Efforts to Preserve Economic Benefits of the Iran Nuclear Deal

Overview
On May 8, 2018, President Trump announced that the United States would cease implementing U.S. commitments under the 2015 multilateral Joint Comprehensive Plan of Action (JCPOA) with Iran. He indicated that, by the end of a “wind down period” on November 4, 2018, all pre-JCPOA U.S. sanctions on foreign firms that conduct transactions in all of Iran’s core economic sectors, including energy, banking, shipping, and manufacturing, would go back into effect. These include sanctions on “petroleum-related transactions” and transactions by foreign banks with Iran’s Central Bank. Several hundred Iranian and third country entities will again be designated by the United States as sanctioned entities, meaning that foreign firms that transact business with these entities could face virtual exclusion from the U.S. economy.

The non-U.S. parties to the JCPOA—the United Kingdom, France, Germany, Russia, China, the European Union (EU) and Iran—opposed the U.S. move and have sought to preserve the accord. The outcome of their efforts may depend on the degree to which Iran perceives that it continues to receive economic benefits of the agreement. To date, Iran has continued to comply with the JCPOA, while insisting it continues to receive promised benefits. However, recent statements by Iranian officials suggest patience may be waning. In August, regarding ongoing EU efforts, Ayatollah Ali Khamenei said that Iran should “give up hope on them over economic issues or the nuclear deal.”

Iran Trade and Investment Post-JCPOA
Iranian leaders are unlikely to remain in the JCPOA if the economy suffers the effects of multilateral sanctions as during 2011-2015. During that time, Iran’s crude oil exports dropped by more than half, and its total trade by value fell nearly 50%, according to International Monetary Fund data. In April 2015, then-Treasury Secretary Jacob Lew said Iran’s economy was about 20% smaller than it would have been had sanctions not been imposed. Iranian officials have stated that avoiding a repeat of such economic damage depends, in particular, on maintaining the ability to export oil and receive payments in hard currency. Oil and petroleum products account for 80% of Iran’s exports, and the proceeds are expected to fund half the 2018-19 budget.

Since adoption of the JCPOA, Iran’s crude exports have more than doubled, reaching about 2.2 million barrels per day (bpd) as of July 2018, according to Bloomberg tanker tracking data. Asia, Iran’s largest market, accounts for more than 65% of crude exports (Figure 1); China is the largest importer, accounting for 30%, followed by India. During the escalation of sanctions in 2011-2015, Asian trading partners cut Iranian oil imports (to earn a U.S. sanctions exemption for “significantly reducing” oil purchases), but did not follow the EU in imposing an embargo.

Iran’s continued adherence to the JCPOA might hinge on whether it can keep its oil exports near current levels—either through continued sales to the EU (Iran’s top pre-sanctions trading partner), through increased sales to Iran’s non-EU customers, or by the identification of alternate buyers. Since 2016, Europe accounted for more than a fifth of Iran’s crude exports. From 2016 to 2017, exports to Europe grew nearly 50%, to over 540,000 bpd in May 2018; within the EU, Italy, Spain, and Greece are the largest importers (Figure 2). However, by July imports fell to their lowest monthly level since September 2016, falling 20% year over year.

Sources: Bloomberg tanker tracking.

Since 2016, oil shipments to Europe have not surpassed pre-sanctions levels, unlike in China and India. Notably, in July, China’s monthly imports from Iran surpassed 800,000 bpd, an increase of 19% year over year; while India’s imports rose 65% year over year. Whether these trends continue will have significant implications for Iran’s ability to maintain oil exports at or close to post-sanctions levels.
After sanctions were eased in 2016, many foreign firms began to resume business ties and investments in Iran, including in the manufacturing, energy, and auto sectors. In 2017, foreign direct investment inflows to Iran increased by nearly 50% to $5 billion, according to the U.N. Conference on Trade and Development. Iran’s imports also expanded by nearly 40% over 2015-2017. However, with re-imposed U.S. sanctions, EU and other foreign firms have begun to pull out of operations and investments in Iran. EU firms with extensive transatlantic business face higher risk of sanctions violations than those less integrated with the U.S.

**JCPOA Preservation Efforts**

Even if Iran’s oil customer base shifts even more sharply toward Asia, EU countries have a substantial strategic and political stake in preserving the JCPOA. The leaders of France, Germany, and the UK (the three European countries that negotiated the JCPOA alongside the U.S., China, and Russia)—and the EU collectively—issued statements expressing “regret” over the decision. EU leaders stated that they remained committed to the JCPOA as “important for our joint security,” and have consistently claimed that the JCPOA is a binding international commitment under U.N. Security Council Resolution 2231.

