TARGETING THE OIL EXPORTS OF IRAN

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*[**Abstract**: Despite international sanctions working against Iran for last several years, Iran has been enjoying a comfortable balance of trade on account of steady export of its crude which has been fetching remunerative prices. It was felt by the U.S. and the European Union that Iran would be forced to curtail its nuclear ambitions if the steady flow of revenues through the export of crude is squeezed by bringing disabilities to the nation states that do not substantially reduce their dependence on Iranian crude. It was expected that Iran would be deprived of its major source of revenue to the extent that its economy would be under pressure to scale down its nuclear ambitions. However, all the major economies, except China, importing oil from Iran have been granted exemptions from the intended disabilities on reducing their supplies from Iran in percentile terms which would not have substantial impact on oil revenues of Iran. Iran would recover a part of the loss with the rise in the prices of crude globally and partly through the sale of its surplus oil through other means.]*

The Iranian oil industry is the oldest in Middle East, discovered in 1908 and has been the primary industry since 1920. Despite a fairly diversified economy, the oil and gas industry continues to be the critical engine of Iranian economic growth. Oil revenues account for about 65% of government revenue[1]. Such critical dependence on oil makes the economy vulnerable to the vagaries of oil prices on which Iran may not have much control. Besides, the country would be required to continuously reinvest in the sector with the objective of maintaining an extraction level which is economically viable otherwise the reserves would be depleted considerably due to decades of exploitation. Capital costs would have to be incurred for setting up of refineries and to keep them technologically upgraded. A considerable investment would also be needed for exploration of new resources—both onshore and offshore. When the price of oil rises, Governments are tempted to over commit themselves to support social welfare, which they would not be able to sustainable if oil prices fall. However, such social welfare programmes are not

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1 Mohamedi, Fareed, "The Oil and Gas Industry," N.d., *The Iran Premier*, United States Institute of Peace.

easy to be rolled back and thus oil dependent governments like Iran come under strain leading to economic uncertainties.

Iran has been under a slew of sanctions—bilateral and multilateral—for more than three decades initially because of a reprisal of siege of the U.S. embassy in 1979 followed by its engagement with Iraq-Iran war for an extended period of eight years and later on for its nuclear programme, which U.S. and its allies perceive as reasons that support Iran's ambition to have nuclear weapons[2]. Therefore, the investments in the oil sector have remained below optimum level because of sanctions resulting in financial constraints. Thus the production of crude oil has been stagnant—at about 50% of the level—in the times of Shah. Similar is the state of affairs in respect of its vast resources of natural gas. For meeting its domestic requirements of oil and gas, which are heavily subsidized, Iran has to depend on imports of refined oil products and supply of gas from neighbouring countries like Turkmenistan[3].

Despite international sanctions which have been working against it, Iran has been enjoying a comfortable balance of trade largely on account of its steady export of its crude on remunerative prices. Thus, the pinch from sanctions which were directed towards slowly reducing the country's production by starving the oil sector of investment while giving oil exports a pass to avoid a price spike in international markets, remained within the manageable capacity, thereby enabling Iran to carry on its nuclear programme as per schedule despite IAEA reporting in 2006 that Iran has been hiding some of its activities from IAEA which would be in breach of its obligation under the NPT.[4]

In the wake of the IAEA report in November 2011 which mentioned that Iran had carried out activities relevant to the development of a nuclear device[5], the US

2 Connell, Michael, "”Strategic Posture Review: Iran," *World Politics Review*, 15 May 2012.
3 *Op. cit*. 3
4 Sardana, M.M.K., "Standoff between Iran and US and its Allies on Nuclear Issues," ISID Discussion Note DN2012/03, April 2012.
5 "Fingers itch for a war on Iran," N.d., *Third World Resurgence*, Third World Network.

decided to target Iran's oil exports[6]. In December 2011 US Congress passed a legislation that would sanction the Central Bank of Iran, through which Tehran gets paid for its oil. President Obama signed the National Defence Authorisation Act of 2012, on December 31, 2011 which imposes sanctions on Iran's financial sector. The enactment offers central banks across the globe a Hobson's choice. They can open accounts with the United States Federal Reserve to facilitate payments for exports and imports to the US and conduct other financial transactions or they can open accounts with Iran's central bank. They cannot do both. This means, in theory, that nations buying Iranian exports, predominantly oil, must terminate purchases from or find other ways to carry out transactions with that country by March 1, 2012, if they wish to keep doing business with the US[7].

