



# PIPELINE POLITICS

The Geopolitical Struggle over an Iran-Pakistan-India Energy Deal

*By Reza Sanati*

Officials from Iran and India came up with an intriguing idea back in 1989: transporting Iranian natural gas to the growing Indian market. As they began to explore the various options, the officials decided to expand their dialogue to include Pakistan, with the notion of constructing a pipeline that would carry the Iranian product both overland to the Pakistani market and through Pakistan to India. The projected Iran-Pakistan-India Pipeline (IPI) would stretch 1,724 miles, or 2,775 kilometers.

A decade after its tumultuous revolution and only a year out of the brutal Iran-Iraq War, Iran desperately needed investment in its energy infrastructure to help chart its post-revolutionary future. The country was seeking to repair damage caused by the war as well as finance new ventures. Iran hoped for an opportunity to exploit its natural gas reserves—the world's second largest. The mega-project could spur economic prosperity in the provinces where the pipeline ran, and becoming a major energy exporter beyond being merely an oil producer stood to enhance Iran's regional and global stature.<sup>1</sup> The prospect of supplying energy to two major markets just next door, both destined for economic growth in the post-Cold War era, was an enticing one for Iran.

For India and Pakistan, the energy needed to fuel economic growth projections could not be provided by indigenous sources. Though both states had sought to diversify their energy sources, with natural gas being a critical component of their strategy, inadequate domestic reserves rendered those plans unviable without foreign supplies. Thus, gaining almost exclusive access to Iran's vast gas reserves via the pipeline would go a long way toward buttressing diversification and energy security. For its part, Pakistan had an additional incentive; the lucrative revenues that would come from transit fees. Finally, the economic integration inherent in the

◁ Iran-Pakistan natural gas pipeline, Chabahar, Iran, March 11, 2013. *Vahid Salemi/Associated Press/Corbis*

project offered the possibility of improving strained India-Pakistan political relations. Hence, some dubbed the IPI the “Peace Pipeline.”

It seemed too good to be true, and perhaps it was. Despite the obvious benefits of the IPI pipeline to regional economic growth and political stability, the idea became ever more deeply entangled in strategic contests, involving not only traditional regional rivalries such as that between India and Pakistan, but the broader U.S.-Iran conflict, which invariably draws in other countries. For much of the last quarter century it appeared that, one way or the other, the pipeline would become a casualty of geopolitics. Perhaps the biggest blow to the IPI pipeline was the tightening of American unilateral and multilateral sanctions on Iran, which would include punitive measures against India and Pakistan if they pursued the project with Iran. Lately, however, the pipeline has been showing new signs of life. Changing regional dynamics—most importantly, Russia’s entry into pipeline deal making—have improved prospects for the IPI once again.

### **The Mumbai Factor**

The longstanding animosity between India and Pakistan worked against early success in the IPI negotiations. Pakistan also had its differences with Iran, as the two countries were supporting opposite sides in Afghanistan (Iran sustaining what became the Northern Alliance, and Pakistan backing the Taliban in southern Afghanistan). The Iraqi invasion of Kuwait in 1990 altered geopolitical calculations for many nations concerning energy security. For example, Iraq and Kuwait had together supplied two-thirds of India’s oil imports, which were severely interrupted by the war.<sup>2</sup> In 1993, India signed a Memorandum of Understanding with Iran for energy cooperation, and began exploring pipeline options with other Persian Gulf states as well. India had determined that the overland pipeline was the most economically attractive and achievable option of natural gas sector cooperation with Iran. Shipping liquefied natural gas (LNG) or constructing an underwater pipeline between Iran and India were far more expensive alternatives. For Iran, sanctions would make those options more difficult to achieve due to difficulties finding external investment and expertise. In 1995, Pakistan signed an agreement with Iran to actually begin the early phases of constructing the overland pipeline. But an impediment arose when Pakistan discovered new natural gas reserves, which temporarily cooled its desire for foreign supplies.

At the beginning of the 2000s, the pendulum swung again. Pakistan realized that its indigenous natural gas reserves were fundamentally inadequate for its growing domestic needs. Unlike India, which had only begun to include natural gas in its national energy mix, Pakistan had long utilized and depended upon natural gas. The rise in oil and natural gas prices focused Indian and Pakistani decision makers on the

need for continual supply diversification in order to counteract the steadily increasing costs of energy imports. So in 2003, Iran and Pakistan established a Joint Working Group, and once again began discussing the viability of the pipeline. The IPI project received another boost with the thawing of Pakistan-India relations in the same year, enabling the two countries to once again explore the possibility of energy cooperation and increased trade. The new optimism did not last long. Three main factors worked to stall progress once more: fundamental disagreements about pricing, concerns about Pakistani border security, and the massive opposition to the pipeline by regional and global stakeholders, most notably the United States.

