



Iran Sanctions at the Halfway Point

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THE ISSUE

- August 6 marked the end of the first 90-day wind down period for sanctions on Iran, with a number of sanction measures snapping back into place. November 4 will mark the end of the 180-day wind down period upon which time oil and energy-related sanctions will come into effect.
- The Trump administration has stated its desire to bring Iranian crude oil and condensate exports to zero. The complex geopolitical, economic, and logistical considerations involved make it very difficult to predict how much Iranian oil will ultimately come off the market and estimates vary widely. Over the next 90 days we will find out which, if any, countries receive waivers and consequently what level of oil supplies will ultimately be affected. This comes at a time when global oil markets are tight due to a combination of intentional supply cutbacks and unplanned disruptions, so further reductions could result in higher prices.
- Restricted oil and gas export opportunities will have a significant impact on the plans of the Iranian government to increase revenues, which the country's sixth 5-year Development Plan heavily relies on. Sanctions will also majorly hamper the National Iranian Oil Company's development plans to increase oil and gas production.
- The reimposition of unilateral sanctions by the United States on Iran also carries geopolitical implications. It has the perverse effect of creating the impetus for countries to come to the aid of Iran. It also creates the possibility of incentivizing further Russian and Chinese involvement in the development of Iran's oil and gas sector, filling the void left by any potential Western company involvement.
- Moving forward with sanctions on Iran, one cannot discount the element of unpredictability that has thus far characterized the administration's tack on other trade and sanctions matters, where the playbook has suggested taking "dealmaking" right up until the deadline and surprised both allies and adversaries with eventual outcomes.

On May 8, President Trump announced the U.S. withdrawal from the Joint Comprehensive Plan of Action (JCPOA), the nuclear agreement endorsed by Iran, the United States, France, Germany, China, Russia, and the United Kingdom. **Concurrent with that action**, Section 1245 of the National Defense Authorization Act of FY 2012 (NDAA) was reactivated,

along with other U.S. sanctions under the Iran Freedom and Counter-proliferation Act (IFCA), the Iran Sanctions Act (ISA), and the Iran Threat Reduction and Syria Human Rights Act of 2012 (ITRSHRA). Departments and agencies are implementing these sanctions with 90-day and 180-day wind down periods, after which time the applicable sanctions come back into full effect.¹ Since May, administration officials from several agencies have been travelling around the world to explain the rationale for the

decision to pull out of the JCPOA and persuade countries to comply with the sanctions program. Earlier this week (following the end of the first 90-day wind down period), the administration **announced** that on August 7 sanctions would be reimposed on:

- Iran’s automotive sector;
- Activities related to the issuance of sovereign debt;
- Transactions related to the Iranian rial;
- Iran’s trade in gold and other precious metals;
- Graphite, aluminum, steel, coal, and software used in industrial processes;
- The acquisition of U.S. bank notes by the government of Iran.

At the same time, the administration reiterated its intent to reimpose on November 5 sanctions on:

- Iran’s port operators and energy, shipping, and shipbuilding sectors;
- Iran’s petroleum related transactions;
- Transactions by foreign financial institutions with the Central Bank of Iran.

The administration will also relist individuals, entities, vessels, and aircraft that were previously included on sanctions lists. The administration **warned** that they intend to fully enforce these sanctions and “those who fail to wind down activities with Iran risk severe consequences.”²

Iran holds the largest combined oil and natural gas reserves in the world and ranks among the top ten oil producers globally with 4.66 million barrels per day (mb/d) of liquids output in 2017. Proximity and access to major energy demand centers make Iran a major player for global supply of crude oil and condensate. The country exported an average of 2.13 mb/d of crude oil and 490,000 b/d of condensate in 2017. Over 60 percent of those exports went to Asia and the rest primarily to the European Union and Turkey. In anticipation of a reinstatement of sanctions, Iran’s production and exports rose earlier this year. Recent figures for July, however, suggest crude oil production has dropped to 3.72 million b/d with crude exports between 2.2 and 2.4 million b/d.

The Trump administration has stated its desire to bring Iranian crude oil and condensate exports to zero—a far more aggressive request than levels targeted under the Obama administration. Given current market tightness, importers are concerned that massive supply constraints, including from areas like Venezuela, Libya, and Nigeria, in

addition to Iran, will increase oil prices to the detriment of consuming economies. Consequently, for both quality and volumetric reasons they are hopeful for a more lenient application of U.S. sanctions. However, to date, the administration seems averse to granting liberal waivers, but officials have repeatedly indicated that such actions could be considered.