The U.S. Congress, while enacting the legislation was cognisant of the sensitivity of oil as a commodity to world economy and thus created exceptions in the law. First, the law stipulates that the US Energy Information Administration (EIA) must prepare and provide reports to the president every 60 days regarding world market oil conditions. These reports must describe the "availability of petroleum and petroleum products produced in countries other than Iran in the sixty days preceding the submission of the report". Following receipt of this information, the president has 90 days to determine "whether the price and supply of petroleum and petroleum products produced in countries other than Iran is sufficient to permit purchases of petroleum and petroleum products from Iran to reduce significantly in volume their purchases from Iran". If the president determines that the answer to the above is in the affirmative, the sanction as proposed in the legislation would become effective within 180 days after the enactment (30th June 2012) against the foreign financial institutions if it falls foul of the president's finding. However, the Congress did take into cognisance that such measures were extreme and left it to the president to grant exemptions. The president can also

[6] Houser, Trevor and Shashank Mohan, "Iran and the 2012 Oil Market Outlook," Rhodium Group, 22 December 2011.

[7] Verleger, Philip K., "Using US Strategic Reserves to Moderate Potential Oil Price Increases from Sanctions on Iran," N.d., Peterson institute for International Economics Policy Brief, Number PB12-6.

grant a four-month waiver to a country if he deems this to be in the national interest[8].

In tandem with the US law aimed at squeezing oil revenues of Iran, EU also decided that its member countries other than Greece, Italy and Spain, would not enter into new contracts with Iran for oil or petrochemicals. They can, however, still import oil from Iran until July 1, under contracts signed before January 23, 2012[9].

European Union and US sanctions targeting Iran's oil export revenues have yet to come fully into force but have already led countries and companies to take steps to reduce their purchases of crude from Iran. National Iranian Oil Company disclosed in Tehran on April 20, 2012 that current exports stood at 2.1 million b/d which in the preceding year stood at 2.3 million b/d. This would imply a fall of 2,00,000 b/d so far even before the EU sanctions come into effect in July. The International Energy Agency estimates that the combined impact of the European and US measures on Iran's crude exports could be as much as 1 million b/d by mid-summer of 2012. Iran hopes to place in Asia, where oil demand is still rising, roughly 500,000 b/d of crude that will no longer be able to go to Europe after June. But efforts by the US to limit Tehran's options appear to be having some success. The US has been pressurising a number of countries to cut back on their Iranian crude purchases after new sanctions designed to curtail Iran's access to international banking systems were signed by President Obama last December. These sanctions, related to the financing of purchases of petroleum and petroleum products, are not scheduled to take effect until June 28, 2012. Washington is offering exemptions to countries which reduce their purchases of Iranian oil and has already struck a deal with Japan, which has agreed to buy lower volumes of Iranian crude. South Korea, which has been relying on Iran for close to 10% of its crude imports, and Sri Lanka, which has been more than 90% dependent on Iranian oil, are also hoping to obtain waivers[10].

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8 *Ibid*.
9 *Ibid*.
10 McQuaile, Margaret, "Iranian Oil Sanctions," A Platts.com News Feature, 30 April 2012.

China had contracted for import of crude from Iran in 2011 @ 5,57,000 b/d and has been the world's largest buyer of Iranian crude and opposes trade restrictions on Iran.[11] However, Iran's oil shipments to China fell for the fourth month in March 2012 to the lowest in 22 months after delays in signing term supply contracts. Imports fell 6.2 per cent to 1.08 million metric tons, or about 2,54,000 b/d. China international United Petroleum & Chemical, UNIPEC, delayed signing a new contract for the year 2012 because of payment issue. The term contract for 2012 is for 15% less purchases from 2,65, 000 to 2,80,000 b/d bought in 2011.

India reduced its share of oil imports from Iran from 12% last year to around 9% of its total imports. While visiting Secretary of State, Hillary Clinton, acknowledged that Indian imports of Iranian oil had been reduced, she called for further cuts. India did mention to the Secretary of State that Iran was "a key country" for India's energy needs. Reacting to US suggestion that India should increase its imports of oil from Saudi Arabia and Iraq; it was pointed out that India was already sourcing almost half of its oil imports from these countries.[12] A week after the visit of Secretary of State in May 2012, New Delhi announced that it would cut its imports by 11% in the coming year. Though US has granted waiver to Japan and 10 European countries after they announced cuts, but it has not done so for India and China, two of the biggest importers of Iranian oil even though they have demonstrated significant cuts. In case of India, US has noted the pledge of 11% of further cuts in 2012; instead of announcing waiver a la Japan, it is expecting a further pledge from India[13].