From a macro perspective, pricing differences could be expected, given that the global gas market does not have the same pricing mechanisms as its oil counterpart. A major sticking point during the negotiations involved the question of periodic reviews of the projected twenty-five-year agreement.<sup>3</sup> Based upon the particular price, and depending upon volatility, these periodic reviews could be either advantageous or disadvantageous to either the producer nation or the consumer nation. Finding the right balance was key, so that each party felt that its economic interests were not being harmed.

In the IPI pipeline's case, several issues were at stake. Iran's concern was the selling price, and how to renegotiate prices based on fluctuations over time. Pakistan drove a hard bargain over transit fees. And Pakistan and India both were concerned with how the final price of natural gas would be quantified. Eventually, the Joint Working Group had achieved much agreement. Even the thorny question of periodic pricing reviews was resolved with an agreement to let future price changes be decided by an independent arbiter.<sup>4</sup>

But by the time the Joint Working Group had come to these agreements, other issues began to intervene. From the start, border security, chiefly concerning Pakistan's Baluchistan province, was a major concern. As the IPI pipeline would traverse through the center of this very restive province, apprehension over security had always permeated discussions regarding the project. As the Pakistani researcher Mehvish Nigar Qureshi has noted, the unequal distribution of revenue generated from resources in Baluchistan had already added to local grievances.<sup>5</sup> In the past, militant groups targeted both state institutions and gas pipelines. And regional events, such as the U.S. invasion and occupation of neighboring Afghanistan, as well as the projection of U.S. power in Pakistan and the region generally, has only exacerbated the problem. Iran has thus been concerned not only with how domestic instability in Pakistan would affect pipeline security, but also whether U.S. opposition to the project might eventually lead to American-inspired physical sabotage.

India seemed to share Iran's concerns. And, from the outset, Indian officials had been wary of the Pakistani link in the pipeline; they worried that Islamabad would be able to

use the gas pipeline as a political weapon. Increasingly, India fretted, too, about political instability in Pakistan, wondering if Islamabad would retain the ability to guarantee the flow of energy supplies through Baluchistan even if its intentions were to do so. The trepidations of Iran and India eventually helped put the IPI pipeline idea in limbo.

Working against progress on the pipeline and economic integration generally were the traditional suspicions between India and Pakistan. Though chiefly related to Kashmir, the instability in Afghanistan greatly contributed to another downward trend in bilateral relations following the 2003 thaw. The Pakistani government had long suspected that India might utilize its massive investments in post-Taliban Afghanistan as leverage against Pakistan. And though Pakistan had quickly sided with the U.S. occupation of Afghanistan, it always had to balance its relationship with the United States with practical considerations toward its former Taliban clients—many of whom now resided in Pakistani territory. Islamabad, in fact, never really committed to either side, but was always hedging. The overt Indian support for the new political order in Afghanistan contrasted with Islamabad's deep mistrust for the Hamid Karzai government and further strained the relationship between Pakistan and India. The strain was evident in the weakening of anti-terrorism cooperation between the two countries.

The Mumbai terrorist attacks of 2008, carried out by the militant group Lashkar e-Taiba (LeT), effectively paralyzed all economic cooperation between India and Pakistan—and undermined potential future progress on the IPI pipeline. Though there has been no verifiable evidence of direct knowledge, involvement, or assistance by the former administration of President Asif Zardari of Pakistan in the Mumbai terror attacks, LeT's open presence within the country—particularly the freedom of movement it had enjoyed and possible links to the country's intelligence service—has enraged India. India formally withdrew from the project a few months later, bringing the feasibility of the IPI pipeline, some twenty years after the idea was first launched, into serious doubt.

### **Energy Diplomacy**

For American strategic thinking, progress on the IPI pipeline would be a major setback for its sanctions policy against Iran. It would produce a significant precedent of open defiance to the U.S.-led sanctions. But more significantly, it would create conditions where America's sanctions policy would be eroded by the economic dependence of Pakistan and India on Iranian natural gas.

