment schemes, investing in regional energy interconnectivity etc.

One key element in this engagement will be the Iranian energy sector. As mentioned previously Iran's has the world's largest gas reserves and the fourth largest global oil reserves.²² As a result, it has a major role to play in the future energy development, with implications for the Middle East region, as well as other regions including the European Union. Before discussing ideas on how future EU-Iran energy relations could be approached, it is important to understand the dynamics in Iran's petroleum sector. Despite external sanctions, in the past decade, Iran has gone from being a consumer of foreign technology and a

²¹ On trade policy see European Commission see <http://ec.europa.eu/trade/policy/policy-making/> and articles 207 and 218 in the Treaty of the Functioning of the EU.

²² Based on the BP Statistical Review 2015.

pure exporter of oil to being an exporter of oil, gas and petroleum products, a manufacturer of petroleum sector equipment as well as a hub for energy connectivity in the region. Undoubtedly, the lifting of sanctions will now shift the attention to attracting foreign investment and technology in order to increase production and efficiency of the existing capacities. Incidentally, while the intensive sanctions regime created a lot of headaches, it also gave Iran the opportunity to optimize the utilization of its resources and create domestic capacities. Some of these domestic capacities are in reality controlled by entities linked to the state (so called semi-state institutions) including the IRGC, while others are owned by genuinely private sector actors. The post-sanctions Iran as a petroleum sector player will not only return to the old levels of oil production and exports, but will also become a significant producer of gas. The growing potential of gas will also pave the way for opportunities in developing gas-based industries in the country. As the following graph indicates, Iran plans to increase gas production to 360 billion cubic meters per year by 2025²³ – an objective that will require external technology and capital. To achieve these objectives and to attract the needed investments and technology, the Iranian authorities have also presented international companies with a new contractual framework (called Iran Petroleum Contract or IPC), which offers greater degree of flexibility to foreign investors. Though it is still a service contract, it has many advantages compared to the previous Buy-Back Model.



Source: National Iranian Oil Company (<http://en.nioc.ir/Portal/Home/>) and EIRG projections.

The Iranian gas sector is the primary example for how Iranian and European interests coincide. Here the stated ambitions of Iran in the gas sector helps us identify opportunities for the EU to develop win-win scenarios and deepen the relationship:

²³ These are government estimates and as such reliable indicators of the overall ambition – industry experts are however less confident in the projected volume being achievable by 2025.

Iran's Stated Goals	How the EU can help
To remain the third largest gas producer in the world with gas production of 360 bcm/y by 2025.	The expansion of the upstream gas production will require investment and technology from European and international companies.
To Inject gas into the oil fields in order to maintain and increase oil production.	EU companies can offer efficient solutions to increase the recovery rates of Iranian oil fields and hence help Iran produce more efficiently.
To supply gas to power plants, gas-based industries and petrochemicals and to export the value added products at economically viable prices.	EU companies would be major sources of technology and investment, but could also join to develop regional opportunities e.g. using Iranian gas in a third country to produce gas-based commodities.
To replace domestic demand for petroleum products with gas and maintain the share of gas in Iran's energy basket above 70 percent.	Some EU countries have had a great track record in optimizing their energy basket and utilizing diverse sources.
To export gas to the regional countries, Indian subcontinent and Europe.	The EU could import as gas, but more likely in the form of gas based commodities (petrochemicals, steel, aluminium, etc.).
To increase energy efficiency in industrial, residential and commercial consumption.	EU companies could offer the needed technologies to improve energy efficiency with clear economic and environmental benefits.