The complex geopolitical, economic, and logistical considerations involved make it very difficult to predict how much Iranian oil will ultimately come off the market and estimates vary widely. The most prominent uncertainty is the potential for the administration to change course. At the same time that administration officials are following through on a maximum pressure strategy to impose sanctions, the president has very publicly introduced the idea of direct talks with Iran to resolve the issue. At some level, other countries must try to figure out whether the United States is likely to achieve negotiations with Iran. Even in this unlikely event, it is not evident what effect those talks would have on the reimposition of sanctions.

Another layer of uncertainty is the fact that each of the governments considering their response to U.S. sanctions has a complex array of issues it is negotiating with the Trump administration. It is not clear where the JCPOA fits into the administration’s priority ranking of issues. It is also unclear whether the administration is willing to consider sanction waivers or other measures that might alleviate sanctions pressures on any given country based on some other bilateral issue—like a trade deal, NATO spending, or something else—or if other countries are negotiating with the administration to “make a deal” on that basis. One final complicating factor is the **tightening oil market** and the upward pressure on prices resulting from the JCPOA announcement and other market and geopolitical related factors. Political sensitivity to higher oil prices around the world and in the United States, particularly before a mid-term election, could influence both the United States and other countries’ strategies for dealing with U.S. sanctions.

For the time being, however, it seems evident that companies and banks with ties to the U.S. financial system will do what it takes to stay on the safe side of U.S. sanctions. Governments and state-owned enterprises with ways around the reach of U.S. sanctions, on the other hand, may see this as an opportunistic time to build greater ties with Iran’s energy sector and deepen alternative banking, insurance, and logistical systems that arose out of necessity during the 2012 round of Iran sanctions.

IMPACTS ON IRAN'S OIL EXPORTS

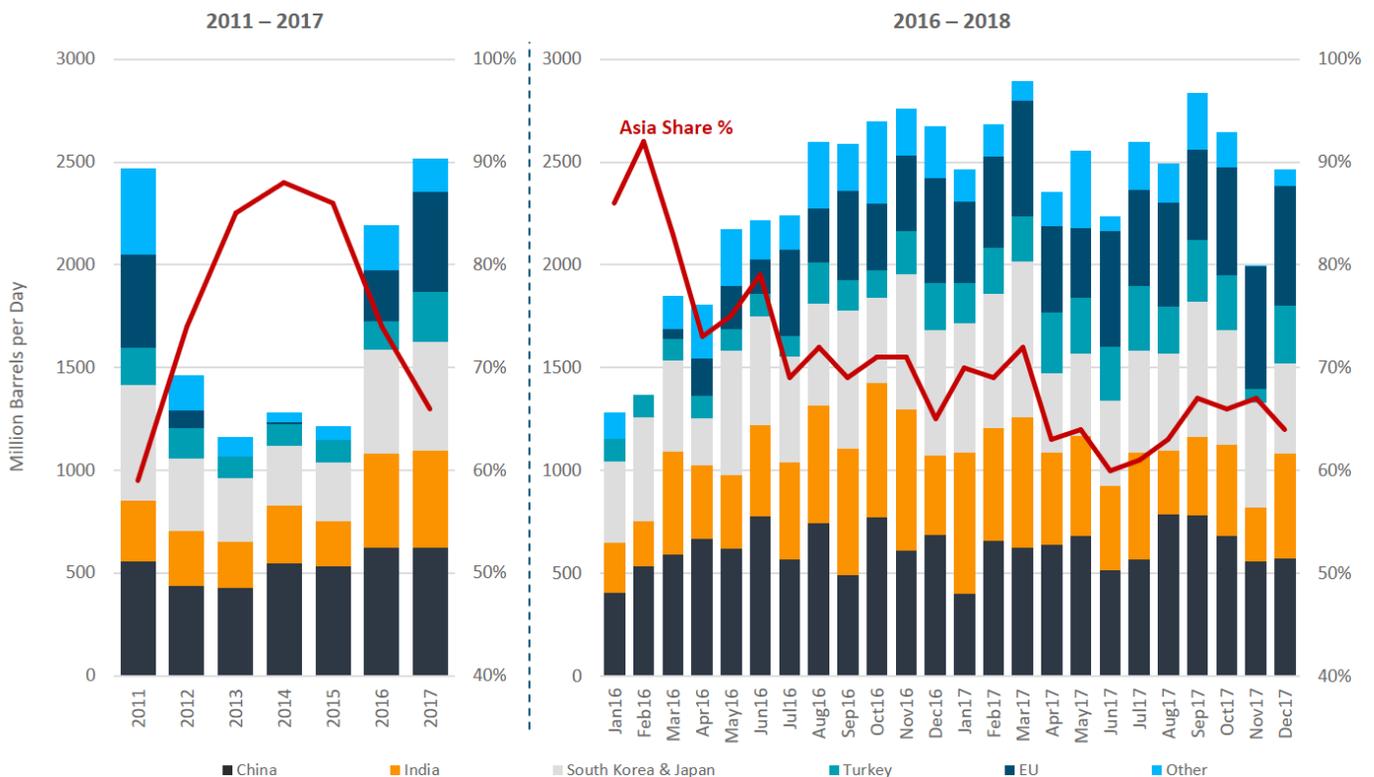
In design and enforcement implementation, U.S. sanctions will impose significant obstacles for Iran in getting its oil to market. The United States itself does not import Iranian crude oil, yet its ability to sanction the activities of companies, banks, and other entities with ties to the U.S. financial system is enough for allies and even some adversaries to restrict business ties with the country. The current administration has voiced its desire to significantly reduce Iranian exports by the November 4 deadline, upon which time U.S. secondary sanctions enter into force. While it is highly unlikely that U.S. sanctions can remove the totality of 2.2 mb/d of Iranian crude oil exports from the market, the sanctions in their current form will undoubtedly impose logistical difficulties for Iranian exporters, cause reductions in export volumes, and may ultimately lead to loss of production volumes principally by delaying needed investment in country.

