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# India-Iran Relations: Part One – Understanding the “Delay” Factor

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# Associate Paper

12 July 2016

## India-Iran Relations: Part One – Understanding the “Delay” Factor

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### Key Points

- Most commentary on India-Iran relations emphasises Iran’s frustration with India’s procrastination without defining what constitutes delay.
- A more nuanced understanding of “delay” as an empirically verifiable fact, rather than as an allegation or complaint, and as a strategically important component of diplomacy, is needed.
- Iran has used complaints about India’s many “delays” as a bargaining chip, while India has used some of those “delays” to strengthen its bargaining power by improving its outside options.
- India and Iran have signalled to each other that neither views the other’s relationships with other countries in the region in zero-sum terms.

### Summary

The Indian Prime Minister’s recent state visit to Iran (22-23 May 2016), the first in 15 years, received a lot of attention in the Indian media. Most of the coverage bordered upon triumphalism. The triumphalists projected the trilateral agreement between Afghanistan, India and Iran on Chabahar as India’s belated answer to its encirclement by China and Pakistan and an answer to the China-Pakistan Economic Corridor (CPEC) that terminates at Pakistan’s Gwadar port, in the neighbourhood of Chabahar. The critical commentary underscored the long gestation period of infrastructure projects, India’s dismal track record

in completing overseas infrastructure projects and China's head start in Iran, reflected in the larger volume of bilateral trade and its railway access to Iran via Central Asia.

Their differences notwithstanding, both the triumphalists and the realists agree that the over-cautious approach of the Indian Government, a lack of political will and strategic clarity, plus bureaucratic red tape are responsible for the belated re-engagement after the historic nuclear deal between the P5+1 and Iran.<sup>1</sup> Until very recently, government functionaries and media in Iran held a similar opinion, which seems to have been suspended, at least for now. The commentary and news on the bilateral relationship, in both India and Iran, are flawed insofar as an explanation of exactly what constitutes a delay is never put forward. A more nuanced understanding of "delay" as an empirically verifiable fact, rather than an allegation or complaint, and as a strategically important component of diplomacy is needed.

## Analysis

### ***A Great Many "Delays"***

Over the past year, Iran has blamed India for a variety of delays. Five distinct "delay" claims can be identified: (a) delay in commencing work on projects conceived of/agreed upon in the pre-nuclear sanctions period; (b) delay in clearing the payments pending for oil purchased during the sanctions regime; (c) delay in finalising the commercial contract on the Chabahar project; (d) delay in reclaiming the Farzad B gas field; and (e) delay in organising the Indian Prime Minister's long pending state visit to Iran. In each of these cases, Iran's complaint is partly justifiable.

India had indeed abandoned projects under the pressure of the United States, whose nuclear diplomacy tried to lock India and Iran into a zero-sum game. India, however, was among the very few countries that maintained political and economic relations with Iran during the sanctions regime. While it is well-known that India remained one of the biggest buyers of Iranian oil even after it had scaled down its imports, not many remember India's other engagements with Iran during the sanctions. For instance, India hosted an Iranian naval flotilla soon after the March 2006 visit to India of President George W. Bush, during which he signed the nuclear co-operation agreement. Two years later, months ahead of the approval of India-specific safeguards by the IAEA, President Mahmoud Ahmadinejad was received in New Delhi. In 2012, Prime Minister Manmohan Singh attended the NAM Summit

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<sup>1</sup> Likewise, there seems to be a broad consensus among both triumphalists and realists that India's potential investment in Chabahar pales in comparison to Chinese investment in neighbouring Gwadar. That, however, is a flawed comparison, as Indian commitment to one port is being compared with Chinese commitment to the entire CPEC project. A fair comparison has to include Indian investment in the railway network leading up to Afghanistan and Central Asia and in the petrochemical and other industries in and around Chabahar. India has, in principle, committed more than US\$10 billion to various projects. Moreover, the potential investment by private companies should be accounted for in India's case because, in the medium term, public sector investment will constitute only a part, even if substantial, of India's overall investment in Iran. Alternatively, India's investment in Chabahar port has to be compared with China's investment in Gwadar port. In any case, India will commit resources based upon a sound assessment, rather than match the fanciful figures being debated in the media.

in Tehran. Iran might still want to remind India of its votes in international bodies that paved the way for the imposition of sanctions. India, however, believes that internationally-mandated sanctions helped to avoid another US-led war in the region and created the necessary space for dialogue. In any case, while there has been a delay, it is not clear how soon India needs to resume work to avoid the *impression* of delay, especially in light of the fact that the process of Iran's rehabilitation into the international economic and financial system has just begun and the US sanctions that are not covered by the Joint Comprehensive Plan of Action (JCPOA) remain in place. Moreover, inflation, changes in the prices of raw materials, improvements in technology and changes in relevant rules and regulations in both countries during the decade of sanctions made renegotiation on the earlier projects unavoidable.

