

## JIIA Strategic Comments(No.5):

### The Future of the Iran Nuclear Agreement after US Withdrawal – Responses by Various Parties to Increasingly Harsh “Secondary Sanctions”

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On December 1, 2018, Meng Wanzhou, deputy chairwoman of the Chinese telecom giant Huawei Technologies Co., Ltd., was arrested in Canada on charges that Huawei attempted to sell Hewlett-Packard computer equipment to Iran's largest mobile-phone company through Huawei's Hong Kong affiliate Skycom between 2009 and 2014 and gave a falsified account of these transactions to the US government. Underlying this incident are two elements: the struggle for hegemony in the hi-tech sector that lies at the root of US-China trade frictions, and a warning by the Trump administration to companies worldwide who continue to do business with Iran. This paper will examine how Iran's major trading partners are responding to the steps taken by the Trump administration to increase pressure not only on China but even on its own friends and allies using the Iran sanctions as a pretext.

#### 1. America's withdrawal from the Iran nuclear agreement

The Joint Comprehensive Plan of Action (JCPOA) between the P5+1 (the five permanent members of the UN Security Council and Germany) and Iran that went into effect in July 2015 is an international agreement that placed Iran's nuclear development activities under strict monitoring by the International Atomic Energy Agency (IAEA) in exchange for sanctions relief. The JCPOA peacefully resolved an international dispute that had raged for 12 years, and was widely acclaimed as a victory for multilateral diplomacy that contributed to the nuclear non-proliferation regime. However, Donald Trump, while still on the campaign trail during the US presidential elections, denounced this agreement as “the worst deal ever” and publicly promised to withdraw the US from the JCPOA unless “the deal's disastrous flaws” were fixed.

In January 2018, President Trump announced that, unless a ban on Iran's missile program and terrorist activities, the abolition of “sunset provisions” that would lift the restrictions on nuclear development after a given period, unrestricted access by IAEA inspectors to military facilities, and other terms were incorporated into the JCPOA by May 12, the US would withdraw from the nuclear agreement. Naturally, the Iranian government objected strongly to what it deemed a unilateral demand undermining the very foundations of its national security.

On May 8, 2018, the US announced its withdrawal from the JCPOA, warning that it would impose “secondary sanctions” on companies and individuals in third countries who continue to do business with

Iran. The first round of sanctions (August 7) included sanctions on Iran's automotive industry, a prohibition on access to US dollars by the Iranian government, and bans on exports of aircraft and spare parts as well as on gold transactions. The second round of sanctions (November 5) targeted Iran's key industries, and was designed to place maximum pressure on Iran to wrest maximum concessions from the country. Exports of crude oil and petroleum products, which account for 60% of Iranian government revenues, as well as its port operation, maritime transport and shipbuilding sectors were subjected to sanctions, Iran's central bank and other major banks were excluded from the SWIFT system and prohibited from using it for transactions, and sanctions were placed on insurance coverage for trade with Iran. Nevertheless, eight countries – China, India, Italy, Greece, Japan, South Korea, Taiwan and Turkey – were granted waivers from US sanctions on Iranian oil imports for a 180-day grace period. This was the consequence of both the US' wish to keep crude oil prices from rising, and the diplomatic efforts made by Japan and the other seven countries to secure exemptions in exchange for reducing their crude oil imports from Iran.