The most significant measure, [Section 1245 of the NDAA](#), essentially prohibits foreign financial institutions from participating in the U.S. financial system if they are involved in settling transactions with Iran's central bank or another Iranian financial institution as designated by the secretary of the treasury.³ Guidance posted by the U.S. Treasury Department on May 8 stipulates that this sanction measure

will take effect following a 180-day wind down period. Countries importing Iranian crude can earn exemptions to this measure pursuant to Section 1245 (d)(4)(D), if the president so determines that the country has “[significantly reduced](#)” purchased volumes during this six-month period.⁴ The State Department is responsible for evaluating exemptions requests on the behalf of the president. The State Department's press release at the time did not offer guidance on what constitutes a “significant reduction,” offering no baseline to cut from or percentage to cut by. Following the doctrine of “maximum pressure,” the Trump administration has left the impression that reductions will have to be significantly steeper than the Obama administration program which allowed for exemptions for countries that cut by 20 percent during each six-month review period.

Unlike the earlier multinational embargo that led to the JCPOA agreement, most countries importing Iranian oil are not willing to join in on sanctioning Iran. Further, others that are compelled to comply under the threat of financial sanctions are likely to face difficulty replacing Iranian barrels. The European Union, China, India, and Turkey have all stated that they will not enforce U.S. sanctions. The European Union and several of its member countries have made clear its rejection to follow course with the

Iranian Crude and Condensate Exports



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Source: CSIS using data from MEEs

