



Select Committee on International Relations

Corrected oral evidence: Transformation of power in the Middle East and the implications for UK foreign policy

Wednesday 1 February 2017

10.40 am

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Members present: Lord Howell of Guildford (Chairman); Baroness Coussins; Lord Grocott; Lord Hannay of Chiswick; Baroness Helic; Baroness Hilton of Eggardon; Lord Inglewood; Lord Jopling; Lord Purvis of Tweed; Lord Reid of Cardowan; Baroness Smith of Newnham; Lord Wood of Anfield.

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Questions 148 – 164

Witnesses

I: Dr Carole Nakhle, Energy Economist, Crystol Energy; Mr Stewart Williams, Vice-President, Wood Mackenzie.

II: Rt Hon Lord Lamont of Lerwick, UK Trade Envoy to Iran.

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Examination of witnesses

Dr Carole Nakhle and Mr Stewart Williams.

Q148 **The Chairman:** Good morning Dr Nakhle and Mr Williams. Thank you very much for joining our deliberation this morning. There are two procedural matters to mention quickly before we continue. First, we in this Committee, including me, are obliged to declare all interests relevant to what we are going to discuss, which is very much to do with oil markets and energy, of course. I declare my interest as a member of the advisory board of Crystol Energy and chairman of the Windsor Energy Group. Are there any other declarations to be made immediately around the table? No. Secondly, I am obliged to tell you, as you should know, that this is a public session. There will be a verbatim transcript of it, which you can look at when it comes to you a few days after this session and of course you can correct it if you wish.

With those procedural matters out of the way, let us turn to the issues in question. As I think you both know, this Committee is conducting an in-depth inquiry into the shifting powers of pattern and the impact of outside powers in the whole Middle East region. This morning we want to focus on the way in which the oil and gas markets and the colossal flows of revenues from gas that some Middle East countries have benefited from to an unbelievable extent over the last few years influence this changing pattern of power.

Perhaps I will begin by asking you the first question, Dr Nakhle, because you have written with great authority on many of these matters. After years of vast oil revenues, there is now lower production in the Middle East because of higher production in the United States of shale and so on, because of the current weakness in the oil price and prospects of oil demands not being as strong as they were in the past, and because of the general attitude of the low-carbon world, which, to put it mildly, is that fossil fuel should be made history. Could you give us an overview of how you feel all that is affecting the thinking on the Middle East and changing the pattern of power within the Middle East? Would you like to start on that basis?

Dr Carole Nakhle: I was born and grew up in the Middle East, and I think that the concept of stability has always been desirable but the region has failed to achieve it. Today, it is more important than ever. If I link it to the oil market it is because of two major developments. First, the destructive forces of the shale revolution have changed the existing structure of the oil market as we have known it for decades. The second important force is the fight against climate change, which has rendered rather meaningless the long-term value of oil and gas reserves in the ground, irrespective of how large they are.

If we take these two developments into consideration, we realise that the old cliché of economic diversification is not really new for Middle Eastern oil and gas producers, who have been talking about economic diversification since the 1970s. Today, this old cliché has acquired a new sense of urgency because of those two developments and demographic

pressures are quite large. If you think about the size of the young working population in countries such as Saudi Arabia, you realise that the heavy reliance on the oil and gas sector will fail to create enough jobs for these people. We have all heard of the massive reforms such as the Saudi Vision 2030, much of which, I must say, is not new; economic diversification features quite strongly in it. There are other new aspects, such as the Saudi Aramco IPO, which is an indirect way for Saudi Arabia to open its sector to private investment. Until today Saudi Arabia has been one of the few countries in the world remaining closed to private investment in the oil sector.

The size and scale of these reforms were triggered by low oil prices. I hesitate when I say low, because they are low relative to the period between 2010 and summer 2014, when we had an oil price of \$100, \$110 a barrel. Today, describing an oil price of \$50 a barrel as low surprises me a bit, because actually it is not low. These countries have economic difficulties because of the loss of export revenues, which is felt quite strongly in these countries because their economies are heavily dependent on the oil sector, and the non-oil sector is quite weak. That is why we have ended up with the massive budget deficits that people are talking about. It is a bit strange that with an oil price of \$50 a barrel these economies are suffering in the way they are today.

However, I would like to clarify one thing. It would be simplistic to describe all Middle Eastern countries in this way. I am talking about the large oil and gas producers; not all Middle Eastern countries are in the same position. There are countries such as Iraq that are heavily dependent on oil; almost 100% of its export revenues come from oil. It is suffering the most, unlike countries such as the UAE and Kuwait, which have accumulated financial reserves through their sovereign wealth fund; or Saudi Arabia, through its bank account in the central bank, SAMA. Countries that have saved some of the big windfalls in the periods of high oil prices can sustain their current position better than countries such as Iraq because they can withdraw from those reserves and they have the capacity to borrow. However, I am not saying that they will not face difficulties in the longer term, and I think they acknowledge that this pattern is not sustainable in the longer term.

The Chairman: Mr Williams, would you like to give us your overall take on the Middle East and the prospect of lower oil demand, lower oil prices, the end of oil and so on?

Mr Stewart Williams: I will echo what Carole said. There is a real push by these countries for diversification. It has been there for a long time, but it is really the shock of the drop in oil prices in the last two years that has galvanised them into doing something. Post the Arab spring, there was obviously a lot of spending, and the Arab spring and Libyan oil coming off the market coincided with an increase in the price of oil up to the \$100 level that Carole talked about. A lot of the Governments saved money, Saudi Arabia in particular, everything was fine and spending

continued. Now that the prices have fallen, some of these countries are still in a good position with their financial reserves.

Saudi Arabia in particular might not have reacted as you would have expected a couple of years ago by bringing down its production, because it had that cushion. However, it is drawing down on those reserves, it has realised that an oil price of \$100, \$110 a barrel is probably not good long term for the oil market, because ultimately it destroys demand. So Saudi is pragmatic about the fact that we should not expect to see \$100-plus a barrel; the price should be lower. But when you look at the economics of these oil-producing states, as Carole pointed out, Iraq is in one of the worst situations, but the fiscal breaking price of the likes of Kuwait, Qatar and the UAE is around \$50 or \$60 a barrel—in the range that we are currently in. Saudi Arabia's is higher, and it is the one country that is diversifying, so it is trying to adjust for it.

The Chairman: We pick up two messages from the oil producers. One is, "Don't worry, chaps. In the end it will be all right. We will balance the energy mix of oil, gas and renewables for ever. Maybe even President Trump will assist us, and on the whole we will continue to get our main support from our oil revenues". That is against a different generation who are saying, "Wait a minute. We must diversify completely". As Dr Nakhle has just said, there are the plans to sell off a bit of Aramco, the 2030 plan of Saudi Arabia, and a real sense that they have to change and diversify. Which of these two schools of thought is predominating? I am looking at Dr Nakhle, and it is a difficult question. Is that the right analysis: that we are getting two stories?

Dr Carole Nakhle: We are, and not only stories but actions. If I go back to the announcement of the Vision 2030, Saudi officials and, if I am not mistaken, the Saudi oil minister, said that low oil prices were good for reforms. Fast forward a year later and we had the OPEC¹ deal, which was to stop oil prices from falling further. This is where I can see a bit of a contradiction, because if low oil prices are good for reforms, maybe Saudi Arabia should have let the market continue to set the prices at the levels they were at before the OPEC deal that was preliminarily announced in September and then finalised in December. This tells me one thing: that these ambitious economic reform targets are going to be difficult to implement. There is a population accustomed to generous subsidies, and we all know that when people are used to subsidies it is very difficult to take them away. The Arab spring has perhaps been limited to other countries outside the Middle East, although Syria is still suffering, as well as Yemen. But this is where I can sympathise with the leaders in the region—that it is not going to be easy to implement those reforms. At least they are trying, and in the coming years we will see more how they are going to change the regulations to encourage private investment, which is most needed, because at the moment it is the public sector that is heavily bloated.

¹ Organization of the Petroleum Exporting Countries

Lord Hannay of Chiswick: Do I understand correctly that you are both saying that countries in the Middle East that are oil and gas producers are not as well placed as they were to deal with any unexpected developments that might come along? They are closer to breaking—perhaps that is the wrong word—or to a pain point than they were. Having answered that, could you say whether the unexpected developments—the known unknowns that are out there—are more on the downside of the oil price or the upside?

The Chairman: Talking about future oil prices is always tricky.

Mr Stewart Williams: Yes. Forecasting price is a difficult one. We have already seen potentially with this oil price uptake that the US can start producing more again, which puts downward pressure on the price. Even this morning, Khalid al-Falih, the Saudi Arabian Energy Minister, welcomed the Trump regime and made very positive comments, indicating that a pro-oil US is helpful. As long as demand increases, US supply is, in his words, more than welcome to come into the mix. The big question is demand and when we will reach peak demand.