The systematic overt and covert opposition of the United States and its allies had long been seen as the greatest hurdle to the completion of the IPI pipeline. Due to primarily U.S. sanctions against Iran—a staple of American policy towards the country since the Iranian Revolution—any nation that conducted major economic transactions

with the Islamic Republic risked severe punitive measures. Since 1996, under the Iran-Libya Sanctions Act, later called the Iran Sanctions Act, American sanctions had taken the form of extraterritoriality, by which Washington would impose unilateral sanctions on third parties that interacted with Tehran.

Yet, from Washington's standpoint, while the threat of sanctions on Pakistan and India did help delay the pipeline, they were not enough to affect the fundamental policy calculations in Islamabad and New Delhi on the feasibility of the project. Thus, Washington needed to offer inducements as well.

In May 2008, the Heritage Foundation released "The Proposed Iran-Pakistan-India Gas Pipeline: An Unacceptable Risk to Regional Security," which provided a clear look at what had already become a bipartisan American policy.<sup>6</sup> On publication, many of the recommendations that the Heritage Foundation made were already visibly underway. However, the report was significant in that it spelled out an integrated approach, which included changing the domestic and regional conditions that had combined to make the IPI pipeline a potentially viable enterprise.

The report's main recommendations included:

- Stepping up U.S. energy diplomacy to discourage pursuit of the pipeline, including bilateral dialogue with India and Pakistan.
- Encouraging greater LNG capacity in India and Pakistan.
- Supporting the Turkmenistan-Afghanistan-Pakistan-India (TAPI) pipeline as an alternative to the IPI pipeline.
- Expanding energy cooperation with India within the framework of the Asia-Pacific Partnership.
- Pursuing U.S.-India civil nuclear cooperation.
- Assisting Pakistan in building large-scale hydroelectric projects, and LNG terminals to meet its growing energy and electricity demand.

The Heritage Foundation's advocacy boiled down to mass public diplomacy against the IPI pipeline, the encouragement of LNG transport (which is markedly more expensive than pipelines) and other alternative sources of energy, and the bolstering of nuclear cooperation with India and Pakistan—for energy generation purposes. Basically, diplomacy pursued in conjunction with the latent threat of sanctions against both nations if they chose to move ahead with Iran on the IPI pipeline.

The American approach enjoyed a good degree of success. Washington signed a deal in 2005 to support the Indian government's surging power needs via the construction of civilian nuclear power plants. The deal was met with stiff resistance from many domestic critics in India, and greeted with alarm by some American critics. Indian skeptics saw an affront to Indian sovereignty; under the accord, India had to separate its nuclear program into civilian and military components, and make the civilian

part accessible for international inspections.<sup>7</sup> But within three years the accord passed through the maze of bureaucracy—the International Atomic Energy Agency (IAEA), the U.S. Congress, and the Indian parliament—and came into force in October 2008. It was hoped that the deal would serve as a useful precedent for non-proliferation policy, and increase the percentage of India's nuclear-generated electricity capacity, which the International Energy Agency (IEA) put at a mere 0.7 percent in 2009.

Meanwhile, and in line with U.S. strategy, India increased its LNG imports from 3.49 billion cubic meters (bcm) in 2004–05 to 12.31 bcm in 2009–10.<sup>8</sup> Most of the additional LNG came from Qatar, an American ally—again in line with the policy of expanding U.S.-India energy cooperation to develop and disseminate technologies within the framework of the Asia-Pacific Partnership.

India had begun to see that the geopolitical disadvantages of the IPI pipeline were now outweighing the potential economic benefits of the project. A deterioration of Indian-Iranian relations became a factor in India's decision to withdraw from the IPI project. New Delhi was influenced by its growing relationship with various states that have antagonistic relations with Iran, specifically some Arab countries in the Gulf, and Israel. Saudi Arabia in particular had long pressed India to limit its economic ties with Iran, and rely on the Arab Gulf states for more of its hydrocarbon imports. The relationship between India and Israel had evolved from simple economic ties to a burgeoning defense and intelligence sharing relationship. Some Indian policy analysts came to doubt the very concept and potential of strategic Iran-India ties, arguing that interaction between New Delhi and Tehran had become mostly on a case-by-case basis.<sup>9</sup> Some believe that Indian officials must have shared Washington's concerns about Iran, noting that energy security is too vital for India to have scrapped the IPI project solely due to American pressure.<sup>10</sup> For its part, Iran grew increasingly suspicious of India, with Iranian analysts perceiving that India had simply played the "Iran card" to exact concessions from the West.<sup>11</sup>

Pakistan, however, saw things differently. It did not have the same policy flexibility as India, due to Islamabad's reliance on natural gas—in 2009, according to the IEA, it accounted for 31.9 percent of Pakistan's energy basket. Moreover, deteriorating relations with Washington over suspicions of Pakistani collusion with the Taliban and its allies further undermined prospects for U.S.-Pakistan energy cooperation.