During the sanctions, the two countries worked out an arrangement under which India paid for oil partly in rupees and the rest in euros, with the latter being deposited into special accounts until sanctions were lifted. The July 2015 nuclear deal was followed by a steady stream of allegations of delay in the transfer of euros frozen in Indian accounts.<sup>2</sup> While it is understandable that Iran needs funds to rebuild its economy, there were practical difficulties in transferring the amounts withheld. It is almost a year since the signing of the JCPOA and yet most Western banks are still reluctant to deal with Iran. In fact, when Prime Minister Modi was in Iran, the Governor of Iran's central bank lamented the very slow progress on the much-awaited rehabilitation of Iran into the international financial system. So, this delay is largely beyond India's control. Moreover, the allegations of delay in payment overlook another crucial problem. It seems that when the arrangement was envisaged, the two sides did not clearly take into account exchange rate fluctuations and interest on the deposits, possibly because this was seen as a temporary problem. There is a third aspect to this problem. In the midst of allegations about delays, Iranian officials also claimed that they were not in a hurry as the money could be used to pay for India's exports to Iran.

The third allegation of delay is related to last year's Memorandum of Understanding on Chabahar port. Iranian officials expressed displeasure at the delay in signing the commercial contract and even threatened that India's time for choice was over. At the time of the signing of the MoU, Iran did not inform India that it had already involved a third party, an Iranian private firm, in the project. This obviously complicated negotiations, as India had until then been working under the assumption that this was an inter-governmental project.

Indian companies found gas in the Farzad-B block, but had to abandon the initial investment for two reasons. The project required massive investment and technology inputs, both of which had become difficult to secure because of sanctions. Moreover, Iran was a tough negotiator, despite sanctions, because oil and gas prices were rising steadily during that period. More recently, Iran put the block on auction and then asked India to make an offer to retake the same. When Indian companies responded, they found themselves constrained by the fact that Iran is still going through the incomplete process of adopting new legislation

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<sup>2</sup> Iran's complaints were readily accepted by the Indian media that was impatiently waiting for the Indian Government's response to the CPEC. This does not, however, seem to have exerted any pressure on the government because Iran is not followed closely in India in the way that the United States, China and Pakistan are.

governing the development of energy resources. Once again, the delay is beyond India's control.

Finally, while Modi was expected to visit Iran sometime after meeting President Hassan Rouhani at Ufa in July 2015, he waited for almost a year. With sluggish progress on so many fronts, it did not make sense to organise a state visit simply for the sake of it.<sup>3</sup>

In short, India's proverbial procrastination notwithstanding, in all the above cases, factors beyond the control of India also played an important role. For instance, the Baloch insurgency in the province of Sistan and Baluchestan added to the difficulties faced by India in Chabahar. Iran's attempt to secure a better deal amid sustained increases in the prices of crude oil and natural gas during the first decade of this century compounded India's difficulties in the energy sector. That Iran, too, contributed to the delay is also suggested by the fact that India constructed the 220-kilometre Delaram-Zaranj highway between 2005 and 2009 at a cost of more than one hundred Indian and Afghan lives and about US\$140 million. This highway is the Afghan counterpart of the road connecting Chabahar to the Afghanistan border. If strategically myopic and lethargic India could complete a project in war-torn Afghanistan, then it could surely do much better in Iran.

### ***Delay as a Bargaining Chip***

The Iranians were certainly aware of this background. What else explains their regular complaints about delays and "threats" to approach others? They used the complaints about delay as bargaining chips but it is not clear if they gained anything beyond what India was willing to offer anyway. There is one exception, though. While India wanted to bundle the infrastructure and energy projects, Iran ensured that the two remained separate. It bears noting, however, that, its complaints notwithstanding, Iran maintained regular high-level contacts, released nine Indians jailed for allegedly smuggling oil, and, most recently, derisively rejected Pakistan's charge that India was misusing its territory to launch subversive activities in Baluchistan.

For the sake of argument, however, let us assume that India did indeed cause unwarranted delays after the JCPOA and then ask what India did in the intervening period.

During this period, President Pranab Mukherjee visited Israel, Jordan and Palestine, and Vice-President Hamid Ansari visited Turkmenistan. Modi travelled to all five Central Asian republics and Afghanistan. In each of these landlocked countries, Modi referred to the possibilities that would be unlocked by the development of Chabahar port. Modi also travelled to Qatar, Pakistan, the United Arab Emirates and Saudi Arabia and attended the G-20 Summit in Turkey. Modi is likely to visit Israel and Pakistan later this year. So, Modi had already visited all the major neighbours of Iran, except Iraq, before reaching Tehran. By the

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<sup>3</sup> The Indian Prime Minister's Tehran visit followed the months of hard work by the ministers and bureaucrats of four different ministries, who visited Iran at regular intervals and engaged their counterparts on the fine print of contentious issues. This visit hopefully marks a change in the Modi Government's foreign policy that so far has been driven mostly by the Prime Minister's charisma and personal relationship management, rather than by a broad coalition of relevant ministries. This aspect of the visit has received insufficient attention so far.

end of this year, he would have visited at least two of Iran's neighbours twice in less than a year.