This comes back to the point about diversification for somewhere like Saudi Arabia and some of the other big Gulf producers. Saudi is not going to slow down its oil business at all; it is trying to build up its non-oil economy to match or even be bigger than the oil economy. Saudi Arabia and some of the other producers such as the UAE and Kuwait are lower-cost producers, which gives them an advantage. So even if oil demand peaks and even starts to come down, those countries see themselves as the efficient producer. Oil consumption might drop, but they still see themselves at the forefront of production, because they have lower costs. For them, there is still a long future in oil, but other countries for which it is more expensive will come and go depending on the environment in which the oil is produced.

Q149 **Lord Purvis of Tweed:** My question follows on from what Mr Williams was saying about the welcome from some quarters to the Trump Administration being overtly about fossil fuels. At the same time, the US is less reliant on the Middle East, and the growth profile of shale in America, which is also an efficient source of energy, seems to be growing. What would you see as the implications of those combined with the relationship with the Middle East? Do you see differences from the Obama Administration, particularly on the security relationship with the Gulf?

Dr Carole Nakhle: If we look at the Obama doctrine, there was an interview in the *Atlantic* journal with former President Obama, which described the Middle East as “high-maintenance allies”. It quoted Mr Obama as saying that he complains privately to friends and advisers that they seek to exploit American muscle for their own narrow and sectarian ends. There was a visible shift in attitude towards the Middle East, which coincided with the shale revolution, which reduced US dependence on the Middle East. So one could argue that if that reliance had not come down,

we would not have seen this shift in the US attitude towards the Middle East.

The big question is whether this will be a sufficient condition for the US completely to turn its back on the Middle East. I tend to believe that it is a necessary but not sufficient factor, because I look at the threat of terrorism, which remains very strong in the Middle East. There is the presence and the safety of Israel, which is the US's closest ally in the region—and even if we look beyond the oil business, there is significant investment by American companies across the Middle East. So yes, the reliance on Middle East oil will come down, but perhaps we should mention the fact that the oil market is global. Even if you stop buying oil from Saudi Arabia, you will still be affected by the oil price, which is set by the global oil market, which is a very important issue.

On the Trump Administration, there is a lot of speculation, and I would be engaging in guess-work if I tried to tell you what he will try to do towards the Middle East. I agree with Stewart that Trump is seen as a pro-industry person, but that could mean reducing further the reliance on Middle Eastern oil, so I am not sure whether that is positive or negative. To give an example of how the Middle East is preparing for the Trump Administration and its policies towards the Middle East, just before the elections I was in Lebanon and a Lebanese radio station carried out a survey about who people would like to see as President—Trump or Hillary Clinton. About 70% voted for Trump. On the day Trump was elected I was in the UAE, and the locals were very excited, describing him as a strong man who will be very good for the Middle East. What does “strong man” mean? I do not know, but that is the kind of sentiment that we have in the Middle East, at least in the Arab Middle East.

The Chairman: It really is extraordinary that on the one hand we have Trump and Tillerson, who are oil men who want to see more production in America and stop getting involved in Middle East wars; and on the other hand, as Dr Nakhle has just said, Trump is seen as the strong man who might favour the Middle East region. It is a very curious dichotomy, is it not?

Mr Stewart Williams: On the US reliance on the Middle East, it is obviously true about the growth of shale oil and the drop of imports of oil. It is quite remarkable that even though, as you say, the Obama Administration retreated from the Middle East and Trump may do more so, the actual reliance on imports from the Middle East has remained flat in the past 10 years. Around 20% to 25% of US imports still come from the Middle East, and most of that is from Saudi Arabia. That has not changed, and one in six Saudi Arabian barrels gets exported to the US. Part of that is the technical issue of what US refineries might take, which were designed for Mexican and Venezuelan heavier crudes. As production falls in those countries, Middle East crude is of similar quality and can replace it. There is still clearly a strong link there, despite the political retrenchment. Certainly, there is a strong link between Saudi and the US.

Lord Purvis of Tweed: May I go back to Saudi Arabia? We had

interesting written evidence from Dr Bassam Fattouh in which he referred to Saudi Arabia. He said that if the US achieved energy independence it could erode the foundation for such a special relationship. Do you think that that is much more long standing?

Mr Stewart Williams: Yes. In fact, US imports of Middle Eastern crude went up last year from about 20% back to 23%. Part of it is a technical issue, the qualities of oil, and importing on one coast and export out of another.

Lord Purvis of Tweed: Is that quite short term?

Mr Stewart Williams: As I said, it has been there throughout the Obama Administration, at that level. The absolute volumes have fallen, of course, because the US is taking less, but the proportion of Middle East crude going into the US is about the same.

Q150 **Baroness Smith of Newnham:** I think you have already seen the question on the paper, but I am going to finesse it slightly, so I will understand if you do not feel able to answer the second bit of it. You have talked about the American dimension and exports to the US. How do you see the outlook for the UK in terms of reliance on the Middle East region and our strategic interests there? Do you envisage any security questions limiting the exports of oil, or our ability to purchase oil for the Middle East, and what is that going to mean for the UK?

Dr Carole Nakhle: The Middle East is not that important to the UK in terms of oil exports. After all, the UK remains a sizable producer, although I know that oil production has peaked and been in decline, but there has been a surprise in the last two years, showing a reversal. I see the importance of the Middle East more as trade partners to the UK. I looked at the numbers and was surprised to see that the UAE and Saudi Arabia are both in the top 15 trade partners to the UK, which includes oil among many other things. So in this sense, if the economies of these countries deteriorate, that will affect trade relations with the UK.

Last year, just to give you a number, there was a decline of UK exports to Saudi Arabia by £0.2 billion. So there is potential there. If the economies get better, the UK can benefit because of this trade relationship, and we should not forget that the historical ties are also important. Middle Eastern people like to send their children to the UK to study, and so on. The big risk is economic. That said, for the UK in its current Brexit mood, strengthening trade relationships with its existing non-EU partners would play an important role.

Mr Stewart Williams: I would just go back to the UK's oil reliance on the Middle East, which is actually very little. It is far less than the US's, for example. Around 4% of imports of oil come from the Persian Gulf. Algeria, although I do not know whether that is covered by your definition of Middle East, is probably our biggest area of imports at 15% or 16%. Through the Arab spring, Algeria has been one of the more stable places. The UK still imports quite a lot of oil from quite unstable countries such

as Nigeria, and there has been far more impact on Nigerian outages—nothing to do with the civil war, just militant activity in the Niger delta—which has caused fluctuations. So we are not particularly reliant on that oil.

However, we are far more reliant on the Middle East for natural gas. About half of our gas is now imported, and even if we see a slight uptick in oil from the North Sea in gas production it will fall again.

Of those gas imports, nearly a third comes from Qatari LNG,² and over time the United Kingdom will become more and more reliant on liquefied natural gas imports. But the beauty of liquefied natural gas imports is that they flexible. Our imports from Qatar will probably increase, but it is a very stable supplier that supplies oil all around the world. But over time there are other sources coming on to the market that give us that flexibility. Cargoes can come from the US, east Africa and Australia. Okay, it does not make much sense selling Australian gas here, but swap arrangements mean that gas could physically come from somewhere else.

The Chairman: So you are really saying that in relation to the UK's reliance on the Middle East hydrocarbon supplies, after we spent the 20th century worrying about oil and so on and then had the blessed period of our own North Sea oil and gas and other sources, with our huge element of gas generating electricity we could be back to a rather heavy reliance on the stability and efficiency of those areas in supplying us on a daily basis. Is that right?

Mr Stewart Williams: Yes. On the increasing reliance on LNG, for example, by 2025 around half our gas needs will be met by liquefied natural gas. It will not all come from Qatar; there are other sources of supply. Qatar remains a very, very stable place. We talk about western or US support for Qatar. I do not know what the situation is now, but the US has one of its largest military bases in Qatar. So it is a strategic place, and I cannot see them downsizing that very much, because obviously the Middle East is still a very important area.

The Chairman: Let us now look at the whole hydrocarbon prospect and the big producers.

Q151 **Lord Inglewood:** Can we turn our focus to Iran? In particular, what do you think our prospects are in the current geopolitical world for further developments of energy markets, for UK investment but also for other companies? What do you think the barriers might be in respect of all that? Finally—the elephant in the room—what impact do you think Mr Trump's policies will have in this way?

The Chairman: Dr Nakhle, you have written on this extensively, so it is certainly your turn.

² Liquefied Natural Gas

Dr Carole Nakhle: And I am still writing, because it is an unfolding story. It is like an onion; the more you peel it, the more you risk shedding tears, because there are a lot of ambiguities and complexities in the system. Iran, we have to face it, is sitting on one of the largest oil and gas reserves in the world, so its potential for oil and gas resources is there and has been proven over decades. But that is below ground. Above ground, the political risks are quite high.