As can be seen above, natural gas will become a key element in the country's economic and energy sector developments. Increasing the utilization of gas is also a desired outcome for the EU, especially with regard to environmental and climate change considerations. At the same time, the Iranian gas potential will have a regional dimension; experts agree that with the exception of Iran and Qatar, the rest of the Persian Gulf countries are gas-poor and that those countries will require gas or electricity imports from other sources in the future.²⁴ Iran is already exporting gas to Turkey and Iraq and has signed agreements to export gas to Oman and potentially to Pakistan. Other countries will follow. In addition, Iran is exporting electricity to many of its immediate neighbours, for instance Iraq.²⁵

²⁴ For example, Bassam Fattouh, "Summer Again: The Swing in Oil Demand in Saudi Arabia" July 2013, : Oxford Energy Comment: <http://www.oxfordenergy.org/wpcms/wp-content/uploads/2013/07/Summer-Again-The-Swing-in-Oil-Demand-in-Saudi-Arabia.pdf>

²⁵ For more details see for example: Iran restarts electricity exports to Iraq. The Iran Project 2016/05/02, <http://theiranproject.com/blog/2016/05/02/iran-restarts-electricity-exports-iraq/>

Using closer trade and energy ties with Iran to consolidate and integrate the entire region's economic development will also help the EU address other critical issues. For example, equitable economic growth is essential for fostering political stability in the entire region. This will, in turn, marginalize those extremist forces that benefit from poor economic conditions, unemployment and underdevelopment. Therefore, in the interest of a more developed and prosperous region, all international stakeholders should help promote energy and trade relations between the regional players. The promotion of win-win scenarios in regional relations through expansion of energy interconnectivity (through pipelines and electricity grids) and cross-border energy projects (such as investments in refineries that receive their feed from neighbouring markets) will certainly also be a win for international players. Besides the gain in regional cohesion and interdependence, EU companies can benefit as technology providers and commercial partners in this development.

Consequently, it is in the interest of the EU to contribute to the growth and availability of Iranian gas as an engine for sustainable regional development and potentially a future source of energy for the EU itself. In the medium term, the focus should be on the region and the premise that a regional cohesion based on energy interconnectivity will provide the world with the needed energy resources and also ease some of the tensions that may cause uncertainties in this important energy hub.

4.4 Environmental and sustainability issues

Iran has been suffering from deteriorating environmental conditions; dust storms, high level of pollution in urban areas, and droughts.²⁶ The water supply in various parts of the country is not replenished in a stable and satisfactory manner due to more unstable weather with unpredictable rainfall as well as unsustainable consumption and waste of ground water.²⁷ The Iranian agricultural sector consumes a lot of water, as do the country's rapidly growing cities, while water recycling is woefully inadequate and under-utilised. So far the various solutions suggested in Iran have been inadequate or unrealistic.²⁸ Environmentally sustainable development and water management are areas where EU institutions and industries are at the forefront in terms of capacity building and technology and know-how.

4.5 Combatting drug trade

Iran is a major transit and consumer country for opiate based drugs from Afghanistan.²⁹ One of the major markets for these drugs is the European Union, and thus the drug trade is a concern to all parties. Under the Khatami presidency, the UNODC set up an office in Iran (1999). In addition, the European Union, as well as individual Member States, have also had various kinds of cooperation with, and support for, Iranian authorities combatting drug addiction and trade.³⁰ Over time, the Iranian use of the death penalty to punish drug traffickers (including juvenile offenders) has generated more and more criticism from Human Rights organisations turning the matter increasingly from a drug combat issue to one of human rights - the EU has a long standing policy of opposing capital punishment.³¹ The response from the EU

²⁶ Bijan Khajepour, "Iran's water crisis reaches critical levels", al-Monitor, 2015-05-01, <http://www.al-monitor.com/pulse/originals/2015/05/iran-water-crisis.html>

²⁷ Kaveh Madani "Water management in Iran: what is causing the looming crisis?", Journal of Environmental Studies and Sciences, December 2014, Volume 4, Issue 4, pp 315-328

²⁸ Ali Mirchi & Kaveh Madani, "A grand but faulty vision for Iran's water problems", Tehran Bureau/The Guardian, 2016-05-09, <http://www.theguardian.com/world/2016/may/09/iran-desalination-water>

²⁹ For an overview of the drug trade in Iran see UNODC Iran fact sheet (Paris Pact) <https://www.paris-pact.net/upload/e20e615974dd55f94302f60fce36e05d.pdf>

³⁰ John Calabrese, "Iran's War on Drugs: Holding the Line?", Middle East Institute Policy Brief, No. 3 December 2007, <http://www.mei.edu/content/irans-war-drugs-holding-line>

³¹ Patrick Gallahue, Roxanne Saucier and Damon Barrett, "Partners in Crime: International Funding for Drug Control and Gross Violations of Human Rights", Harm Reduction International, 2012,

has been to concentrate on harm reduction and other drug demand reduction efforts and avoid drug supply cooperation where the death penalty is part of the Iranian approach to reduce the drug trade.