## **2. The impact of re-imposed sanctions on the Iranian economy**

At the end of July, the value of Iranian rial has lost about 60% since the beginning of the year, leading to an inflation rate of over 20% and sparking frequent citizen protests. In addition, hardline conservative factions within Iran intensified their attacks on the Rouhani government that had pursued the nuclear agreement and, for a time, there were moves afoot in the Islamic Consultative Assembly to demand the president's dismissal. The Iranian government responded by introducing a multiple exchange rate system, lowering the official parity rate, banning the import of luxury goods, establishing a foreign currency quota system, and even going so far as to impose price controls on daily necessities. At the same time, President Hassan Rouhani sought to assuage some of the public's dissatisfaction by replacing the central bank governor, the finance minister and labor minister who were taking the brunt of public criticism. The rial's value bottomed out at US\$1=190,000 rial at the end of September, when the inflation rate began settling down and Iran's economic chaos reached a lull. In the name of "a resistance economy", Supreme Leader Ayatollah Ali Khamenei urged people to demonstrate solidarity, and political disputes have quieted down since September. At the very least, the nation is pulling together to stand up to "American bullying" for the remaining two years of Trump's term of office.

Iran has survived under nearly 40 years of sanctions since diplomatic relations with the US were severed in 1980 by devising clever sanction workarounds and survival measures. Many countries – with the exception of states such as Israel, Saudi Arabia and the UAE that regard Iran as an arch enemy – have bristled at the US' latest sanctions against Iran. While the Iranian people continue to voice their displeasure with their economic difficulties, there has been no surge in support for regime change, contrary to the Trump administration's expectations. The current circumstances are unlike those during the Ahmadinejad administration, which pursued nuclear development in the face of considerable public opposition and brought the country under sanctions as a result. Despite diminished expectations, the Rouhani administration does enjoy passive support, with a majority of citizens indicating a degree of empathy for the government's predicament.

In the realm of foreign policy, President Rouhani and Mohammad Ali Jafari, Commander of the Islamic Revolutionary Guard Corps hinted in July at hardline responses to the Trump administration's withdrawal from the JCPOA, including pulling Iran out of the agreement, restarting nuclear activities, and closing the Strait of Hormuz. To avoid military attacks from Israel and the US as well as the international isolation that a withdrawal from the JCPOA would bring, however, the Iranian government has adhered to a policy of maintaining the JCPOA. Iran's continued compliance with the JCPOA was confirmed in the latest IAEA report released in November. Iran has been engaged in a diplomatic offensive aimed at closer collaboration with the remaining JCPOA signatories (the three EU states of Germany, France and the UK as well as China and Russia) and its key petroleum export destinations, especially China, India, and Turkey. Iran's conclusion of the Convention on the Legal Status of the Caspian Sea with four other Caspian states in August can be seen as part of this offensive.

### **3. The EU's response**

In return for abiding by the JCPOA, Iran has asked the EU to maintain economic ties and to develop a system to indemnify Iran for the harm caused by re-imposed US sanctions. The EU has openly declared its firm support for the JCPOA, in August initiating "blocking statutes" to shield EU companies doing business with Iran from secondary US sanctions, and providing Iran with an eight million euro assistance policy package. In September, Federica Mogherini, High Representative of the European Union for Foreign Affairs and Security Policy, announced plans to set up a "Special Purpose Vehicle" (SPV) to offer companies doing business with Iran a legal means of settling transactions. The SPV is designed to facilitate settlement with Iran for imports/exports of primarily humanitarian goods exempted from US sanctions and to assist EU companies in continuing to do business with Iran, and the EU has indicated that it may make the SPV available to non-EU third countries. With major EU companies already having announced their withdrawal from Iran, though, it is likely that the SPV will be used by small and medium-sized companies having no dealings with the US. The political significance of these moves is noteworthy, although concerns remain that the SPV, despite a focus on humanitarian goods, will itself become the target of additional US sanctions in future.

### **4. The responses of Russia and China**

By announcing that they would uphold the JCPOA even after the US' withdrawal, JCPOA signatories Russia and China have presented themselves as defenders of multilateral diplomacy and international rules. Russia is an oil producing country, however, and does not need to import petroleum from Iran. Consequently, Russia is said to be considering extending to the EU the "oil-for-goods agreement" it signed in 2014 – a scheme by which it sells petroleum imported from Iran on Iran's behalf, with the proceeds used to pay for Russian-made goods. There have also been press reports that Russia is contemplating the creation of a regional integrated payment network between the former Soviet bloc and Iran. Russia is a key security partner for Iran, as evidenced in its common support for the Assad government in the Syrian

civil war and its conduct of joint operations. In addition, it has proven a reliable friend, not least by strongly supporting Iran's position in nuclear talks since 2013.