On the question of what Iran has been trying to do to attract investment, the sixth national development plan—the latest one, from March 2016 to March 2021—sets Iran's economic policy. Iran needs about \$200 billion of investment in its oil and gas sector, including petrochemicals. This is clearly not pocket money. It needs this money, because it wants to be able to increase its production. As you know, in the years of sanctions the Chinese might have been there but western technology was not used in the country. When I was in Iran last year, I was told by Iranians that because of the sanctions they have learned how to do it by themselves and that they do not need international players. That is true up to a point, but the rapid decline rates of its oilfields are among the highest in the region, much higher than its neighbours. So it definitely needs the technology and the investment, and it has acknowledged that, but investment is not going to flow only because there are reserves there. We need to give investors an attractive legislative, regulatory, fiscal and contractual framework.

In 2013, the Iranians announced that they would be offering a new type of contract to investors—the so-called Iranian petroleum contract, which became later the enhanced buy-back. Iran is perhaps the only country in the world that offers a buy-back agreement, which was introduced in the mid-1990s to get around the constitution, which prohibits any private or international investment in its oil and gas sector. But then the oil buy-backs were of a short duration and they imposed very strict terms on the investors, including a duration of seven years, so the investor would develop the field and then hand it over to the national Iranian oil company. With the new contract, the duration will be much longer—around 25 years—and the terms will be much more lenient. That is what we have been told. We have not seen the nitty-gritty details of the contracts that will make a big difference to the outcome of the contract. What is the point of me having a contract for 25 years if it is going to expose me to more risk? So far, we know that a lot of the most important commercial terms in those contracts are going to be heavily negotiated between the oil companies and the Iranians.

Because of that, I do not think that the Iranians will be able to sign many contracts at the same time. We heard of many companies coming to Iran and signing MoUs, but MoUs or heads of agreement are not actual contracts. The financial obligations of these MoUs are very small compared with the major oil contracts. We are talking about billions of dollars compared with hundreds of thousands or millions to conduct studies. When I look at this and at Iran's need for investment, when I see how many contracts need to be negotiated, some of the contracts that

were signed—the MoUs—may become oil contracts in the future and will increase Iran's production, but I do not think that we will see a sudden massive increase in production in the market, because those contracts are going to be negotiated on a smaller scale with a smaller number of players, and they will take time to be negotiated and signed.

The Chairman: There may or may not be a massive increase, but will the Iranians take the slightest notice of OPEC quotas and attempts to reorganise production in the light of the oil price developments of the past two or three years?

Dr Carole Nakhle: Interestingly, although the OPEC deal sounded like it was putting a constraint on Iran, it used Iran's pre-sanctions production as a basis from which to adjust Iranian production. As a result, if you look at the implications of the OPEC deal, it allows Iran to increase production, not reduce it. I think the OPEC deal was favourable to Iran because it put a floor on the oil price because it was going downwards, and at the same time Iran is allowed to increase its production further up to a certain limit—I think 3.9 million barrels a day.

The Chairman: How does that play with their antagonists, the Saudis, at the other end of OPEC? Surely they must take a rather dim view of this kind of calculation.

Dr Carole Nakhle: I think there were two main benefits from the deal. First, it showed that OPEC is still a functioning organisation. Just before that deal, many people started to say, "OPEC is dead. OPEC is over". Actually, OPEC showed that despite political differences, between Saudi Arabia and Iran mainly, it can still reach an agreement. The second main benefit was not about increasing prices so much as about putting a limit on the price, stopping it declining further. In this sense, having that deal was important to all OPEC players, irrespective of Saudi Arabia or Iran, even though Saudi Arabia risks losing further market share if it is going to carry more of the burden of the production cuts.

The Chairman: We must move on to another aspect.

Lord Inglewood: Can I just make one small point? You talked about selling oil, but you did not touch so much on the barriers or otherwise to investment from a country such as this into Iran. Do you see that becoming easier and more satisfactory for the investor or not?

The Chairman: Mr Williams, any thoughts?

Mr Stewart Williams: If you look at the list of international oil companies that have pre-qualified for this, there are not many UK companies on it. There are not many UK companies capable of making that investment. But a lot of the potential investment would be for the contracting companies lower down—the Engineering, procurement, and construction EPC companies, the smaller engineering companies. I was in Iran, coincidentally at the same time as Carole, and I saw that they are quite behind on their technology, even some of the more simple things.

They can do a lot of simple things very well, but in order to enhance their oil production they will need more specialist equipment and UK companies could provide that. But there are natural barriers to doing business there. You often have to partner with a local company. Certainly the big international oil operators have to partner up with local companies. I think that about 12 companies have been named so far.

Going back to your original question on what Trump can do, you have to be very careful in your due diligence to look at these companies. There is a blacklist of 170 or so companies which the US accuses of being involved in terrorism, the development of ballistic missiles or human rights abuses, and you have to do some very strict due diligence to make sure that the partner you go with is in no way related to that. That whole process slows down investment, both for the big International oil companies IOCs and even the smaller engineering contractors, which—and I agree with Carole here—will ultimately delay an increase in Iran's production. We see it increasing production but not significantly, even out to 2020.

Dr Carole Nakhle: Quickly, on financing, we are seeing that the smaller the scale of the business, the easier it is, because there are some banks, in Oman and other places, which are willing to take the risks with the financial transactions and are not concerned about the remaining sanctions that the US still imposes on Iran. But when it comes to the big oil deals of billions of dollars, as long as we have this issue of finances, we will still see a handicap on investors coming to Iran. This is where the question of scale comes in—a few hundred thousand or a couple of billions. It makes a big difference to the facility of financing.

The Chairman: We now move on to another area of oil production in the Middle East region. Lord Jopling.

Q152 **Lord Jopling:** You mentioned Iraq briefly earlier. You have a situation there where the Kurds have taken control of some of the oil resources, particularly around Mosul. ISIS, again, has exploited some of these resources for its own ends. What are the implications of this situation for the long-term stability of Iraq and the further development of Iraq's energy sector, given the misappropriation of those resources?

Dr Carole Nakhle: Iraq has been suffering for decades from wars, instability, sanctions and, recently, Daesh/ ISIS. In spite of these problems, in 2015 Iraq had the largest net increase in production in the world, mainly because it has opened its doors to international investors and we saw the boost in production that oil companies managed to achieve in Iraq. That said, the major oil production facilities in Iraq are concentrated largely in the south. Whatever happened in the north was more than compensated for by the massive increases in oil production from the south.

On the economic impact, Iraq was suffering economically even during periods of high oil prices. I have to admit that some of these problems are self-inflicted because of the lack of effort to diversify the economy. It

remains one of the economies that is most dependent on oil revenues. The level of corruption sadly remains quite high, which can be a big barrier to further investment in the country. I used to work in the oil industry, and my colleagues really complained about the delays in getting things approved because of the bureaucracy and the red tape. For private business, just as for any other person, time is money. All these things have backfired, and they outweighed the benefits that any high oil prices could have brought to the Iraqi economy.

I am not downplaying the potential risks of instability in Iraq. We know that even though the Iraqis have managed to recapture some parts of Mosul from ISIS, that has incurred massive military expenses for the Iraqi Government. They also have to rebuild those areas. They have to look after the more than 4 million displaced people. They have to rehabilitate the oilfields and the oil facilities that ISIS or Daesh set on fire as they were leaving some areas. So the financial burden on Iraq is quite high, and it is far from being stable. But it has to start with Iraq creating a more attractive environment for private investment. Yes, we have the big oil companies there but we have massive infrastructural bottlenecks, and those require investment. Unless that changes positively in the coming years, we might see Iraqi production not maintaining its growth of the past few years.

The Chairman: Mr Williams, there were high hopes, were there not? The Iraqis talked about going to 6 million or even 12 million barrels a day. Now they have problems with the Kurds, they have Daesh occupying a third of their territory. How do you see the situation now?

Mr Stewart Williams: The original estimates from the Government were much higher than that—around 11 million barrels a day—which you did not have to be an expert on the Middle East to realise would not happen. It is much lower than that now, but it has still been increasing. As for the security risk from Daesh or IS, they are very much in the north of the country and most of the production is from the south, where it is relatively safe. Occasionally, you might see a random attack, but nothing significant. So most of the production is very safe. We saw outages in production from the north when IS was moving south, but the Peshmerga and the Iraqi forces, with help from the American forces, have pushed them back.

Production is still resuming from northern Iraq and the Kurdistan area. What is interesting is that the Kurdistan Regional Government have taken control of some of the federal Iraqi facilities and are producing them on behalf of the Government and exporting that oil through Turkey, almost taking that as their oil in lieu of what they should be receiving from the federal Government as part of their national budget. We do not think that IS will physically impede Iraqi oil very much, but there is still a dispute between Baghdad and Irbil, the capital of Kurdistan.