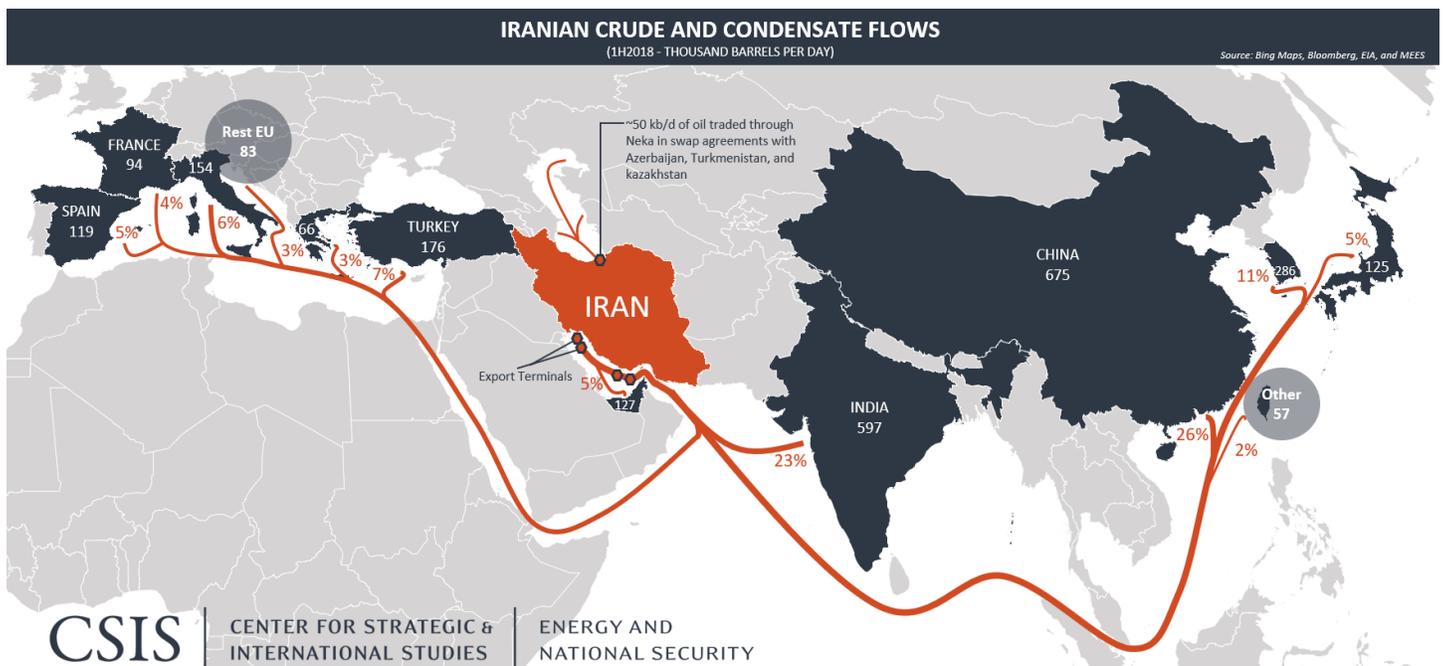
United States in withdrawing from the JCPOA, as have the other members of the UN Security Council's P5+1, namely China and Russia, which together put forth a joint statement on their “[unwavering support](#)” for the JCPOA.⁵ Not only is the European Union exploring steps to save the JCPOA by expanding trade with Iran in certain economic areas, but on August 7, the European Commission will attempt to protect EU entities from sanctions by updating its blocking statute to include U.S.-imposed sanctions on Iran. According to a European Commission [press release](#), the blocking statute allows EU operators to recover damages arising from U.S. sanctions and nullifies the effect in the European Union of any foreign court rulings against them.⁶ It also forbids EU businesses from complying with those sanctions, unless they get explicit authorization by the commission. However, according to a senior administration official, the United States is “[not particularly concerned](#)” by EU efforts to protect European firms from U.S. sanctions on Iran.⁷ And the fear of U.S. financial sanctions is likely to prove effective in reducing overall Iranian flow to Europe. A further wrinkle may yet involve developments that emerge from President Trump's recent meeting with European Commission President Jean-Claude Juncker and discussions to set aside tariff actions if an accommodation can be reached with respect to Iran.

Turkey, another major importer of Iranian crude oil, has made clear that it will continue to trade with Iran, and with the two countries sharing a land border it is hard to see U.S. sanctions having much of an impact on its level of imports. China and India have both indicated they will not enforce U.S. sanctions, but India has applied for a waiver whereas

China has not. China has reportedly committed to limiting (rather than increasing) imports from Iran but that was prior to the most recent announcement of retaliatory tariffs.

South Korea and Japan stand out as two countries that have indicated their willingness to comply with U.S. sanctions but are seeking waivers in order to avoid the most painful cuts. So far, South Korea, which imported 286 kb/d for the first six months of 2018, has made the largest reductions, cutting its imports in June by over 40 percent (year-on-year), and [reportedly](#) ceased to lift any barrels in July, with the government still waiting for a response on its waiver application.⁸ Japan (125 kb/d – 1H2018) will also likely move in the same direction if it does not secure a waiver from the administration. Japanese imports of Iranian crude oil surged in May and June, ostensibly to stock up on supplies before the sanctions went into effect.