The frequent use of the death penalty³² is problematic, and there is a growing debate inside Iran on whether it is effective in the fight against drug trafficking.³³ The Iranian official line is that only major criminals involved in the drug trade are sentenced to death. Yet the data on how many are executed and the judicial reliability of the sentences are very much disputed. Here the EU could make an effort to convince its Iranian interlocutors that greater transparency on this issue would be helpful for enhancing cooperation in this area. In the long run the EU must also face the fact that while the death penalty is a problem in its anti-drug cooperation with Iran it cannot neglect the need for joint efforts to combat the drug supply transiting Iran.

4.6 Nuclear safety and security

Nuclear safety and security presents an opportunity for cooperation between the GCC and Iran. Iran is home to the Bushehr nuclear power plant, a light-water moderated and cooled reactor, built using German and Russian technology. The plant sits on the intersection of three tectonic plates and just across the water from Iran's Gulf Arab neighbours. The GCC countries are deeply concerned because Bushehr is located closer to some of their capitals than to Tehran. The predominant weather pattern in the Persian Gulf is northwestern winds, making the Gulf States vulnerable to any radiation leaks. Any accident would also disrupt the Gulf's water supplies because of the nature of coastal currents (circling counter clockwise). Finally, high temperatures in the area mean the plant's cooling function has to work much harder and dust makes it difficult to keep the equipment clean.

Iran submits the plant to routine IAEA safety checks and is subject to greater transparency in its nuclear programme following the 2015 JCPOA. But it remains the only country operating a nuclear power plant not party to the Convention on Nuclear Safety³⁴, which ensures adherence to international safety standards and additional safety reviews.

The Gulf Arab states want even greater transparency on Iran's Bushehr operations. Some Iranian officials indicated a willingness to discuss the regional safety and security of nuclear programmes with their neighbours. In February 2015, Head of the Atomic Energy Organization of Iran (AEOI) Ali Akbar Salehi stated Iran was prepared to establish a regional safety convention to monitor the nuclear facilities in the region.³⁵ Iran could take it a step further and invite its neighbours to joint safety reviews of its nuclear facilities as a first step to build confidence. Following the EU-Iran announcement of cooperation on nuclear safety in April 2016,³⁶ the EU should encourage and assist Iran and the GCC in developing a similar plan for transparency on regional nuclear programmes. In line with the EU's non-proliferation

http://www.ihra.net/files/2012/06/20/Partners_in_Crime_web1.pdf, and Amnesty International, "Addicted to Death. Executions for drug offences in Iran", 2011, <https://www.amnesty.org/en/documents/mde13/090/2011/en/>

³² There has been a marked increase in executions in the last decade, see U.N Special rapporteur Ahmed Shaheed's report, "Situation of human rights in the Islamic Republic of Iran, 2015-10-06, http://www.un.org/ga/search/view_doc.asp?symbol=A/70/411

³³ Mahrokh Gholamhosseinpour, "Drug Trafficking and the Death Penalty: Should the Law Change?", IranWire 28/12/2015, <https://en.iranwire.com/features/6986/>

³⁴ The Convention, part of the IAEA structure, was adopted in 1994 and came into power in 1996 and has to date 78 Contracting Parties. See <http://www-ns.iaea.org/conventions/nuclear-safety.asp>

³⁵ "AEOI: Iran ready to set up regional nuclear safety pact", Iran Daily, 1 February 2015

³⁶ "EU-Iran cooperate on nuclear safety", World Nuclear News, 22 April 2016

strategy,³⁷ the EU must act as a facilitator or promote academic/think-tank level facilitators in convening such multilateral gatherings to discuss regional nuclear safety and security.