Lord Grocott: I know that things are changing on the ground all the time, but as of now, if it is a sensible question, what are the proportions of Iraqi oil production as between the Kurdish areas, ISIL areas and the

Iraqi Government areas?

I have a second question on the same theme. Given all the stability over so many years, can you give us a picture of the potential, with the actual production today, if everything was sorted out above ground?

Mr Stewart Williams: On the first question, I do not believe that IS has much control of any Iraqi fields. When it retreated it blew things up—it blew up refineries. It still probably has control of oilfields in Syria, near the Deir ez-Zor area, but in Iraq itself, we do not think they are selling oil to any significant extent. From the Kurdish area versus the south, broadly speaking around 10% of Iraqi oil comes from that area, the vast majority down in the south. They are producing a round total of 4.8 million barrels a day, so they have grown quite well. They could probably bring that up to 6 million barrels a day, but by 2025 it might be more than that. It really depends on sustained investment. Unfortunately, with the low oil price, even though Iraq relies on foreign companies providing all this capital, because of the oil price—the Government have also been fighting IS and spending a lot of its budget there—it has not been able to pay the contractors. So the contractors have naturally also slowed down their investments, which naturally slows down oil capacity for the future.

Baroness Smith of Newnham: A question has always puzzled me. If IS has control—you say that it is not going to take too much of the Iraqi oil; nevertheless, Daesh is getting receipts from oil—how can they sell it? How is it not possible to refuse to purchase oil that is produced by Daesh rather than through Baghdad or the Kurds?

Dr Carole Nakhle: We are looking at a region where smugglers are very active, so irrespective of whether you are smuggling cigarettes, oil or anything else, there is an established web in the region. Therefore, oil can be quite easy to sell, because once it has left the field and goes on a truck, it can make its way anywhere, so it is very difficult to trace that. Not all the oil that ISIS was producing was being sold on the black market, because some of it was refined using quite primitive refining methods and used for the consumption of the areas that they were controlling. ISIS oil production is concentrated more in Syria than in Iraq. It has benefited, but it had other means of making money from other illicit trade, kidnapping and ransoms, stolen antiques, and so on.

The Chairman: There are two giant influences that we have not even touched on yet, which really dominate the whole scene: Russia and China.

Q153 **Baroness Coussins:** Turning to two Asian-Pacific countries and particularly China, could you comment on what you see as the strategic implications of their increasing reliance on Middle East oil. We have heard evidence from others that China's presence in the region thus far is driven overwhelmingly by business interests alongside a reluctance to get involved geopolitically. In the light of increasing reliance of oil, do you think that that non-interventionist policy is sustainable, or do you see a change in the Chinese policy on the horizon?

Dr Carole Nakhle: If we look at the figures in the oil trade between China and the Middle East, we can see that there is an increase in the Chinese reliance on Middle East oil, whereby more than 50% of Chinese oil imports come from the Middle East. We have seen a similar reliance of the Middle East on the Asian market, partly by design, because Asia will be the biggest growth centre for oil demand in future, and partly because of the refineries in China, which can take Middle Eastern oil.

China's involvement in the Middle East fits with the one belt, one road strategy, whereby economic projects are the main drivers. China is not new to the region; it has been investing in countries such as Iraq directly in the upstream oil and gas sector. It has been in Iran, despite the sanctions, and has been trading with Israel, and if it can it would like to retain neutrality on politics. I read a paper that the Chinese published, entitled, I think, *Middle East Policy*. A few terms kept on being repeated: peace, peaceful, stability, and economic development. Peace alone figured more than 25 times in fewer than eight pages. So, ideally, the Chinese do not want to be involved in the entangled politics because they do business with countries with very diverging interests, but whether they can maintain that neutrality is a big question. That said, if I am not mistaken, Japan gets more than 83% of its oil from the Middle East, yet Japan is not that involved in Middle Eastern politics and maintains a neutral relationship with various partners. So it is debatable.

Q154 **Lord Reid of Cardowan:** My question follows directly from the one that has just been asked, which you answered by saying, "That is a big question". We are putting you on the spot and asking you the big questions. Is it sustainable to have increasing economic interests in the area, not just as a supplier of oil and as an area in which you are investing but to stay out of political involvement when, as you pointed out, in Iraq and elsewhere the conditions for investment flourishing are heavily dependent on stability, including political stability? Let me ask you the big question: do you think that it is a sustainable policy to rely on investment and avoid getting involved in the politics and social stability of the Middle East?

Dr Carole Nakhle: I feel that if China is to be more involved in the politics of the Middle East, it would be more as a mediator to ensure that everybody gets on well with each other. But if we push that question to ask whether China will be involved militarily if it is required, as for example the US has been, I find it hard to see that happening. I think that China would still look to the US or western allies to play that role. It will of course try to mediate and try to maintain good relationships with everyone. It may be pushed to take sides, but it will try to resist that as much as possible.

The Chairman: Can we turn, finally, to the Russian influence and situation—it comes into everything that we have discussed—both politically and as one of the world's biggest oil producers? How does its shadow work on the new Middle East scene that is unfolding before us?

Q155 **Baroness Hilton of Eggardon:** You have effectively asked my question,

Lord Chairman. Russia is getting more involved. Do you think that is because it is reliant on more oil from the Middle East, or is it just to enhance its status as a world power, which Putin is enthusiastic about? Russia's current relationship with Iran, for instance, has surprised many of us. Do you think that it has a reliance on Middle Eastern oil, or is it purely a matter of geopolitical status?

The Chairman: Lady Hilton has put it much better than me.

Mr Stewart Williams: Russia, and before that the Soviet Union, has had a long relationship with the Middle East. In fact, the Soviet Union was the first country to recognise the sovereignty of Saudi Arabia. It has been a bit of a torrid history. The relationship is more symbolic and more about your second point. In terms of the level of oil investment, Russian companies control about 0.5% of Middle East oil, which is absolutely dwarfed by its own production at home. I think that the Russians have seen an opportunity to grow their presence and to take a bigger place on the stage in the world. They see that opportunity, and why not? Even though it may look as if the Russians have sided with the Shia, given their position on Syria and the fact that companies are being qualified to go into Iran, they still have a good relationship with Saudi Arabia. That was played out in the OPEC agreement and in the very fact that the Saudis and the Russians came to an agreement on price, so there is still a working relationship between the two.

Dr Carole Nakhle: May I add a few aspects? To answer the question directly, there is not much of an energy interest for Russia in the Middle East, but the Russians have the following interests. First, the deal with OPEC was mainly to salvage the oil price and to stop it declining further, which will be beneficial for Russia. Secondly, I do not think that Russia did it just for the oil price. Russia's interest in getting closer to the Middle Eastern countries is also to convince them to invest in Russia, because the Russian economy has been suffering as a result of the sanctions. By filling a power vacuum and standing by the side of the old allies—in this case, Syria—it is trying to show that it is a reliable force in the Middle East. I would say that this is where its interest in the Middle East lies, economically.

The Chairman: Do you think that when the Kremlin is dealing with OPEC it can control its own oil and price output in the precise way that quota discipline would demand? Is it in control of the whole system from Moscow?

Dr Carole Nakhle: Russia is interesting. This is not the first time that it has agreed with OPEC to cut its production, but in the past it has been a free rider. It has said that it would cut, it has waited for the oil price to increase, then allowed its existing production to benefit from the higher prices. But this time it seems to be determined and the orders seem to have come from the highest level of authority in Russia. Even if it does not want to do it intentionally, people are talking about natural decline in the production in Russia. One can say that that is about less investment,

but there is this natural decline, which the Russians would equate to cutting production, but I do not think they would deliberately cut it.

The Chairman: We have kept you two experts for an hour and I have a massive list of things that we have not discussed, such as Libya, the Egypt-Israel situation, the eastern Mediterranean, including Lebanon, and many other aspects. You have been enormously helpful in the areas that we have asked you about and we are very grateful for that. I should have said at the beginning that I notice, Dr Nakhle, that you are the founder of the Access for Women in Energy foundation, which is a cause that we can all support. Thank you very much for your time. We have only touched on the massive complexity of the world energy market and how the Middle East is affected by it, but we are extremely grateful to you for guiding us along the way with some of these complex issues.

Examination of witness

Lord Lamont of Lerwick.

Q156 **The Chairman:** Lord Lamont, welcome. Thank you very much for joining us this morning and giving us your time and expertise. I will make the procedural statement, which you will know already, that this is a public session. It is recorded. There is a transcript and you can see the transcript afterwards and amend it as you wish. You sat in on the earlier session, so you have heard where some of our interests lie, particularly on the energy side, but we are looking to you, having held some of the highest offices in the land and now as the UK trade envoy to Iran, to broaden the picture. Please could you give us a short overview of how you see the broader Iran situation? That would be very helpful to the Committee.