The position that various governments have taken towards the U.S. sanctions might also be very different from what the companies in those countries do. For example, India's imports of Iranian oil (597 kb/d – 1H2018) have [surged](#) since the U.S. announcement, reaching 768 kb/d in July.⁹ What direction the Indian government, and in turn its state-owned refineries, will take if it does not receive a waiver remains uncertain. However, for non-state-owned actors such as the Nayara Energy refining group (formerly Essar Oil), which is majority owned by Rosneft, the message that its creditors (i.e. Western banks) have [provided](#) is clear—cease all Iranian purchases or else credit lines will be severed.¹⁰ This is the same situation that the vast majority of European refiners find themselves in, regardless of pronouncements from the



European Union that it will stand against U.S. sanctions. Any private entity with ties to the U.S. financial system will very likely cease to import Iranian oil because of the push from both banks and insurance groups. The majority of China's imports come through its state-owned enterprises, many of which could likely find ways of dealing with Iran without being subject to U.S. sanctions.

All of these factors introduce a significant range of uncertainty into the estimates for how much Iranian oil can come off the market by and after November 4. The low end of the range is 450 kb/d (assuming massive non-compliance) all the way to 2.0 mb/d. A mid-range figure is more likely given several factors, including (1) the ability of large purchasers of Iranian crude to avoid U.S. sanctions (including Russia that may import Iranian crude and export it under a different name); (2) the administration's propensity to impose maximum pressure but settle for something less; (3) the ability of Iran to evade sanctions through bartering and other means (privatization of oil sales and massive price discounting).

