

November 18, 2013

France and the Iranian Negotiations

Earlier this month, negotiations between Iran and the P5+1 (U.S., U.K., France, China and Russia, the five permanent members of the U.N. Security Council, plus Germany) failed to reach an agreement despite great hopes that one was near. In fact, on expectations that a proposed nuclear deal was in the offing, U.S. Secretary of State Kerry cut short his talks with Israel and the Palestinians to join the discussions. However, near the end of the talks, France raised objections to the proposed agreement and its concerns could not be resolved. And so, the parties agreed to meet later this month but with lower level officials manning the discussions.

U.S. and French relations have seen many twists and turns since the end of WWII. France refused to join NATO and opted for its own nuclear arsenal. It tried to hew a line between the U.S. and the U.S.S.R. during the Cold War, upsetting both sides at times. France was a reluctant ally during the Gulf War and was strongly opposed to America's war to oust Saddam Hussein in 2003. However, France strongly backed the effort to protect Libyans from the wrath of Muammar Gaddafi in 2011 and also pressed to use military force against the Assad regime for deploying chemical weapons. France is one of the best examples of Lord Palmerston's famous quote, "Nations have permanent interests but no permanent friends."

In this report, we will examine the reasons behind French objections to a nuclear deal with Iran. We will begin with an examination of France's relations with the Middle East, focusing on its relations with Israel. Using this history as a guide, we will analyze why the French scotched the potential agreement. A short discussion will follow of the impact of France's objection on the evolution of U.S. policy with Iran. As always, we will conclude with market ramifications.

France, Israel and the Middle East

France was a colonial power with extensive holdings in North Africa and the Levant. Perhaps the most important colony was Algeria. French emigration to Algeria led the settlers to demand full citizenship rights in their new land. France established its court system in Algeria, giving French nationals living in Algeria full access to the French legal system. Although officially a colony, the French tended to view Algeria as part of France. Thus, France tended to react strongly against any move for Algerian independence. Of course, after WWII, the breakup of the European colonial system began, increasing tensions in Algeria.

France also had interests in the Levant. It controlled what is present-day Syria and Lebanon. Although Israel was part of the British mandate, the U.K. transferred the Palestinian issue to the U.N. after the war. When the U.N. declared the establishment of Israel (Resolution 181), the U.S. and France both enthusiastically supported this development.

However, unlike the U.S., France backed up this support with arms sales. The U.S., wanting to project an “even-handed” image to the region, refrained from selling arms to either the Arabs or Israel to prevent giving the appearance of favoring either side. Although there was strong support for Israel among Americans, the potential for development of Arab oil supplies led the Truman and Eisenhower administrations to avoid direct military support to prevent harming relations with the Arab states.

For Israel, this was a major issue. Israel is a small nation surrounded by enemies, both real and potential. Against a determined and unified enemy, the country could be overrun. Thus, to survive, Israel needed a strong, developed economy ally. France played this role from the inception of Israel in 1948 until 1967.

The primary reason the French supported Israel is that it wanted help in keeping Algeria from becoming independent. Gen. Nasser, the ruler of Egypt, was supporting independence movements in the region. Having a strong Israel on Egypt’s border was a potential tool to distract Nasser from expanding this support for Algerian independence.

The 1956 Suez Incident is a good example of French-Israeli relations. In July 1956, Nasser seized the Suez Canal. Nasser acted after the U.S. and U.K. withdrew support for the Aswan Dam; America and Britain made this move after Egypt improved ties with the Soviet Union and established diplomatic relations with Red China. The U.K., France and Israel were part of dual plans—the French and British had Operation Revise while France and Israel launched Operation Kadesh. The British and French operation was designed to gain air superiority and

secure the canal while Israel invaded the Sinai Peninsula.

The military operation was a success. The political fallout was disastrous. President Eisenhower was furious with the incident. Nearly simultaneous to this event was the Soviet incursion into Hungary to oust the government there; for the U.S. to oppose the Soviet invasion but support the allies in Egypt was seen as incongruous. In addition, America’s official policy in the region was one of even treatment; the Eisenhower government feared that supporting Britain, France and Israel would turn the Arab states toward the Soviets. The U.S. went as far as to inform Britain it would dump British pounds held in reserve and threaten a currency crisis if troops were not removed.