Lord Lamont of Lerwick: Thank you very much indeed. I welcome the opportunity to come before the Committee. This report is extremely timely, because we could very soon be faced with an extremely serious crisis between the West and Iran. The President of the United States, Mr Trump, during the campaign promised to tear up the nuclear agreement, which he described as a lousy agreement. General Mattis has threatened to impose new sanctions while keeping the agreement for other things, which would be regarded by the Iranians as a breach of the agreement. Within the first week of the new Congress, two Bills were put before the House for extra sanctions on Iran. The Iran Sanctions Act was renewed by President Obama, which disturbed the Iranians. That means that the presidential waiver has to be exercised every 120 days. The next waiver would be due in April if sanctions are not to be imposed on Iran. All this feeds into the narrative, as seen by the Iranians, of western treachery—the West is not to be trusted—and will be music to the hardliners.

The nuclear agreement was a triumph of multilateral diplomacy. It was worth having for its own sake, as just a nuclear agreement, regardless of what it subsequently might or might not lead to. However, the hope was

that it would gradually lead to more involvement and trade and thus to some improvement in relations between the West and Iran. The answer to the situation that we are in is to make the agreement work—it is not working from an Iranian point of view, as we will come to in later questions—not to have a new agreement or to seek to amend it.

I will make a second point about foreign policy. During General Mattis's hearings before the Senate, Senator McCain described Iran as seeking to make the region in its own image. General Mattis himself is on record as saying that Iran is "a revolutionary cause devoted to mayhem". I hope that this Committee will regard such statements with deep scepticism. Such statements are certainly complementary to ignoring the subsidisation of terrorism through madrassahs and the production of people from madrassahs, supported by states in the Gulf. They ignore the huge military expenditure, compared with Iran's, of Iran's neighbours. I do not believe that Iran has any territorial designs on any other country in the region. We hear a lot about the stirring up of the Shia minorities in the different Gulf states. Many of those Shia minorities look not to the religious model of government, the version of Islamism in Iran: the Vilayat-e Faqih—the rule of the jurist. They look much more to Najaf and Karbala in Iraq, to Ayatollah Sistani, rather than the model of government in Iran.

Lastly, Iran has its own security concerns. The invasion of Saddam Hussein is ever present in Iranian minds. This is a major security concern and remains so today. This is not the first time we have seen Iran trying to engage with the West. We had it with President Khatami. President Khatami tried to improve relations with the West, offered a grand bargain, was rejected, was called part of the axis of evil, and what was the result? The result was an expansion of Iran's nuclear programme, more hardliners and President Ahmadinejad.

The Chairman: That is fascinating, and all the issues you raise are ones we will come to in detail in our questions. Perhaps we might fix for a moment on the broad foreign policy issue of whether Iran is moving forward into the comity of nations or is being seen as a source of mayhem, as the Americans said. What is actually happening within Iran as these pressures develop? Is there disappointment that the deal, which we will come to, has not led to liberalisation, expansion, higher living standards and more investment? Is that in turn handing power back to the Revolutionary Guard and the extremists very rapidly, or is a balance being maintained? What is your take on that?

Lord Lamont of Lerwick: The nuclear agreement, when it was signed, was extremely popular in Iran. The conclusion of the deal led to favourable results from President Rouhani's point of view in the elections both for the Majlis and for the Assembly of Experts—the body that monitors and chooses the Supreme Leader. Since then, however, there has been growing disillusionment in Iran that the deal is not being implemented, that the West is reneging and that Iran is not seeing the benefits of the deal. One hears the phrase, "It's all ink on paper".

The essence of the problem is that the sanctions that were lifted by the United States and Europe differ. The United States has retained primary sanctions—this was quite open at the time; everybody knew this but they did not see the consequences—which particularly affect the banks. In recent years the banks in Europe have been fined huge sums of money by the United States for sanctions infringement and breaching anti-money laundering “know your customer” regulations. The result of these massive fines is that European banks are terrified to lend money or even to process payments. It has become extremely difficult to finance trade with Iran.

Just to give an illustration, the Iranian banks in London, of which I think there are five, cannot clear sterling and cannot get correspondent banking relationships. That is why, for example, the Iranian embassy has no bank account. It cannot get a bank to handle its day-do-day payment of council tax—I do not think it pays council tax—or its gas and electricity bills. It has to pay those in cash. There is a sort of paralysis here. The other day I was talking to—I had better not name it—a very well-known multinational company that wished to pay a large sum of money to Iran. It had to do it through a Japanese bank, with a payment route in China, and had to pay in renminbi in the end.

This is all leading to a lot of criticism in Iran. Undoubtedly, the hardliners are saying, “We told you that you couldn’t trust the West, that you couldn’t trust America in particular”. The Supreme Leader, Ayatollah Khamenei, was always very ambivalent in his support of the agreement. He gave his support for the negotiations somewhat reluctantly, publicly at least, and he is now saying, “I told you that you couldn’t trust the United States”.

Baroness Helic: I used to work in the Foreign Office and I remember the attacks on the British embassy, the freezing of relationships and then the defrosting of relationships, putting them on an operable basis for the two countries to interact. I have noticed recently that we have gone in a slightly different direction. Only a few weeks ago, Iran was described as a malign country, and if I am correct Minister Ellwood had quite an uncomfortable visit there. Are we in the process of abandoning our previous policy and getting closer to the Trump Administration way of thinking about Iran, potentially even completely flipping to the ways in which we operated towards Iran a few years ago?

Lord Lamont of Lerwick: I hope not. Britain has articulated in its rhetoric more animosity towards Iran, although it has its reasons—I am not saying that it does not—than countries such as Germany, France or Italy have. Germany in particular tends to keep its head down. I think that this has had some effect on trade. The banking problem still affects Germany, but it is interesting that Germany’s exports are 20 times the level of the UK’s and France’s are something like 10 or 11 times the level. We have used words such as “malign”. It is fair to say that the Prime Minister’s speech in Bahrain, when she used the word “aggression”, went down very badly in Iran. Of course, we have different interests and we

would take the view that Iran has been complicit in the actions of Russia that we very strongly disapprove of. However, many people would argue that although we may object to what Iran is doing in Syria, it is not trying to expand its influence or acquire territory; it is trying to maintain the status quo as it was, Syria being the only Arab ally that it had.

To go back to the beginning of your question, we have to be careful. We just assume that the language that we adopt will have no effect on our relationship and does not cause extreme offence in Iran.

Q157 Lord Purvis of Tweed: To follow on from that, the Prime Minister in her Philadelphia speech agreed with the USA's description of Iran's "malign influence" and clearly disagrees strongly with you, as she said: "it is a priority for the UK too as we support our allies in the Gulf states to push back against Iran's aggressive efforts to build an arc of influence from Tehran through to the Mediterranean". If one looks at the UKTI³ website, as I did this morning, which is promoting Iran as a place for British business to work in, there seems to be a glaring inconsistency with the Prime Minister's speech. How do you, as a trade envoy, try to balance the two?

Lord Lamont of Lerwick: I am not a member of the Government.

Lord Purvis of Tweed: You are her trade envoy, though.

Lord Lamont of Lerwick: I am the trade envoy of the Government and when I talk to Iranians it is largely about trade and economic matters. Any views that I express on foreign policy are strictly my own. I am in no way denying that we have different interests from those of Iran in the region. I am not saying for one moment that I support what Iran is doing in Syria, but I do not think that the idea that Iran has territorial ambitions is correct. We hear a lot about the Shia crescent, and what you said reflected what Senator McCain said. If Iran has more influence in the region—more Shia sympathisers—that is largely a product of the American invasion of Iraq, which altered the entire balance between Shia and Sunni in the region. The United States also removed Iran's other main enemy, the Taliban in Afghanistan. Both those actions have increased Iran's influence.

This business of the Shia crescent and the Shia minorities throughout the region is something that you used to get in Ottoman times; the Ottomans would see the Shia as agents of the Safavid dynasty in Iran. As I said in my opening remarks, many of the Shia in Bahrain and Iraq—less so in south Lebanon—do not want in their form of governance to emulate the type of theocracy that there is in Iran, which is, in a phrase that you will probably know and that I have just used, Vilayat-e Faqih: the rule of the jurists. Ayatollah Sistani in Iraq is perhaps the most senior ayatollah in the Shia world and many of the people in Bahrain look to him. Even Mr Nimr al-Nimr, the cleric who was active in the eastern province of Saudi Arabia and was executed recently, did not look to Iran, despite the riots

³ Now the Department for International Trade

and the attack on the Saudi embassy; he looked much more to Iraq. It is wrong to think that the Shia minority is always controlled by Iran.