In the economic arena, China is one of Iran's biggest trading partners, ranking first for exports and third for imports, and this is of crucial importance for the Iranian economy. As the largest importer of Iranian crude oil, China has undertaken several approaches to continue its imports. In March of this year, China launched the first renminbi-denominated crude oil futures market at the Shanghai International Energy Exchange in the Shanghai Free Trade Zone, the dual objectives of which are thought to be to maintain petroleum dealings with Iran and to internationalize the Chinese yuan.

In August, Zhuhai Zhenrong Corporation, a Chinese state-run petroleum trader, and China Petroleum & Chemical Corporation (Sinopec) concluded an agreement with the state-run Iranian Petroleum Corporation on purchasing crude oil at a discounted price using tankers owned by Iran's state-operated tanker company. On December 12, Reuters reported that the China National Petroleum Corporation (CNPC) intended to suspend its investment in the South Pars gas field while at the same time investing in projects to develop the Masjed Soleyman and Azadegan oil fields and continuing to import crude oil from Iran.

As was the case before the nuclear deal, both the Chinese government and Chinese companies appear to be planning to move into the Iranian market under more advantageous conditions after European and Japanese companies pull out because of sanctions. However, Chinese companies have become far more globalized since the earlier Iran sanctions. Accordingly, increased dealings with the US have made major corporations more vulnerable to secondary US sanctions. In April 2018, Zhongxing Telecommunication Equipment Corporation (ZTE), China's second-largest telecommunications equipment manufacturer, was fined approximately US\$900 million by the US Department of Commerce for violating sanctions against Iran and prohibited from trading in US-made products for seven years, putting the company's survival as a going concern at risk.

Fearing that Iran sanctions might hobble it in negotiations as trade frictions between the US and China escalate, the Chinese government has begun inducing small and medium-sized companies unlikely to be targeted by sanctions to take on active roles in Iran in the place of large corporations. China has from time to time used its relations with Iran as leverage to win more concessions from the US, but the recent Huawei incident shows that the "Iran card" cuts both ways.

## **5. Recommended responses by Japan**

The first measure Japan should take at the governmental level would be to negotiate with the US government for an extension of its sanctions waiver on importing Iranian oil after May. In doing so, Japan should emphasize that maintaining the good bilateral relations Iran and Japan have consistently enjoyed since establishing diplomatic relations in 1929 offers a rare channel enabling Japan not only to pursue its foreign policy objectives and secure a reliable petroleum supply but also to serve as a conduit for information between the US and Iran, and then leverage this point to extract as many compromises as

possible from the American government. Secondly, Japan should urge the US to respect international agreements, including the JCPOA, by declaring the Japanese government's commitment to supporting the JCPOA and to continuing its technical and moral support for the IAEA as it monitors and verifies JCPOA implementation. Thirdly, Japan should engage in discussions and exchanges of information with the EU and major importers of Iranian petroleum to determine how Japan can contribute to multilateral frameworks such as SPV and the oil-for-goods agreement to maintain the JCPOA.

At the private-sector level, trade relations with Iran can likely be preserved by taking advantage of oil embargo waivers to import Iranian crude oil, and utilizing the money owed for that crude oil to export humanitarian goods (medical supplies and equipment, environmental equipment, etc.). Japanese companies can also collaborate with the Japanese government in collecting information with an eye on a future suspension of US sanctions on Iran. The roles played by Japan's Ministry of Foreign Affairs and Ministry of Economy, Trade and Industry as well as JETRO, JICA and JBIC in supporting such activities by Japanese companies will undoubtedly take on growing importance.

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