Time and again U.S. has been reaffirming India's "immense strategic importance to the United States". After a meeting between Prime Minister Man Mohan Singh and visiting U.S. Secretary of Defence Leon Panetta on 6th June 2012 at New Delhi, Panetta remarked: "The US views India as a net provider of security from the Indian Ocean to Afghanistan and beyond". Accordingly, the US defence officials

[11] Narayanan, Pratish, "Iran May Lose 9.5% of Oil Contracts as Asian Buyers Cut Imports," *Bloomberg*, 03 May 2012.

[12] Kumara, Sarath, "Clinton pressures India to support sanctions on Iran," Worls Socialist Web Site, 15 May 2012.

[13] Lakshmi, Rama, "India will cut oil imports from Iran by 11%," *The Washington Post*, 15 May 2012.

have been stating that India could take a more active role in Afghanistan, including by training Afghan security forces after the US draws down most of its forces by the end of 2014. It is also believed by the US that India is expected to play a more active role in Afghanistan in economic and political domains as well.[14] In the same breath, the US diplomats perceive India's unwillingness to go whole hog with USA's designs in Iran as New Delhi's failure to meet its obvious potential to lead globally, "thereby equating in a spurious sort of way, India's leadership ambitions with toeing the American line."[15] Such a duality on behalf of US gives room for thought that the US practices on the principle that "If you are not with us, you are against us". Time and again US has exhibited such a trait in their international relations. When Shah of Iran expressed his reservation on reducing the price of Iranian crude in 1973the US Department of State perceived that, overnight, the Persian Monarch from 'Gendarme of the Persian Gulf' was turned into a dangerous megalomanic[16]. In the mid 1980s, the US had not only praised Saddam as progressive for educating Iraqi women and advancing people's welfare (vis-à-vis other Arab States) but also rewarded him by selling significant amounts of dual purpose arms export. Such a perception was to change overnight when Saddam stuck out an independent course of action.[17]

If US considers India as its long term strategic partner in the region to safeguard mutual interests, then US should assure, through its actions and words, a matching degree of freedom to India in retaining its inherent strength and building up regional equations with other partners on the foundation of intense mutual interest so that strategic, economic and political gains sought to be achieved by the two strategic allies are cohered with the aspirations of states within the region. The hanging sword of sanctions having the potential of crippling the entire economy of the country, is not pointing towards confidence building measure

[14] Barnes, Julian E., "U.S. Seeks Larger Role for India in Afghanistan," *The Wall Street Journal*, 05 June 2012.

[15] Karnad, Bharat, "U.S. Wrong on India's Iran Policy," *The Diplomat*, 19 March 2012.

[16] Shoamanesh, Sam Sasan, "History Brief: Timeline of US-Iran Relations until the Obama Administration – Key Facts & Catalysts," N.d., MIT *International Review*.

[17] Barnett, Courtenay, "Oil, conflict and the future of global energy supplies," Global Research, 22 January 2006.

firming up long term strategic partnership. Rather US should have implicit belief that its strategic partners like India would voluntarily address the concerns of US weighing other relevant factors relating to its economic and political strategies in the region. Correspondingly, US would also be required to moderate its utterances accommodating the concerns of its strategic ally.

The US diplomats have been downplaying Delhi's economic interests in Iran. The fact that India gets 12% of its oil requirements from Iran is dismissed by them as a "weak defence," because Delhi has had many years to find new suppliers while there were not many suppliers to step in until Iraq stabilised to resume its oil production. Also, it is ignored that many of India's refineries are geared towards processing Iranian crude. If India were to switch to other sources, this would require a substantial investment to retrofit the refineries to process other types of crude[18]. To force India to alter its investment planning to suit American Foreign Police interests in the region would be towards weakening its strategic ally, i.e. India.