In the end, the Suez incident clearly signaled that the European colonial period was coming to an end and that the new world order was being run by the U.S. and U.S.S.R. Still, the French remained supportive of Israel; in fact, as something of a *quid pro quo* for Israel’s participation, France built Israel a nuclear reactor in 1957. This reactor became the basis of Israel’s never officially acknowledged but generally believed nuclear weapons stockpile. Israel was interested in nuclear weapons as another counterweight to its small geopolitical footprint. A successful invader could be faced with retaliatory nuclear strikes.

By the early 1960s, France’s colonial system was clearly crumbling. France had lost Indochina in 1954 at the famous battle of Dien Bien Phu. By 1962, the bloody conflict for Algerian independence had ended with the Evian Accords. In short order most of the rest of France’s colonies became independent.

Consistent with the aforementioned quote from Lord Palmerston, French interest in Israel was beginning to lessen. Now needing oil from the Arab states, President De Gaulle was trying to improve relations with these countries. France's prior support for Israel was not consistent with that goal.

The rupture in French-Israeli relations came in the aftermath of the Six-Day War. As tensions in the region rose, President De Gaulle told Israeli officials that under no circumstances should Israel attack first. Since France was Israel's primary military supplier, De Gaulle was confident that Israel would not dare defy his wishes and risk an arms embargo.¹

However, Israel, noticing that Jordan, Syria and Egypt were mobilizing troops, preemptively attacked. The military operation was wildly successful, with the Israeli Defense Force capturing the Sinai Peninsula, the West Bank and the Golan Heights in just six days. In response, a furious Charles De Gaulle implemented an arms embargo that remained in place until 2011. Relations with other French presidents vacillated; Mitterrand and Sarkozy were generally supportive, whereas Chirac tended to oppose Israel.

In the aftermath of the Six-Day War, President Johnson, under pressure from Israeli supporters in the U.S., became Israel's primary outside arms supplier in 1968. During the Cold War, having the support of Israel in the region was important. Having a democratic outpost in the region acted as a support against Soviet influence. Although American support of

Israel did hurt relations with the Arab states, leading to an oil embargo by OPEC during the Yom Kippur War in 1973, for the most part, the U.S. and Israel have remained allies. However, the end of the Cold War has made the relationship somewhat less important to the U.S. This change has been an issue with the last three administrations and, in part, explains the current cool relations seen with the Obama administration.

Why Did the French Prevent a Deal?

We believe there are two primary reasons why France thwarted a deal. First, the French have historically vied for superpower status and want (and need) to play a role on the global stage. President Hollande is suffering from low approval ratings; his domestic policies are generally not pleasing either the left or the right. The National Front, once a neo-Nazi fringe party, recently won a key local election mostly by running against Hollande's policies, showing how unpopular the president is at this time.

As is often the case, leaders who are in trouble at home try to bolster their authority with a robust foreign policy. France was a leader in the operation to oust Gaddafi in Libya, has inserted troops in Mali to push back al Qaeda-linked insurgents and has operated counterinsurgencies in other African nations, mostly in former colonies. France strongly supported military operations against Syria for deploying chemical weapons. According to reports, France had warplanes "on the tarmac" and was prepared to launch strikes when President Obama decided to consult Congress.

Of course, France could have gone alone in Syria. But, it knew it didn't have the ability to conduct operations without the U.S. In fact, the operations in Libya could not have

¹ It should be noted that while the U.S. did not overtly supply arms to Israel, during the Kennedy administration, the U.S. actively supported the French in supplying Israel and had a secret treaty with the West Germans to supply Israel as well.

occurred without U.S. participation. Although France aspires to superpower status, in reality, it is not. Still, that doesn't mean France won't "pick its spots" to try to recapture past glory.

Second, and perhaps more importantly, France fears that Israel will be willing to attack Iran unilaterally and that the Obama administration is underestimating this risk. France remembers well that Israel defied President De Gaulle and launched pre-emptive airstrikes in 1967. The Hollande administration is concerned that if an accord with Iran does not give Israel comfort that Iran will not develop a nuclear weapon, Israel may engage in airstrikes which carries the risk of causing a broader Middle East war.

The key issue that likely led to French intransigence is the Arak nuclear reactor. This is a heavy water reactor which generates plutonium in its process of creating electricity. If allowed to operate, it would give Iran another avenue to enrich uranium to weapons grade other than the use of centrifuges. Israel has a history of preventing the use of such reactors. It bombed a similar reactor in Iraq in 1981 (Osirik) and in Syria in 2007 (Dair Alzour). Both these attacks occurred before the installations were fueled; once the nuclear material is installed, bombing them runs the risk of spewing nuclear materials into the environment, creating a Chernobyl-style situation.