**EU Efforts**

The EU has taken a number of steps in an effort to maintain the economic benefits for Iran of the JCPOA. In early June, the EU updated a 1996 “blocking regulation” that seeks to protect EU firms from potential U.S. penalties for violations of sanctions. It prohibits EU firms from complying with U.S. sanctions on Iran, and allows firms to recover damages that arise from noncompliance. Member states oversee implementation; in practice, there have been few cases of enforcement. Few experts expect that measure, which entered into force on August 6, 2018, to persuade major firms to undertake the financial risks of violating sanctions. Further EU efforts may center on incentivizing small and medium-sized enterprises (SMEs) with less financial ties or exposure to the U.S. market to expand business ties.

At Iran’s request, on May 25 the EU convened in Vienna a meeting of the remaining members of the Joint Commission—the JCPOA-established body that oversees the accord’s implementation. The meeting reportedly discussed various EU options to try to continue providing Iran with sanctions relief. As a result of that and other EU meetings, the UK, France, and Germany jointly requested that the Trump Administration grant exemptions to EU firms that continue to do business with Iran. Most U.S. Iran sanctions laws authorize such exemptions, but U.S. officials have indicated they are unlikely to grant such requests because doing so would reduce the effectiveness of re-imposed sanctions in pressuring Iran economically.

With exemptions unlikely, EU countries have explored—without clear results to date—mechanisms under which their central banks, or multilateral banks such as the European Investment Bank (EIB), might make payments to Iran’s Central Bank for oil or support EU investments in Iran. In June, the European Commission updated the EIB’s external lending mandate to make Iran potentially eligible for EIB investments. However, it is uncertain whether such steps would avoid U.S. sanctions, and the proposals have been met with some resistance in Europe. Many view the EIB as less likely to be a viable channel, due to its U.S. exposure. Still, EU officials are seeking viable alternatives:

- following talks between France, Germany and the UK in August, French Finance Minister Bruno Le Maire emphasized, “we are determined to work on an independent European or Franco-German financing tool,” to allow “us to avoid being the collateral victims” of U.S. sanctions.
- In order to help support Iran’s economy, the European Commission adopted an €18 million package in late August for “projects supporting sustainable economic and social development” in Iran. This includes €8 million in assistance to the private sector, such as support for “high-potential” Iranian SMEs and technical assistance to Iran’s Trade Promotion Organization.

Another source of U.S.-EU friction is a U.S. request that the Brussels-based SWIFT electronic payments network expel Iranian banks from its system. The EU wants Iran to remain within the network and has indicated it would not, as it did in 2012, ask SWIFT to remove Iranian banks. German Foreign Minister Heiko Maas has advocated for SWIFT to become more independent of the U.S and for the development of other independent European payment channels.

**Role of Non-EU Countries**

Non-EU countries are increasingly critical if Iran is to continue receiving the economic benefits of the JCPOA. China and India, Iran’s two largest oil customers, have indicated they will continue economic engagement, and recent data suggests the Asian buyers are beginning to absorb Iran’s oil export volumes as other countries scale back. If China and India were to continue increasing Iranian oil imports, it is possible that these two countries alone may keep Iran’s exports close to early 2018 level, even if the EU is unable to develop a mechanism to continue buying Iranian oil and other countries like Japan and South Korea reduce their imports of oil from Iran dramatically.

The shifts in Iran’s oil export patterns might further increase Iran’s reliance on China, which is already a top trading partner and source of financing and investments in infrastructure in Iran. Unlike the EU, the Chinese government has some capacity to direct some firms, many of which are state-owned or state-influenced, to continue transacting business with Iran despite U.S. sanctions. India and Iran have reportedly agreed to use India’s currency, the rupee, as a means of maintaining economic ties. In addition, following the decision by India’s top shipping company to cease transporting oil from Iran, the Indian government announced it would permit state refiners to continue to import Iranian oil, with Iran arranging to cover cost, insurance and freight. Chinese state oil traders have also shifted to using Iran-operated tankers to deliver oil.

Cathleen D. Cimino-Isaacs, cciminoisaacs@crs.loc.gov, 7-1173
Kenneth Katzman, kkatzman@crs.loc.gov, 7-7612
Derek E. Mix, dmix@crs.loc.gov, 7-9116