4.7 Ongoing cooperation today: Fighting the Islamic State of Iraq and al-Sham

Today, combatting Islamic State of Iraq and al-Sham (ISIS)³⁸ in Iraq in particular, presents the most immediate opportunity for dialogue with Iran and limited collaboration with the West. Iraq's stability is an important concern for Iranians, who still remember the two countries' devastating eight-year war in the 1980s. Iran sees ISIS as a grave threat in its own backyard. In addition, Iran's religious links, high volume of trade and 1,500 km of porous border it shares with Iraq, make Tehran more committed to Iraq than any other regional player.³⁹

While at first Iran sought to keep its presence as limited as possible in order to "lead from behind", it did not hesitate to empower local groups to fight ISIS. In an effort to downplay the sectarian side of the fighting in Iraq, Iran armed multiple groups, including the Iraqi army and Kurdish Sunnis. Iranian presence in Iraq is now a fact of life. Iran's ability to constrain and control Shia militias in the fight against ISIS will determine how Iraqis, regional powers and the rest of the international community view Iran and its policies. Iran and the West have similar goals for Iraq: avoiding partition, a potentially devastating sectarian civil war, and defeating ISIS.

While Western leaders were generally in favour of limited coordination with Iran on fighting ISIS,⁴⁰ Iran was more reticent. This was especially the case publicly during the nuclear negotiations; Iran did not want the talks on its nuclear programme to spill over into talks on other regional security issues. But some Iranian officials indicated they welcomed US airstrikes against ISIS, because they helped the "paralysed" Iraqi army.⁴¹ They also provided Iranian-controlled militias and advisers with air cover for their advances. Coordination however, would be purely tactical, as in the successful Amerli counter-offensive.⁴²

Today, with the removal of a barrier to dialogue with Iran and the increasingly normal nature of dialogue between the West and Iran, coordination on the fight against ISIS could become a more sustained low-level cooperation. In fact, this is already the case with Australia with whom a pledge was made in April 2015 to share intelligence on the fight against ISIS.⁴³

³⁷ See the Council of the European Union, "Fight against the proliferation of weapons of mass destruction - The EU's strategy against the proliferation of Weapons of Mass Destruction", 9 December 2003,

<http://register.consilium.europa.eu/doc/srv?l=EN&f=ST%2015708%202003%20INIT>

³⁸ al-Sham (Bilad al-Sham) refers to Levant or Syria. The group is also referred to as Islamic State of Iraq and the Levant (ISIL) or Da'esh (Arabic acronym)

³⁹ Dina Esfandiary and Ariane Tabatabai, "Iran's ISIS policy", International Affairs, January 2015, Volume 91, Number 1,

⁴⁰ "ISIS threat: Cameron wants an alliance with Iran", The Independent, 17 August 2014

⁴¹ "Iran, U.S. signal openness to cooperation on Iraq", The Washington Post, 16 June 2014

https://www.washingtonpost.com/world/middle-east/iran-us-signal-openness-to-cooperation-on-iraq/2014/06/16/5002cf1f-112c-4533-a530-4a4cbf274378_story.html

⁴² Speech by Seyed Hossein Mousavian, former head, Foreign Relations Committee, Supreme National Security Council, Iran, at IISS 'Global Strategic Review', 20 Sept. 2014, Oslo, Norway

⁴³ "Australia and Iran will share intelligence to fight IS", BBC News, 20 April 2015, <http://www.bbc.co.uk/news/world-australia-32376976>

4.8 Areas where cooperation will be difficult

4.8.1 Syria

While combatting ISIS in Iraq presents an opportunity for dialogue with Iran, the conflict in Syria is more problematic. Here, Tehran and the West have different goals. Iran wants the Alawite regime to remain in power, while the US and its allies want President Assad and his regime to go. Both, however, want to get rid of ISIS in Syria.