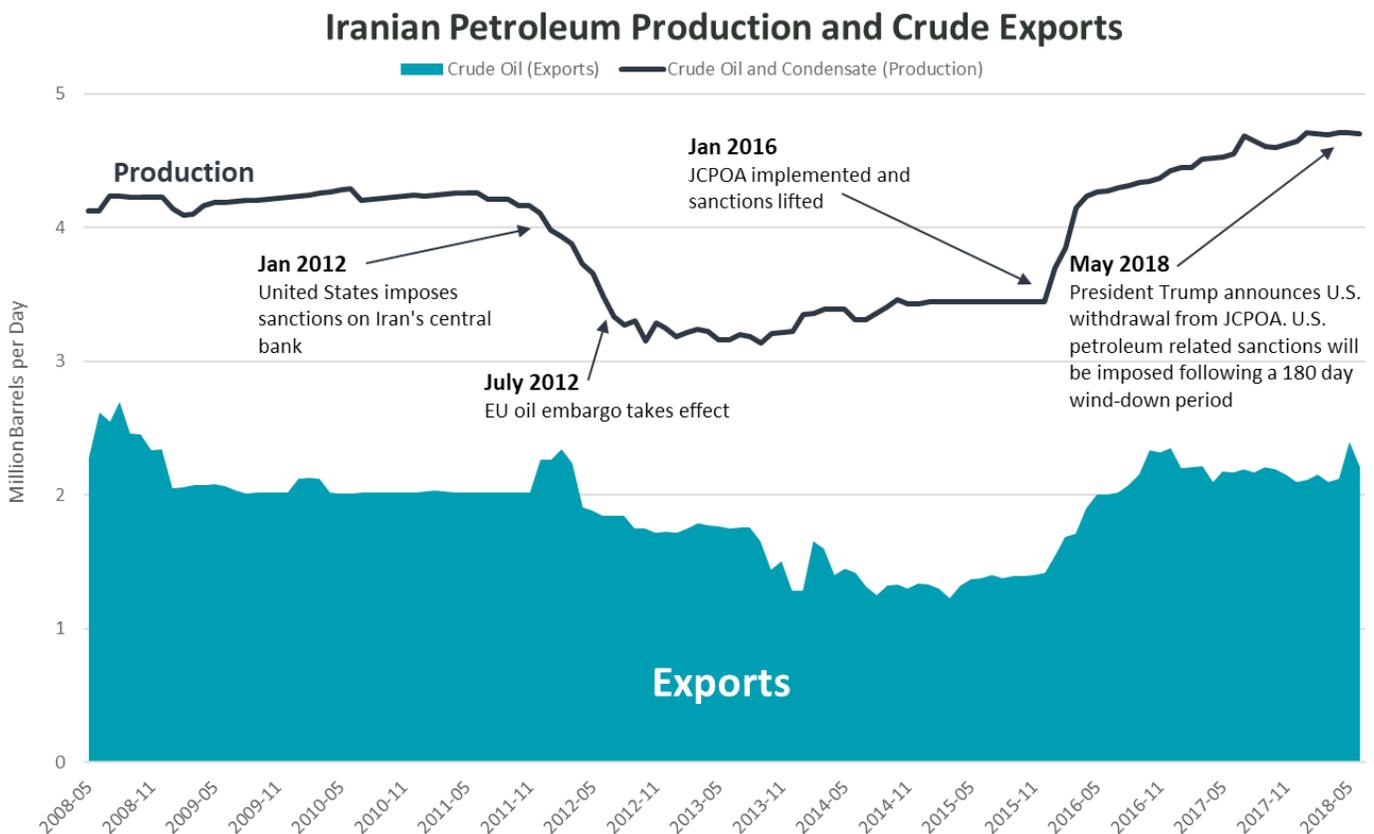
IMPACTS ON IRAN

Domestically for Iran, the sanctions are already proving to have a significant impact. While the recent oil price increase will help to moderate some of the sanction effects, the country finds itself in a very difficult economic situation,

with high rates of inflation and shortages in imported goods, which have resulted in mass demonstrations. The sanctions will have a significant impact on any plans to increase revenues, which the country's sixth 5-year Development Plan heavily relies on. Sanctions will also majorly hamper the National Iranian Oil Company's development plans.

The development of Iran's energy industry has been majorly hampered for decades as a result of underinvestment and a lack of access to technology. International sanctions and the associated political risks of doing business there, along with unattractive contract terms offered prior to the Iran Petroleum Contract (IPC) and general mismanagement of the industry, were the prime factors that caused a lack of foreign investment. While hopes had been high, following the implementation of the JCPOA and the development of the IPC, that direly needed investment and technology would flow into its energy industry, outside involvement has been slow to materialize and will be further forestalled as a result of the recent U.S. decision to withdraw from the JCPOA.

While Iran has signed numerous MOUs with international companies to jointly develop several of its reservoirs, only two such contracts have concluded. France's Total was



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Source: CSIS using data from US EIA and JODI

the first Western company to return to Iran after almost a decade, in partnership with China's CNPC and Iranian PetroPars for the development of Phase 11 South Pars gas field. However, the company has already had to announce its withdrawal from the country, having failed to obtain a sanctions waiver from the United States. As a result, the 50 percent stake of which Total held in the consortium will now be transferred to CNPC of China.

The U.S. withdrawal will see all efforts of European companies to engage in the development of Iran's oil and gas industry grind to a halt, just at a time when the industry was showing renewed interest in long-term developments, following a slump in activity as a result of the oil price collapse in 2014. Virtually all Western international oil and gas majors that are capable of developing the multi-billion-dollar projects on offer in Iran are tied into the U.S. financial system through the banking and insurance industries. Their business would be majorly affected by any secondary sanctions put in place if they engaged in activities in Iran. Companies were already hesitant to sign agreements in Iran for this reason. As such, the status quo for Iran's oil and gas industry is likely to prevail for the foreseeable future. That is, a lack of foreign investment and access to technology will cause major upstream challenges and prevent NIOC from achieving its production growth goals.

IMPACTS ON GEOPOLITICS

The reimposition of unilateral sanctions by the United States on Iran also carries geopolitical implications. Some sanctions experts have cautioned that the United States is courting overuse and overreach in sanctions use, which brings with it the possibility of [creating an ecosystem of sanctioned actors](#) who can cooperate with each other to limit sanction effects.¹¹ It is also having the perverse effect of creating the impetus for countries to come to the aid of Iran.

As stated earlier, the European Union is not only trying to protect its companies from being harmed by U.S. sanctions, it is also working to ensure the continued existence of the JCPOA by aiding the Iranian economy through expanded trade. While these measures are likely to be quite limited, particularly in the energy space, it does reorient the international community's approach to dealing with Iran in a significant and potentially consequential way.

China and Russia are both actively seeking opportunities to diminish their vulnerability to U.S. sanctions pressure. These sanctions create the possibility of incentivizing greater Russian and Chinese involvement directly in the development of Iran's oil and gas sector from both sides. They

have already resulted in an increased presence of Chinese actors by forcing Total's withdrawal, and Russian presence may grow because of more lucrative terms being put on offer in the face of reduced demand from Western companies. There are also indications in Iran's energy landscape that may suggest that the Iranian government is proactively developing a long-term energy strategy to minimize the risk of potential future sanctions, and Russia's increasing presence in Iran's energy scene is one of them. This dynamic may help to moderate some of the effects of sanctions.