There is no firm assurance if the world would be able to make up for the shortfall if Iranian supplies come to a halt or are substantially reduced. Analysts predict that Iran's exports could eventually drop by half, by 1 million barrels per day or more, after the July embargo by the European Union kicks in and the US slaps sanctions on foreign banks that keep on buying Iranian Oil. It is being suggested that Saudi Arabia has increased production by 600,000 b/d since last year, and it is estimated that spare capacity in OPEC countries is at about 2.7 million barrels a day. While that's low by historical standards, there are signs that it might be enough for now. Global oil demand has been slackening in the first two months of 2012—China's consumption grew by just 1,60,000 b/d, less than expected—and the surge in bio-fuel production has given the world some breathing room. However, when global oil prices are high, a cut in Iranian supply would make the world more vulnerable to any further disruptions. Civil strife in places such as Yemen, South Sudan and Syria has taken about 6,00,000 b /d off market. Further squeeze would be felt

[18] *Op. cit*. 15

because of inability of tankers to get insurance cover if they move cargo from Iranian ports[19]. Saudi oil production is already at historically unprecedented levels, and it was unable to supplement the loss of Libya's rather insignificant oil exports last summer, forcing Western nations to tap into their strategic reserves[20].

Besides India has been having growing trade relationship with Iran with the intention to establish infrastructure projects in Iran linking the Iranian part of Chabahar on the North Arabian Sea with a railway line to Turkmenistan, Kazakhstan and Russia via Hazarajat, a mineral rich area in Afghanistan where an Indian consortium has secured mining concessions. Also, India is building a highway connecting Chabahar to Milak and Zarang, which has a road link to Dilaram in Afghanistan, a 213 kilometre stretch. A considerable investment has been made by India in enlarging the port of Chabahar capable of handling 6 million tons of cargo and will serve as the entry port for Indian business. The whole of Infrastructure development is strategically important and is towards maintaining the strategic presence of India in the region on US withdrawing from there in 2014. India could extend vital food assistance to Afghanistan to the tune of 100,000 tons through the port of Chabahar only when direct land route via Pakistan was denied even for reaching food assistance to Afghanistan.

India is to contend with the fact that it is home to a large Shia population which has to maintain strong theological links with the Shia community of Iran. These have been strong cultural ties between the two countries spanning over centuries and bringing about a thaw in such relation would not be recommended in the larger interest[21].

Therefore, if, in the opinion of US, India is to play a strategic role in the US foreign policy to the Asia-Pacific, that role would be served by India's strong and growing relations with Iran rather than weakening that axis.

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19 Plumer, Brad, "As sanctions squeeze Iran, how will the world make up the lost oil?" *The Washington Post*, 31 March 2012.

20 *Op. cit*. 18

21 *Ibid*.

While this note is being developed, news has just come in (12th June 2012) that India has been exempted from Iran oil sanctions along with other six economies, namely, Malaysia, Republic of Korea, South Africa, Sri Lanka, Turkey and Taiwan as it has been appreciated that all these economies have significantly reduced their volume of crude oil purchases from Iran. These seven economies now join eleven countries which were granted exemption in March 2012. Removal of sword of sanctions over the US-India engagement softens the stick to the anti-India constituency in Washington—including a strong pro Israel lobby unable or unwilling to comprehend India's ties with Iran and always on the lookout for alleged Indian infractions vis-à-vis Tehran—to beat New Delhi with.[22]

Interestingly, all the major economies other than China importing crude oil from Iran have been granted exemptions as on date even though Washington has demonstrated time and again that it has no leverage worth the name vis-à-vis Beijing. May be US is still wary of the fact that China may be buying the surplus crude left with Iran because of reduced off take by other economies on a discounted price and collect Iranian gratitude in bargain for lessoning the impact of squeeze sought to be brought about by US by curtailing its oil revenues. There are indications that Iran has already started offering discounts for the supplies of crude to its Asian Customers[23]. Perhaps, a decision on whether to grant a waiver to China would follow separately on public interest consideration as US would not be in a position to implement sanctions against China and that too after singling it out.

From Iran's perspective, the biggest calculation to make is whether the drop in exports will hurt more than the benefit the country would experience from rising prices if tensions flare or supplies from elsewhere get disrupted[24].

Once the major economies import oil from Iran, albeit in reduced quantities, the entities coming in the way of insurance of the oil tankers ferrying Iranian crude would fall in line in due course and as a corollary, U.S. would also be required to

[22] Rajghatta, Chidanand, "India exempted from Iran oil sanctions following compliance," *The Times of India*, 12 June 2012.
[23] *Op. cit*. 19
[24] *Op. cit*. 5

look the other way when the ships call on its ports after touching Iranian ports even within the disability period of 180 days.

It appears that the intended effect of sanctions sought to be brought on countries importing crude from Iran would only be partial and marginal. In its exercise of attempting sanctions against oil importing countries from Iran, US has tested its capacity of maneuverability and limits of exerting pressure on such countries, a majority of whom like Japan, India and South Korea are its strategic partners in security and economy.