Iran's efforts in Syria include overtly supporting the Assad regime, supplying money and surveillance equipment, and funding, training and arming local popular committee militias. By April 2014, Iran reportedly provided up to \$12.6 billion in financial support to the Assad regime. Its efforts have been a drain on its own resources at a time when Iran was facing the most comprehensive sanctions.

But slowly, Iran is beginning to feel the pain of its involvement in Syria. The number of IRGC personnel killed in action has risen, including that of senior commander Hossein Hamedani on 9 October 2015. This sparked a resumption of the internal debate about the goal of Iranian intervention in Syria. But reports that Iran intensified its efforts on the ground has in turn complicated the initiatives to resolve the crisis through negotiations held in Vienna late October 2015. Notably, this was the first round of talks in which Tehran was taking part. It is a step forward to recognise that there can be no resolution of the Syria crisis without one of the major players present at the table.

5 Policy recommendations: Strategic and Structured dialogue

What the EU and Iran need is a strategic and structured dialogue. Strategic here means that it must reach beyond the list of specific (usually contentious) issues, look at the larger picture and set more long term goals for what kind of relationship the two parties want to have. Structured, in that it is underpinned by regular interaction on civil servant and technical levels dealing with a variety of sectors; thus, establishing an institutionalised process for pursuing a variety of solutions and exchanges.

1. The project to establish an EU Delegation in Tehran has made progress. While this is a delicate and slow process, the very ambition and its eventual success highlights that the EU is genuinely interested in a relationship with Iran and that it is acting independently from the US.
2. It is therefore important to establish working committees for relevant sectors where regular interaction can allow the parties to go beyond high politics and build multi-level cooperation between institutions. This allows, for instance, for a more credible and effective exchange on human rights, as the relevant judicial authorities involved in practices related to human rights on both sides can interact with one another. By highlighting the importance of practice and adherence to the rule of law these issues can better be resolved. Such a structured approach is far more useful than a case-by-case exchange which tends to politicise matters and thus make them even more intractable.
3. A very important aspect of building a better relationship is also to create a better understanding of what the EU is, its institutions as well as its 'internal logic'. There is a serious lack of knowledge in Iran of how the EU works both in political and institutional terms, which creates misunderstandings. For many areas of cooperation this lack of knowledge impedes Iranian ability to access and interact with EU institutions and instruments of cooperation. This is particularly important in areas where technical, educational and research cooperation could otherwise grow significantly. A specific EU liaison office to facilitate access to institutional resources relevant for academic and industry cooperation in Tehran would be a good step to remedy this lacuna.
4. A more regular interparliamentary exchange is needed between the European Parliament and the Iranian Majlis. The interaction between these two elected bodies has been very irregular and often

been hostage to the overall international political climate. A more institutionalised exchange where relevant parliamentary committees from each side could interact would facilitate a better mutual understanding of how politics are conducted and what are the priorities and preferences in each chamber.

5. These political and institutional relationships must also be accompanied by greater facilitation of communication and cooperation between civil society actors. Cultural programmes, targeted academic exchange programs (rather than individual students/local faculty initiatives), and grassroots organisations dealing with social and environmental issues, must be encouraged and supported.
6. Similarly, it is important to underline that increased trade with Iran presents a win-win not only between the parties but also in political terms. Of particular relevance for Iran and the EU are three areas where technology transfer and environmental and human health concerns are salient features; renewable energies, urban sustainability, and water management.
7. Initiate and sustain a dialogue on a new security architecture for the Middle East, beginning with the Persian Gulf, using the vast European experience of OSCE and multilateral exchange. The EU is in a unique position to undertake this as it has good relations with all major actors in the region and will give the process credibility and bring all the parties in as stakeholders. The first step is to initiate a strategic discussion on conflict resolution and use this as a stepping stone to resolve the present conflicts in the region. The second step is to use the various areas of cooperation mentioned in this report (nuclear safety, combatting drugs etc.) and expand the conversation to include Iran's Arab neighbours.
8. The EU-Iran dialogue should also look beyond the common concerns in the Middle East. Some examples include the stabilisation of Afghanistan and mediation of conflicts such as the one between Armenia and Azerbaijan.

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