France wants to be sure that the deal with Iran won't trigger unexpected military action by Israel. We would not expect Israel to like any peace deal with Iran. But, the key is creating one that Israel can live with.

The Bad Cop?

There is some speculation that France took this action to act as "the bad cop." This describes a well-worn interrogation method, where one detective tries to befriend the accused while the other acts hostile. The hope is to encourage the accused to talk to the friendly questioner so as to avoid talking to the intimidating one.

Although there may have been coordination between the U.S. and France on this issue, we rather doubt it. In terms of foreign policy, there isn't a lot of evidence to suggest that the administration was looking to make tougher sanctions. Instead, as we noted above, France had its own reasons for preventing a deal at this meeting.

However, a case can be made that the French did the U.S. a favor. It will be very difficult to sell a deal with Iran to Congress, Israel or the Sunnis in the region. By taking on the role of the bad cop, now France agreeing to any deal will carry more credibility. In addition, the delay caused by France will give the administration time to make its case to Congress. We note that both Secretary of State Kerry and Vice President Biden have already started that process.

What Will a Deal Look Like?

The media has given the impression that an agreement would mean a rapid removal of sanctions and a curtailment of Iran's nuclear program. In fact, we expect a normalization of relations to take a long time. It is important to remember that Nixon met with Mao in 1972; the U.S. did not recognize Red China until 1978. Thus, what we can expect is a series of agreements that move the U.S. and Iran toward normalization. In this process, it will still be possible for an unraveling. After all, Ayatollah Khamenei is 74 years old and there have been

questions about his health for some time. If there is a change in power in Iran, he could be succeeded by an even more hardline leader. And so, we expect the path of normalization will likely be slow so as to develop political support among all the players which will improve the odds that the changes will be accepted.

Ramifications

This paper examined the history of French and Israeli relations and how they have evolved since the creation of Israel. What we have attempted to show is that nations have interests. When those interests coincide, nations are allies. When they don't, they can become distant, or even become enemies.

The U.S. has engaged in a policy of inserting itself into the Middle East to protect oil flows. During the Cold War, American foreign policy was active; the U.S. sided with Israel, the Shah's Iran and the Arab oil kingdoms to prevent Soviet influence from growing in the region. Of course, after the Iranian Revolution in 1979, the U.S. was not only trying to undermine Soviet influence, but it was also trying to isolate Iran.

The end of the Cold War has changed America's goals in the region but policy has remained remarkably static. The alignment of Israel and the Arab kingdoms remained in place; the isolation of Iran, along with Hussein's Iraq after the 1990 Persian Gulf War, was the goal.

However, the American energy revolution, the 2008 Financial Crisis and the rise of China have prompted a reevaluation of

relations. The Obama administration wants to shift its policy focus away from the Middle East and toward Asia. For this to occur, it has to adjust policy from isolating nations in the area to creating a balance of power in the region, forcing the countries in the area to take more responsibility for their own defense and foreign relations. To create this balance, some degree of normalization with Iran will be necessary.

Needless to say, those who benefited from the earlier policy are not happy. The bloc aligned against Iran wants the U.S. to eliminate the threat altogether. However, the U.S. would have to commit to a major war for this to occur and it isn't obvious that even a victorious outcome would create a stable region. Instead, we would likely see Iran become a power vacuum like what is occurring in Iraq.

For the markets, this transition is fraught with risk. As we have noted above, Israel will always need an outside patron. Although it is difficult to conceive of another nation replacing the U.S., France or Russia may be open to that role. The potential for miscalculation and war increase as the U.S. "footprint" shrinks and will only diminish as the balance of power parameters are re-established. Brent crude oil probably is most affected by Middle East tensions as U.S. crude oil remains isolated by the infrastructure and legal barriers to oil exports.

Bill O'Grady
November 18, 2013

Confluence Investment Management LLC

Confluence Investment Management LLC is an independent, SEC Registered Investment Advisor located in St. Louis, Missouri. The firm provides professional portfolio management and advisory services to institutional and individual clients. Confluence's investment philosophy is based upon independent, fundamental research that integrates the firm's evaluation of market cycles, macroeconomics and geopolitical analysis with a value-driven, fundamental company-specific approach. The firm's portfolio management philosophy begins by assessing risk, and follows through by positioning client portfolios to achieve stated income and growth objectives. The Confluence team is comprised of experienced investment professionals who are dedicated to an exceptional level of client service and communication.