In the middle of the negotiations with Iran, India hinted that it was evaluating proposals for gas supply from other countries. Petronet LNG indeed managed to nudge Qatar's RasGas to halve the gas price and waive a hefty contractual penalty. The UAE offered to store its crude oil in India's strategic storage facilities, with two-thirds of the oil to be supplied free. In addition, the Gulf countries also showed interest in joint exploration and production in the energy sector and investment in India's infrastructure sector.<sup>4</sup> Even as it was securing these deals, however, India also ratcheted up its potential investment commitment to Iranian projects and relaxed visa norms for Iranian citizens.

In short, while remaining engaged with Iran, the Indian Government did not restrict its relationships with Tehran's rivals because, even in the best case scenario, Iran's energy sector needs a few years to achieve its full potential and, in any case, Iran alone cannot satisfy India's energy requirements. On the other hand, the importance of the Gulf countries as sources of energy supplies, destinations for Indian exports and expatriate workers, and as occasional partners against terrorism and even Pakistan, is unlikely to diminish anytime soon. Likewise, in the near future, Israel will remain indispensable to India's defence preparedness.<sup>5</sup>

So, it could be argued that the "delay" in engaging at the highest level was judiciously used by the Indian Government to build its bargaining power vis-à-vis Iran by improving relations with Tehran's competitors and also to signal to it that India does not view its relationship with countries in the Middle East in zero-sum terms.<sup>6</sup> When Modi landed in Tehran, his hosts knew that Afghanistan had swung back towards India after a brief ill-advised romance with Pakistan and that India had struck favourable deals with Iran's energy market competitors in the Gulf region. Moreover, the prospect of revived ties with Iran (along with India's emergence as a major energy importer), added to India's bargaining power in the region and helped to improve its relations with the Gulf countries and Afghanistan.<sup>7</sup>

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<sup>4</sup> There is another reason why India's diversified energy diplomacy makes sense. India had hoped that it would be able to bundle energy and infrastructure projects and enhance its bargaining power in the former vis-à-vis Iran. But, since Iran did not allow India to exploit bundling, the latter had to invest in outside options to enhance its bargaining power.

<sup>5</sup> The government seems to have gone out of its way to *simultaneously* engage all countries in the region. For instance, in 2015, a week after an Indian fleet visited Iran (in August), another fleet paid a visit to all six Gulf countries (in September). Earlier in August 2015, India had sent a warship to Israel. Likewise, in 2016, a fortnight after the Prime Minister's visit to Saudi Arabia (2-3 April), the Foreign Minister visited Tehran (16-17 April). A month later, the Defence Minister and an Indian Navy flotilla visited Oman and the UAE (20-23 May), while the Prime Minister was in Iran (22-23 May). Incidentally, this seems to have been the first-ever visit by an Indian Defence Minister to the UAE.

<sup>6</sup> In all fairness, it must be added that Iran and India are on the same page in this regard. When, for instance, the Iranian Ambassador's attention was drawn to India's growing relationship with Israel, he said: 'If they [Israel] are your friends, don't let them choose your enemies.'

<sup>7</sup> The Gulf countries' decision to court India should be read as a signal to Pakistan (that wants to remain neutral in Middle Eastern conflicts) and as an attempt to counter a resurgent Iran. India is using the Gulf countries to corner Pakistan and improve relations with Iran. China is flirting with Iran to push friendless Pakistan deeper into its embrace, while Afghanistan is engaging India and Iran to

Delay, therefore, should not necessarily be seen as undesirable because it is wrong to assume that first-mover advantage is available in all contexts. The uncertainty surrounding Iran's petroleum legislation and its rehabilitation into the international financial system, together with the complex nature of negotiations over energy and infrastructure projects, suggest that first movers might not necessarily enjoy an edge over others. So, the Indian approach of gradual reengagement might not be such a bad idea after all.

To conclude, while discussions about delay in international relations are often unclear on what constitutes timely action and lack a clear understanding of the role of delays in negotiations, it would be better to view delay as an integral part of diplomacy.

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make Pakistan see reason. Further, it can be argued that India is in this game to address the growing China-Pakistan nexus, among other issues. In short, each of these countries is using its engagement with others in the region to further its own interests but, at the end of the day, it is not clear who is using whom. In this diplomatic game of musical chairs there is no guarantee that larger countries will ultimately emerge as the victors. The best that India can do at the moment is to remain focussed on economic relations and avoid getting entangled in Middle Eastern conflicts.