Pakistan had long attempted to obtain external investors for the IPI pipeline. Major foreign energy companies, such as Malaysia's Petronas, Royal Dutch Shell, France's Total, and Australia's BHP, had expressed interest in a consortium to fund the huge endeavor. But with escalation of U.S. pressure, these firms gradually walked back their interest. Although Iran had begun construction of the pipeline on its territory, India's exit from the project essentially reduced it to an Iran-Pakistan venture. Due to

investment concerns, and Pakistan's domestic economic deterioration, even Pakistan's involvement was in doubt. The "Peace Pipeline" seemed doomed.

### **Russia to the Rescue?**

In the last few years, however, a series of seemingly disconnected events and trends have created conditions in which the IPI pipeline has once again become a viable option.

Due to the extreme imbalance of power in the U.S.-Pakistan relationship, Pakistan was highly vulnerable to American pressure. After the Indian exit from the IPI project, Washington began to publicly and forcefully ask Pakistan to formally withdraw from the project as well, and accept some of the inducements India had been given. After the Obama administration's intensification of sanctions, Riyadh also openly pushed Islamabad to ditch its project with Iran. Washington's strategy was essentially to publicly force Islamabad to adopt its policy preferences.

But the ensuing deterioration in U.S.-Pakistan relations halted any real progress towards energy cooperation, forcing Pakistan to think again about the eventual prospects for the IPI pipeline. Though Pakistan had enlisted as an ally in the American war on terror, its relationship with Washington significantly worsened in 2011 after the killing of Osama Bin Laden in an American military raid on the Pakistani city of Abbottabad. This episode triggered extreme anger and mistrust on both sides. The Americans felt betrayed, having provided Pakistani security forces with billions of dollars for anti-terror cooperation only to discover that Bin Laden was hiding out in Pakistan right under their noses; Pakistan, for its part, was humiliated by the raid's violation of its sovereignty. Intermittent U.S. drone strikes into Pakistan against suspected Taliban targets still add to the embarrassment felt by the country's political elite and to the fury felt by the general population.

The important new variable in favor of the IPI pipeline was the entry of Russia into the deal. Moscow's interest had an economic and strategic rationale that predated the events that led to the project's collapse in 2009. Russia possesses the world's largest reserves of natural gas, with Iran holding the second largest reserves. As the Turkish scholar Bezen Coşkun has highlighted, Russia is keen to protect the primacy of Russian natural gas in the European energy market—a Russian vital interest—to the extent of ensuring that Iran is neutralized as a potential competitor in the future.<sup>12</sup> Iran has shown interest in joining the Turkey-Austria pipeline, known as the Nabucco project, and presents itself to Europe as an alternative to Russia as a natural gas supplier.<sup>13</sup>

Russia's involvement in the IPI pipeline makes good strategic sense. It would help steer Iranian gas exports away from European consumers, thus strengthening Russia's leverage in the European market.<sup>14</sup> And by joining the IPI project, Moscow could become an indispensable partner with three major regional players: Iran, Pakistan,

and India. Once again, Russia can deal with—and control—potential energy rivals through cooperation.<sup>15</sup>

In early 2012, Pakistan formally reached out to Russia to secure finances for the IPI pipeline. Russia in turn requested that Pakistan award Gazprom, the Russian energy giant, a non-bid \$1.2 billion slice of the pipeline-laying contract.<sup>16</sup> The move would give Russia an exclusive position in the construction of the pipeline in Pakistan, and a significant stake in the overall IPI enterprise. The prospects for reviving the pipeline were further aided by the completion of the Iranian portion of the pipeline up to the Pakistani border, inaugurated by the heads of state of both countries in March 2013. These developments have inspired Pakistan to take a more defiant posture against the threat of U.S. sanctions, publicly projecting that its portion of the pipeline would be finished by December 2014.