Interestingly, when Mr Gates, the Defense Secretary under both George W Bush and President Obama, visited Bahrain at the time of the Shia uprising, it was publicly reported that he told the king of Bahrain to stop blaming Iran for the Shia uprising and look to the conditions under which the Shia lived in Bahrain. Of course, the Shia, throughout the Middle East, have been treated in most countries very much as second-class citizens. That is why these Shia defence groups and organisations—as in Saudi Arabia and as in Lebanon, with Amal and Hezbollah—have come into existence. Many of them predated the Islamic revolution in 1979. It is about the second-class status of Shia throughout the region.

Lord Hannay of Chiswick: I do not wish to belittle at all the cause for complaint that the Iranians have about the way in which the agreement to lift sanctions has worked, which you have outlined, but do you not think that there is probably a pretty large element in that of simply trying to get more benefit out of the lifting of sanctions by making our flesh creep, as opposed to a likelihood that they will break out of the agreement?

Secondly, even if the hardliners were to win the presidential elections in May, their options would be rather limited, would they not? If they took the initiative to break out of the agreement, they would immediately trigger off the snapback on sanctions and everything that has been done so far would be removed, and if they resumed their nuclear programmes and chucked out the IAEA⁴ they would make it very likely that there would be a conflict. In a sense, we have to aim off a little, do we not?

Lord Lamont of Lerwick: Yes and no. I do not wholly accept what you said at the beginning: that the effect of the banking boycott is being exaggerated. I see this daily in my role as the trade envoy and as chairman of the British Iranian Chamber of Commerce. British companies just cannot do business with Iran. They find it extremely difficult, because they cannot get any banking facilities at all. RBS has just announced—I am not sure what the purpose is—that for any transaction to do with Iran at all, even for £5, there will be a fee of £10,000. This is an extraordinary way in which to facilitate trade. The banks do not want to process payments with Iran. The situation is similar in France and less so in Germany, where there are a number of German-Iranian-owned banks. I think that it is a real problem. However, I agree with the second part of your question when you said that they do not really have anywhere else to go. There is no fallback option.

The Iranians want to improve trade relations with the rest of the world, as you heard in the earlier part of the session. They want access to western technology. They are fed up with relying on the Chinese and on trading just with Asia. So, as you say, I do not think that even the hardliners would necessarily tear it up. It is very difficult to predict what

⁴ International Atomic Energy Agency

they would do. Rationally, I agree that they have nowhere else to go, but it is very dangerous just to assume that nothing will happen and that we have them in a corner. Actually, the real priority ought to be to make the agreement work—make the Iranians feel there is benefit from this, and then we will have a chance to improve relations more generally.

Lord Jopling: I want to follow that up. You described graphically how the agreement is not working. Your answer to Lord Hannay implied that you do not think that they will tear it up. Certainly, in this inquiry we have asked others whether they think the problems you have highlighted will cause them to break out of it. Nobody, as far as I recall, has suggested that they will break out of it. But the United States is where a lot of the problems have come from. I was in Washington when Mr Netanyahu addressed Congress. He devoted almost his entire speech to a tirade against the agreement, and the response of the Congress was, to put it mildly, overexcited. They leapt to their feet more than 40 times. I see no prospect, whatever Trump says, of Congress agreeing to remove the problems you have referred to. To sum this up, does it not mean that the agreement is likely to trundle along, however unsatisfactory it may be, just as it is now, with very few prospects of it changing?

Lord Lamont of Lerwick: That may be right, because OFAC,⁵ the authority responsible for enforcing sanctions for the United States, has attempted to be helpful. On its website, it has been clarifying how it will apply the sanctions. For example, on due diligence in dealing with possible terrorist organisations and sanctioned entities, it says, “Provided you do adequate, normal due diligence, we will not pursue you”. That is quite helpful, but I cannot see a Trump Administration continuing with that sort of clarification, saying, “We will not prosecute you if you do this or you can demonstrate that you have made reasonable attempts to do this”.

You are probably right that it will just go on, from an Iranian point of view, in a very unsatisfactory way, and the Iranians might not tear it up. Although I think that the agreement is worth having in its own right because of the stopping of proliferation, which is the main purpose of it, the hope was that the agreement would gradually lead to Iran becoming more interconnected with the outside world, with more trade and more interaction with foreigners, and that this might lead gradually to an improvement in relations, possibly even with the United States. But at the moment, the way the agreement is being implemented is feeding into the narrative that is built on the Iranian history of being interfered with, being double-crossed and being dealt with badly by the West. The whole Iranian Revolution in 1979 was very much a reaction against being manipulated and being interfered with by foreign powers, particularly Britain and the United States. I do not think we always understand how Britain is seen in a very unfavourable light by many Iranians.

Q158 **Lord Inglewood:** You have more or less answered the question I was

⁵ The Office of Foreign Assets Control of the US Treasury Department

going to put to you, which is: in your experience, are we perceived in this country as being duplicitous and perfidious, or do they see us as we see ourselves: as people of the highest consistency and integrity?

Lord Lamont of Lerwick: Someone once said, "The Iranians are the last people who think that Britain is a very great power in the world". Just this week the Supreme Leader, Ayatollah Khamenei, made a quite outspoken speech in which he referred to the main threats to Iran being Zionism, America and Britain. We were up there, right at the front.

Baroness Coussins: I agree with you about the importance of the deal and of making it work on both sides. But if Iran is looking for better and more trade relations, is it not shooting itself in the foot by imprisoning British-Iranian dual nationals such as Nazanin Zaghari-Ratcliffe? What more do you think can be done on that front?

Lord Lamont of Lerwick: I totally agree with you on that, and I have raised that with the Iranians on several occasions. I have written to people I thought might have influence within Iran about the case of Nazanin and another dual national, Mr Foroughi, who has been in prison for some years. There seems to be some sort of deliberate campaign against dual nationals. Some have suggested that it is because hardliners, who want to undermine the deal, wish to frustrate and prevent the return of diasporan Iranians who have dual nationality and who obviously can do a lot for business in Iran, to prevent them challenging the establishment, which is deep into business. Do not forget that the IRGC—the Revolutionary Guards—have a lot of business interests in Iran. Opening up is in many ways a threat to their interests. President Rouhani has been very courageous and open and public about saying that the IRGC should keep out of business. He has been attempting to constraint their activity in the economy. As you say, the treatment of people such as Nazanin makes life for people such as me, who advocate a better relationship with Iran, extremely difficult. The people who are ultimately hurt by this are the people of Iran.

The Chairman: Now let us focus on the actual deal. Lord Hannay.

- Q159 **Lord Hannay of Chiswick:** There are obvious inadequacies in the nuclear deal. The most obvious one is that it runs for only a limited number of years and is not necessarily to be regarded as very stable or long-term. There is obviously the remaining huge concern about what would happen if Iran, after the period when the deal remains, however long it is, were to resume a programme that could be interpreted only as a weapons programme or preparation for a weapons programme. Do you think that one possible way of removing that fear and concern, which could also be attractive to a US Administration who have slated the agreement as being the worst ever done, would be to try to address this problem of the short-term nature of it and try to see if we could generalise and globalise some of the constraints in it on the level you can enrich to, the number of centrifuges, the question of separation of spent fuel, and so on, more widely across the world and thus make the Iranians feel that they were no longer being picked on? The questions so far have

revealed that there is nobody in this Committee—certainly not you—who thinks that we would be better off without the deal. We all think that sustaining the deal is the right thing to do. But do you think its development in this way might avoid a straightforward confrontation between five members of the P5+1⁶ and the United States Administration?

Lord Lamont of Lerwick: That is a very interesting idea, and in the longer term perhaps processes such as enrichment ought to be internationalised, and when countries wish to enrich uranium they should do so in partnership with other countries and obviously under international supervision, as it is according to the NPT.⁷ Internationalising nuclear programmes in this way would be a way of aligning the constraints on Iran at the moment with the rest of the world. However, one problem would be that the non-aligned movement—to use an old-fashioned phrase—or third-world countries will not want to be in an inferior position to advanced industrialised countries. As you know, they already think that advanced countries are in a favourable position, and it would be quite a challenge to get them to sign up to something that did not put countries such as Britain and the United States on the same basis. It would be very difficult to get the United States to sign up to something like that. So it is a very good idea, but it would require a lot of very energetic diplomacy.

On the issue of the short-term nature of the agreement, most of the provisions last 15 years, but some go on longer—and, of course, the NPT applies to Iran, which has said that it will abide in perpetuity with the provisions of the NPT. It has specifically said that it will not do R&D into certain areas of technology. I know very little about these things, but for a nuclear warhead the uranium or plutonium has to be in metallurgical form. It has said that it will not do research into that. There are some specific areas of the agreement that last until 2036 or 2041. For example, there will be very close monitoring of the production of centrifuge rotors and bellows until 2036, the significance of which is that it will make it very difficult for them to divert those key components into a secret nuclear programme while their mainstream programme is being monitored at the same time. That is also true of the production of uranium concentrate, yellowcake, is being monitored until 2041, by which time I will be 99. Again, given the NPT provisions that we are applying to the main programme, it would be very difficult to divert material to some secret programme.