In November 2017, Igor Sechin announced that [Rosneft and NIOC](#) "have agreed on a deal to work together on a number of strategic projects in Iran worth up to \$30 billion." One month later, Gazprom and NIOC announced an agreement on a range of operations including integrated projects to explore, produce, transmit, and process hydrocarbons. Gazprom's agreement also includes collaboration in construction of the Iran-Pakistan (and India) pipeline. Technology transfer to improve refining and petrochemical operations in Iran is another part of these agreements.

As previously mentioned, while Iran has signed numerous MOUs with international companies, only two such contracts have concluded. One with Total and CNPC, and the other with Zarubezhneft, a Russian state-owned oil company. Zarubezhneft and NIOC signed two ten-year contracts for Aban and Western Paydar fields in partnership with another prequalified private Iranian service company, Dana Energy. The mentioned fields are not significant in terms of reserve estimates or production rates but fill the category of shared border fields (with Iraq) which is one of the top priorities of IPC. This contract is also of political significance since it is the first ever oil contract between Iran and a Russian company. The vacuum created by the absence of Western companies appears to be the main reason for a strong Russian presence in the first round of MoUs signed between NIOC and the foreign companies. U.S. sanctions have targeted both countries, and their common interest in the current Middle East political scene has brought the two countries closer than ever.

Support for Iran among the UN leadership is not a foregone conclusion, however. Time and again the Trump administration has said it is reimposing sanctions in order to deal with the full-suite of Iranian offenses—not limited to the nuclear program but including terrorist financing and efforts to foment regional instability. The question remains whether or not the perception of Iranians stirring up regional conflict will erode support for them from countries in Europe as well as China and Russia. For example, the Iranian Revolutionary Guard, in retaliation to sanctions,

has threatened to cut off the Strait of Hormuz and the approximately 19 million barrels that flow to markets daily through it. U.S. Navy officials have noted an increase in Iranian naval activity in the region around the Strait of Hormuz. In addition, on July 25, Saudi Aramco announced that it temporarily suspended its oil shipments through the Bab el-Mandeb Strait (into the Red Sea) following an attack by Yemeni Houthi rebels on two of its crude oil carriers. In April a Houthi attack damaged another Saudi owned crude vessel off the west coast of Yemen. The Houthis have vowed to step up targets on the Kingdom's oil infrastructure. Riyadh has accused Iran of supplying the Houthis, who control Yemeni capital Sana'a and northern parts of the country, with increasingly sophisticated ballistic missiles. Iran denies arming the rebels, despite evidence provided publicly by U.S. officials (and subsequently verified by the UN) to the contrary. Any involvement by Iran in this latest attack has yet to be proven. However, should the Iranians perpetuate higher oil prices by threats to oil flows in the region, or perpetrate a successful attack on vessels traversing key sea lanes, it is quite likely that any support for them would erode on a broad international basis.

CONCLUSION

The reimposition of sanctions on August 7 following the first phase of the wind down period is instructive in several ways but unlikely to be the final pronouncement. Countries have had the opportunity to hear firsthand from the administration their perspective on the JCPOA

and the criteria for imposing sanctions and have begun to negotiate for waivers, voice their opposition, and take the necessary logistical steps to secure crude supplies. Trade flows will undoubtedly change as a consequence and oil prices and market distortions will no doubt be influential. New (potential) geopolitical alignments and the broader implications of linking trade, tariffs, and sanctions along with broader security concerns are likely to impact longer-term outcomes. Over the next 90 days we will find out what, if any, countries receive waivers, what further guidance is given on what reductions, short of going to zero, are acceptable to secure such waivers, and consequently what level of oil supplies will ultimately be impacted. Of course, all of this plays out in a market already besieged by geopolitical risk and tight supplies. And, of course, one cannot discount the element of unpredictability that has thus far characterized the administration's tack on other trade and sanctions matters, where the playbook has suggested taking "dealmaking" right up until the deadline and surprised both allies and adversaries with eventual outcomes. ■

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Photo: ATTA KENARE/AFP/Getty Images

ENDNOTES

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