Add to the mix that Washington had proved unable to sponsor meaningful alternatives that would fundamentally change the energy equations for the better in Pakistan or in India. For example, as part of its energy diplomacy, the United States pushed the proposed Trans-Afghanistan pipeline as an alternative to the IPI pipeline. But the venture has questionable feasibility in at least the foreseeable future. India would have the same concerns about Pakistan as the transit country; the persistent security problems inside Afghanistan—the country remains an active war zone, with U.S. troops due to withdraw in 2014—make the project implausible in the near term.

The United States has experienced mixed results from its energy diplomacy. While security issues have paralyzed energy cooperation with Pakistan, political problems have undermined the potential for U.S.-India cooperation. The much-heralded nuclear cooperation has seen few tangible benefits, remaining largely stagnant since 2009. Lisa Curtis, a co-author of the Heritage Foundation report, says that an important problem is the Indian parliament's move to virtually shut out American companies from India's civil nuclear industry.<sup>17</sup> Another hurdle for India's nuclear program is the galvanizing of anti-nuclear activists in the country after the nuclear power disaster in Fukushima, Japan.<sup>18</sup>

The most successful element of American policy has been the growth of LNG in the Indian energy market, which has given India a modest degree of diversification. But LNG has not fundamentally addressed India's mounting energy problems. It is impractical for India to depend on exports of LNG from the United States, and the utility of LNG imports generally depends on factors outside India's control, such as the global price. A realization has begun to dawn in India that New Delhi is paying a high price by opting out of the IPI pipeline.

This was dramatically brought home by the sweltering summer days of July 2012, when India experienced the biggest systematic power outage in recorded history. The

outage affected twenty of the country's twenty-eight provinces, cutting off electricity to some 700 million people and causing large chunks of the economy to grind to a halt. While the exact causes of the blackout remain contested, the broad consensus is that the hydroelectric component of India's electricity generation, which contributes roughly 19 percent to the country's electricity consumption, severely dropped production due to unexpected low rainfall from a weak monsoon season. The episode once again highlighted India's lack of sufficient energy diversification—an imbalance that has not been rectified by inducements such as the U.S.-India nuclear deal or the increase in LNG imports. India, in other words, remains in search of a comprehensive solution to its energy needs. In Pakistan, meanwhile, the energy crisis has evolved into a threat to the government, compounding the security, demographic, social, and economic problems that the country faces.

Robin Mills, an energy consultant and author of *Capturing Carbon: The New Weapon in the War Against Climate Change*, has argued that domestic energy restructuring would go a long way in both Pakistan's and India's quests for greater energy security.<sup>19</sup> This would entail addressing consumer payment delinquencies and electricity theft, reducing subsidies, improving the climate for investment in offshore and shale gas, and broadening the use of solar and wind power.<sup>20</sup> Yet, considering the sheer amount of time that would take Pakistan and India to implement such measures and the growth trajectories of both economies, it is difficult to see how they will manage to feed their energy needs without a substantial outside source of energy that would fundamentally alter, for the better, their quest for continued supply diversification. It has been this very calculation that has always kept the IPI project alive, albeit at times in hibernation.

### Diminishing American Influence

The IPI pipeline is like a chain; it has many links. For it to properly function, all the links need to withstand the pressures that could make them snap. The pressures remain in force. But due to domestic and regional factors, these links are strengthening in ways we have not seen before, thus giving the IPI pipeline a second chance.

With the Iranian section completed, Gazprom's entry into the scheme as a major investor makes Pakistan the country to watch. The ability and willingness of Pakistan to buck outside opposition and forge ahead with construction will be crucial. Russia's role will be critical as well: Will Moscow follow through with the Gazprom investment? Or will it play the "Pakistan card" as leverage in its complex geopolitical dealings with Washington?

The importance of the pipeline—as a major engine of economic growth, and to promote political and strategic interdependence in the subcontinent—will ultimately depend on India. Many Indian policy analysts now see India becoming more

independent in its energy policy, in part due to a perception of diminishing American influence in the region. The United States, thanks to development of new energy resources in North America, is becoming less reliant on conventional supplies from the Persian Gulf. In turn, Gulf energy resources are becoming a greater factor for Asian nations, notably India and China. This leads to a conclusion that India has sufficient incentive to assert the independence of India's foreign policy and defy the threat of American sanctions over the IPI pipeline.<sup>21</sup> To India, the IPI pipeline is evolving from being a potentially critical part of its energy diversification policy to a component of India's larger geostrategic interests. If the pipeline's construction within Pakistan penetrates all the way to the Indian border, as it was originally planned to do, an energy-needy India may be hard pressed to ignore it.

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