We will also have the benefit of the additional protocol, which has not yet been ratified by Iran, but it has said that it will do so and it is behaving as though it has signed the additional protocol, which gives the IAEA the opportunity to visit sites that have not been declared as nuclear sites but where they suspect or might have reason to believe that something illicit is going on. Of course, the knowledge of what is going on in Iran with the use of the additional protocol will build up very significantly over the

⁶ The five permanent members of the UN Security Council and Germany

⁷ The Non-Proliferation Treaty

years. By the end of 15 years, with the additional protocol, the IAEA will know a huge amount about what is happening in Iran.

Lord Hannay of Chiswick: Could I just ask you to situate that against allegations—quite well-founded ones—that the Iranians’ missile programme is not in full conformity with the JCPOA⁸ and seems to have an intent that is not quite as pacific as what you have been talking about?

Lord Lamont of Lerwick: As I understand it, the UN ban on ballistic missile testing was lessened on implementation day for the JCPOA—that is, in January last year—and it became a call to Iran not to test ballistic missiles. There is no equivalent to the NPT to do with missile tests or the chemical weapons agreement. Iran has quite openly stated that it is not covered by the JCPOA. For Iran, testing missiles is an absolute red line. During the Iran-Iraq war, it found that it had to buy missiles on the open market when Teheran and other cities were under attack from Iraq. Other countries in the Gulf have ballistic missiles; there is a strategic missile force in Saudi Arabia, and there are air-to-ground missiles which countries such as UAE and Abu Dhabi have. The Iranian air force is relatively weak. I once heard General Petraeus say that the UAE air force could wipe out the entire Iranian air force in half a day. We sell these huge amounts of arms to the Gulf and take no account of what effect it might have on the psychology of the Iranians.

The Chairman: Did they not buy this latest missile from the North Koreans—the Musudan missile that they tested out on Sunday?

Lord Lamont of Lerwick: I do not know about that. I think they are manufactured locally. I am not sure that they are always quite as successful as the Iranians maintain. I remember some while ago that there was a photograph on page one of the *Financial Times* of an Iranian missile test, and underneath it said that the photograph would appear to have been doctored because four of the missiles did not take off successfully.

The Chairman: Baroness Smith, did you want to pursue the possible Brexit impact on the whole deal negotiation? We did not quite cover it, I think.

Q160 **Baroness Smith of Newnham:** No, we did not quite. The witness biography suggests that Lord Lamont is well placed to discuss the future of the UK from a pro-Brexit standpoint. Clearly, the deal was part of an E3+3⁹ agreement, and the UK will find itself in potentially uncharted territory when we leave the European Union. One question is to what extent you think the UK will have a significant role—obviously, you are a trade envoy to Iran, but I mean in the security arena. To what extent does the European Union still have a role to play in Iran? Would he argue in Parliament and to the Government that for the United Kingdom to continue to be influential in the security field we should be as close as

⁸ The Joint Comprehensive Plan of Action aka the Iran nuclear deal

⁹ France, Germany and the UK, and China, Russia and the US

possible to our European Union erstwhile partners?

Lord Lamont of Lerwick: Yes, I would agree with that. We will be part of the joint commission, which is responsible for monitoring the agreement and hearing complaints from either party as to whether the agreement is being upheld. So we will continue to have a very close role. Obviously, we will not be part of the internal EU discussion, but I would have thought it perfectly possible that we could establish a mechanism whereby we could co-ordinate or collaborate with the EU—and it is extremely important that we do so. If we were to get into a situation where the United States tore up the agreement, it would be very difficult, but I would be sympathetic to looking at a way whereby Europe might continue to have the agreement with Iran. I saw that the French Foreign Minister earlier this week said that France was very strongly in favour of maintaining the agreement and would oppose efforts, if any were made by the United States Government, to tear up the agreement. One ought to make the point, just for the sake of even-handedness of course, that it is always an objective of Iranian policy to try to separate Europe from the United States.

The Chairman: We have been talking about the deal, but in every day's newspapers there are reports of tension between the Iranians and the Americans or the Iranians and other powers in the region. Lord Reid wanted to pursue this.

Lord Reid of Cardowan: Just to broaden it out, you mentioned earlier the historic relationship between Sunni and Shia, which tends to be the prism through which a lot of people see this. Yet, apart from religious differences, there are of course ethnic differences as well. There are Arabs and Persians, who have an equally long historical relationship. Of course, we have a complex web of relationships with many of the Arab states, particularly the Gulf states. They certainly have a perception, and act in lobbying terms on that perception, that the West has been far too soft on Iran with regard to missiles, as Lord Hannay said, sponsoring terrorism, and their own minorities, or in some cases even Shia majorities, in the Gulf states. Do we take it from what you are saying that we should be highly sceptical of claims of that political lobbying, or do you accept that we have to respond not only to Israel's concerns but to those of our other allies in the region? This gets to the nub of what you have been implying throughout. You have not used the word "propaganda", but there is an exaggerated fear of Iran that is being encouraged by, among others, the Arab states. Is that a correct perception of your feelings on this?

Lord Lamont of Lerwick: I think that Arab countries' fears have increased. They were always there when the Shah was in charge of Iran, but they have increased, first, as I said earlier, by the toppling of Saddam Hussein, which has made the concept of the Shia Crescent more credible but was not something that Iran itself brought into being. Secondly, there was the declared aim of Obama to tilt away from the Middle East towards Asia, which led to a feeling that perhaps they might be neglected. But, yes, I do not think that our attitude is entirely even-handed. We have

very close relationships—I am not saying for one minute that they should be torn up, but we have close commercial and historical relationships. We have, as you know, an intelligence relationship, particularly with Saudi Arabia. That means that we tend to see things entirely through the Arab countries' eyes and do not see the insecurities that the Iranians have.

You are quite right to make the point that there are many different layers in this: the divisions between Shia and Sunni and Arab and non-Arab. The Gulf states take the line that Iran has no business interfering in Arab affairs. Now what does that mean? Does that mean that Iran, because it is a non-Arab country, does not have a great say in security in the Persian Gulf? Is that a matter entirely for the Gulf Arab states? That seems an unreal view. We have bought into the view that Iran should have no say in Arab affairs, when plainly it wants to be recognised and has a legitimate argument for being a country that is important within its particular region.

When you say, "soft on terrorism", please do not misunderstand me. I am in no way supporting Iranian policy in Syria or anything like that, but one has to distinguish between that and what we call terrorism. Iran has been quick to make the point that the President of the United States has made this executive order banning people from six countries, including Iran, from entering the United States, but not one of the countries that provided the nationals that were involved in 9/11 has been included in this.

The Iranians themselves have a strong interest in fighting terrorism in the region. They are very afraid of ISIS and of ISIS getting a foothold or getting control of Iraq—the country that invaded them, in a war that lasted longer than the First World War and cost them almost as many casualties as we suffered in the Second World War, and that is a minimum. We should not forget that Iran suffers from terrorism itself. There has been the assassination of nuclear scientists, some of them very junior—people shot in the streets because they have been involved in the nuclear programme. Somebody somewhere is behind these acts.

We hear a lot about Iran and cyberwarfare. The first act of cyberwarfare appears to have been, if what we read is right, by Israel and the United States, with Stuxnet fed into the Iranian nuclear programme. Since then the Iranians have developed their own form of cyberwarfare as a reaction. There have been allegations about attacks on Aramco, which may well be true—I have no idea. So I do not think that we have been remotely soft on Iran; we have sometimes failed to see things as they see them, from their point of view.

The Chairman: Lord Grocott, would you like to combine the Israeli question with the other question you were going to ask?

Q161 **Lord Grocott:** Yes, I suppose it relates to it quite a lot. Picking up on Lord Reid's point, you described very convincingly—for me, at any rate—the grounds for some sense of victimhood on the part of the Iranians with regard to western involvement in the Middle East over a very long time.

You also described their military fears, in relation to Israel but also to the Gulf states. Arms exports and supplies in the region are a huge issue, as we have heard from some other witnesses. What are your views on that? In very crude terms, for obvious reasons, in relation to Iran we try to limit or control the capacity to be a threat, whereas we could be perceived in other parts of the Middle East to be providing the equipment that can fan flames—and is dramatically so doing, it could be said, in Saudi Arabia and Yemen. What do you have to say about the whole issue of arms supplies in the Middle East?

Lord Lamont of Lerwick: Well, Britain and the United States have exported massive amounts of arms to the Gulf states. Iran is subject to an arms embargo. Iran spends much less on defence than Saudi Arabia does. I do not know whether that is true, but I read that the UAE defence budget is larger than Iran's. Iran would be a very difficult country to invade, but, as I said, it does not have a strong air force. One can take both an aggressive view and a defensive view of Iran's alliances with different groups in the region, such as Hezbollah. Part of this, as I said before, is the Shi'ites' reaction to their own position.

But I think Iran sees the connections that it has with different groups throughout the region as an asset, for its own asymmetric defence. This was once put very vividly by Larijani, the Speaker of the Iranian Parliament and former nuclear negotiator, who said, "If Iran is attacked by the United States, expect Israel in a wheelchair": He was, in effect, saying "We know we can't defend ourselves, but we're capable of attacking Israel in response". They will not give up these groups while they feel insecure.

Interestingly, in 2003, President Khatami offered to the West and the United States the grand bargain in which relations would have been normalised; Iran would have stopped the anti-Israeli activities of Hamas and Hezbollah. The relationship with Hamas has very much deteriorated since. He offered that in 2003; he wanted to normalise relations. At that time, as you know, Iran was giving some help with the invasion of Afghanistan with the northern alliance. It was rejected, but that was part of what he put forward—reining in some of those groups.

Lord Grocott: In a different respect about the Gulf states, we have had evidence from earlier witnesses that the Gulf states, whatever their rhetoric might be in relation to Iran, in practical terms carry on economic relationships, presumably to the benefit of both sides. Would you like to comment on that?

Lord Lamont of Lerwick: Before I comment on that, can I make one rather impertinent suggestion? To some of you, it might appear rather outré. I gather that the Committee was going to go to Teheran but that that is now unlikely, but perhaps you might take evidence from an Iranian living outside Iran who has close connections, someone like Hossein Mousavian, an academic at Princeton University, who used to be Iran's nuclear negotiator and who understands 100% the Iranian Government's viewpoint and could tell you exactly. Rather than just

having it from someone like me, you could get from someone who had been an official of the Iranian Government, which might be very helpful to the Committee.

The Chairman: Thank you for that suggestion.

Lord Lamont of Lerwick: On Lord Grocott's question, yes, there is more Gulf involvement in Iran than you might think. There is a lot of property investment from Saudi Arabia in Teheran. Some of the investment is rather indirect. For example, the Austrian oil company, OMV, is part owned by the Abu Dhabi Investment Authority, and that is a major investment in Iran. Dubai is a major trading partner of Iran; a lot of British goods are probably unrecorded as going to Iran, because they go through Dubai. Within the UAE, Dubai perhaps has a slightly more favourable view of Iran than do other countries within the UAE, because it is so close and there are many people of Iranian extraction there as well. Although it is outside the GCC,¹⁰ Oman has a very close relationship with Iran. A lot of trade goes via Oman, and it has been a very important country diplomatically in fostering contact. The original nuclear start-up negotiations were conducted in Oman; a lot of secret diplomacy went through Oman.

Q162 **Lord Hannay of Chiswick:** After the somewhat depressing depiction that you gave of the mutual insecurity in the region and the fears that Iranians have of Arabs and Arabs have of Iranians, does it strike you that a medium to long-term aim ought to be a sort of commitment not to interfere in people's internal affairs and not to destabilise other countries, but to work for greater co-operation, which we managed for some period of time in Europe, at any rate? What attitude do you think the Iranians would take to some kind of regional live and let live modus vivendi? It looks pretty unrealistic at the moment, but is that not what should be the medium to long-term aim of those who want to see a more stable Middle East?

Lord Lamont of Lerwick: I totally agree with you. What is needed is some sort of regional architecture in which Iran and Saudi Arabia are involved and Turkey and Egypt might be involved. There has to be a recognition of the role of the main players all having a say. The Iranian Foreign Ministers—I am talking not just about Zarif but his predecessors—have floated ideas like that, and Iran would quite like to be closer to the GCC, but the GCC is not very keen on that. I think that President Ahmadinejad was invited to a GCC meeting a few years ago, which is the sort of thing that ought to happen more regularly.

An interesting statement was made by Admiral Shamkhani, the secretary of the Iranian national security council just a few weeks ago. It is interesting because he is an Arab who has that position in Iran. As you know, only 50% of the population of Iran are actually Persian. He said that, contrary to what many people think, it is not a foreign policy objective for Iran to overthrow the House of Saud. If that were to

¹⁰ Gulf Cooperation Council

happen, it would have disastrous consequences for the region, because it would result in the Balkanisation of Saudi Arabia and almost certainly part of Saudi Arabia would fall into the hands of al-Qaeda or ISIS.

- Q163 **Lord Reid of Cardowan:** The dog that has not barked so far is Israel. It certainly appears from time to time that it is the foreign policy ambition of Iran to wipe Israel off the map—I think those were the words of the previous President. Just as there is tension between Arabs and Iran, there is obviously a very great tension between Israel and Iran. You mentioned the Stuxnet virus earlier, which may not have been the first act of cyberwarfare because there has been Georgia and Estonia and so on, but certainly in its magnitude it was a game changer. Some people might argue that that method of cyber-intervention in the Iranian nuclear production happened at least partly because the Americans feared that, absent something like that, the Israelis might attack with unintended but huge consequences. So there has obviously been a great potential volcano there, lying just beneath the surface in that relationship. Do you have any views on whether any incremental measures could be taken to try to reduce the tension between the two?

Lord Lamont of Lerwick: I think you are right in asking the question, although I am not sure that I know the answer. Incremental measures would be the only things that would be realistic. Interestingly, as you will remember, even during the time during Khomeini's Iran, there were secret contacts with Israel—and, indeed, Israel supplied Iran with weapons during the Iran-Iraq war, despite all the rhetoric. I understand entirely Israel's fears about Iran because of the rhetoric that has sometimes come out, and obviously Israel would be the most at risk were Iran to develop a nuclear weapon.

I do not think that Iran is at all likely to attack Israel, given that Israel has a massive ability to retaliate. Some of the outlandish things you hear from American Senators about mad mullahs going to their deaths and the destruction of Israel are plainly absolute nonsense.

For Iran, the anti-Israeli rhetoric has sometimes been very convenient politically in appealing to the Arab street. Iran wants to appeal to the Arab street to legitimise itself as a country in the region that is showing up the Saudis, or whoever, in their attitudes toward Israel. The Iranian public are not very interested at all and do not want to be involved in any quarrel with Israel. Interestingly, as you know, Iran is the only country in the Middle East outside Israel with a Jewish population. The Jews have guaranteed representation in the Iranian parliament. Undoubtedly, the attitude towards Israel—the perceived hostility—has been one of the major reasons for making America hesitant about improving relations with Iran.

- Q164 **The Chairman:** Lord Lamont, we have been bombarding you with questions for an hour. Can we go back to where you began? You began by saying that you saw a very serious crisis coming in relation to Iran. We all know the Persian nation has always been a bit of a trouble to the West, ever since Xerxes tried to cross the Hellespont, but are you now

saying that if we do not go ahead with the Iran nuclear deal you see the weaponising of Iran's nuclear power and a weaponising of the whole area, and possible attacks between Israel and Iran, as Lord Reid has just been talking about? Is that the disaster that you see looming unless the Iran nuclear deal can somehow be sustained and developed?

Lord Lamont of Lerwick: No, I do not see the weaponising of the nuclear programme. I do not think Iran would go down that route. It would open itself up to an attack from the United States. Even if the agreement is torn up, I do not see the Iranians doing that. What they might do, of course, is what I think they did before—goodness knows what their ultimate intentions were—perhaps developing enrichment facilities outside the agreement, giving themselves an option. No one knows—certainly I do not—exactly what they were intending, but one of their aims after the Iran-Iraq war, or in the latter stages of the Iran-Iraq war, may have been to have the nuclear option, but at least as far as public evidence went they never went beyond having it as an option.

I do not see the Iranians weaponising or developing a nuclear weapon. That is not what I am saying. I am saying that if the agreement is torn up, I think the hardliners will get an upper hand and the tensions in the region between Iran and its neighbours—and anything it can do in the region to annoy the West—will become much greater. I think there will be a very severe deterioration in relations, and the total undermining of the reformists and people such as Rouhani.

The whole history of Iran since the revolution in 1979 has been about the tension between the more radical elements and the pragmatists. Whenever the pragmatists have had the upper hand and have come to the West, as Khatami did, they have been rejected. I do not doubt for one minute that Rouhani is sincere about opening up Iran and having deeper commercial contacts, leading to changes in Iran, but this is all fiercely contested. We talk about Iran and Iranian attitudes as though there was one single attitude, but Iran is a country where there are several centres of power. The situation between those different factions is very competitive. The tearing up of the agreement would give the upper hand to the more radical, much more hard-line, anti-western elements.

The Chairman: Thank you. You have spoken with enormous authority and knowledge, ending on a slightly sombre note. I hope that countries and places outside this Committee can hear what you are saying, as I am sure they will. On behalf of the Committee, thank you very much indeed for sharing your time, knowledge and expertise with us.