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Efforts to Preserve Economic Benefits of the Iran Nuclear Deal

Overview

On May 8, 2018, President Donald 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" (by November 4, 2018), all U.S. sanctions in place prior to the JCPOA—which target foreign firms that conduct transactions in all of Iran's core economic sectors, including energy, banking, shipping, insurance, manufacturing, and hard currency trading—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 exclusion from the U.S. economy and financial system.

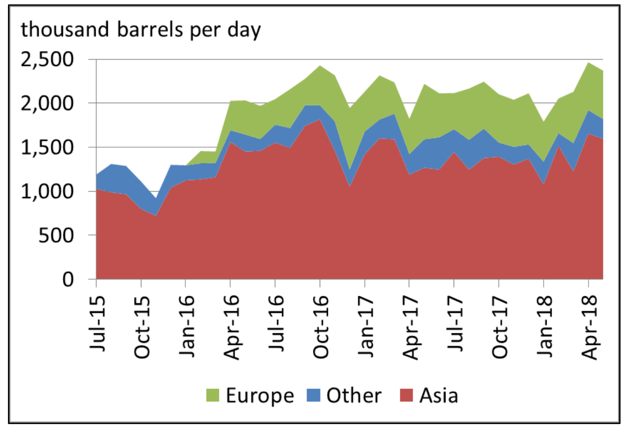
The non-U.S. parties to the JCPOA—the United Kingdom, France, Germany, Russia, China, the European Union (EU) and Iran—opposed the U.S. move and have undertaken intensive negotiations to try to preserve the accord. The outcome of their efforts may depend on the degree to which Iran perceives that it continues to receive economic benefits of the agreement. To date, Iran has continued to comply with the JCPOA, while insisting that the EU guarantee that Iran continues to receive promised JCPOA benefits.

Iran Trade and Investment Post-JCPOA

Iranian leaders are unlikely to remain in the JCPOA if the Iranian economy suffers the effects of multilateral sanctions that it did 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 Iran uses oil proceeds to fund the government (it expects oil to fund half of its 2018-2019 budget).

Since adoption of the JCPOA, Iran's crude exports have more than doubled, reaching about 2.4 million barrels per day (bpd) as of May 2018, according to Bloomberg tanker tracking data. Asia remains Iran's largest market, accounting for 65% of crude exports (**Figure 1**); China is the largest importer, accounting for 30%, followed by India. During the escalation of sanctions, major 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.

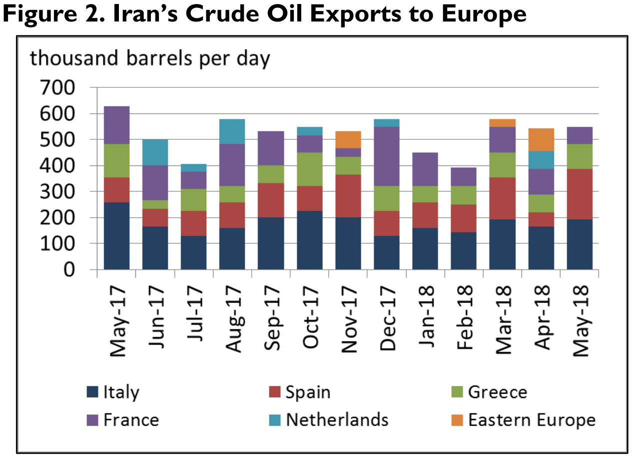
Figure 1. Iran's Crude Oil Exports by Region



Source: Bloomberg tanker tracking.

Iran's policy toward the JCPOA might hinge on whether it can continue to benefit from oil revenues from the EU—Iran's top pre-sanctions trading partner. With the resumption of energy trade, Europe now accounts for nearly a quarter of Iran's crude exports. From 2016 to 2017, those exports to Europe grew nearly 50%, reaching over 540,000 bpd in May 2018; among EU countries, Italy, Spain, and Greece are the largest importers (**Figure 2**). Shipments to Europe have not surpassed pre-sanctions levels, however, unlike in the case of China and India.

Figure 2. Iran's Crude Oil Exports to Europe



Source: Bloomberg tanker tracking.

After sanctions were eased in 2016, many foreign firms began to resume business ties and investments in Iran, including in the manufacturing, energy, and transport sectors. In 2017, foreign direct investment (FDI) 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 in the post-sanctions period, by nearly 40% between 2015 and 2017.

JCPOA Preservation Efforts

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 United States, China, and Russia)—as well as 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." European diplomats have consistently claimed that the JCPOA is a binding international commitment under U.N. Security Council Resolution 2231, which endorsed the accord.

The EU has moved assertively to try to maintain the economic benefits for Iran of the JCPOA. 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 implementation of the accord. The meeting reportedly discussed various EU options, including those discussed below, to try to continue providing Iran with sanctions relief.

In early June, the EU updated a 1996 "blocking regulation" that seeks to protect EU firms from potential U.S. penalties for violations of U.S. 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 are responsible for implementation; in practice, there have been few cases of enforcement. Few experts expect that measure (expected to enter into force in August 2018) to persuade major firms to undertake the financial risks of violating U.S. sanctions. Further, EU efforts may center on incentivizing small and medium- sized enterprises with less financial ties or exposure to the U.S. market to maintain or expand business ties.

Among other steps, in early June, the UK, French, and German governments jointly requested that the Trump Administration provide specific exemptions to EU companies that continue to transact business with Iran. Most U.S. Iran sanctions laws authorize such exemptions, but Administration officials have indicated they are unlikely to grant such requests because doing so would reduce the effectiveness of reimposed sanctions. EU countries reportedly are also exploring 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. Also 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. 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.

Non-EU countries might continue to furnish Iran with economic benefits. Officials in China and India, the two largest oil customers of Iran, have indicated that they will continue economic engagement with Iran. China's stance might further increase Iran's reliance on that country, which is already a large trading partner and source of financing and investments in infrastructure in Iran. Unlike the EU, the Chinese government has some capacity to direct its firms, which generally are state-owned, 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 engagement, although, as noted below, some India firms are ceasing transactions with Iran nonetheless.

Efforts Faltering?

EU firms with extensive transatlantic business face higher risk of violating U.S. sanctions than those less integrated with the U.S. market. Aircraft maker Airbus, whose planes use U.S. components, will have its U.S. license to supply 100 aircraft to Iran revoked (as did Boeing), preventing deliveries beyond the three already supplied. EU and some other foreign firms appear to be opting to avoid such risk by scaling back operations and investments in Iran. Examples follow.

- French energy major Total has indicated plans to pull out of a $4.7 billion joint venture with China National Petroleum Corporation (CNPC) to develop the South Pars gas field, unless it can obtain a waiver. It may transfer its stake to CNPC.
- European oil refiners, including Total, Italy's ENI and Saras, Spain's Repsol and Cepsa, and Greece's Hellenic Petroleum, have indicated they are winding down purchases of Iran's crude, along with potential withdrawal from the Iranian market of banks, insurance, and shipping companies, such as Germany's Allianz and DZ Bank, and Denmark's AP Moller-Maersk. India's refiners Reliance Ltd. and Indian Oil Corp. indicated they would cut Iranian oil buys after the State Bank of India said it would stop dealing with Tehran.
- Auto companies have announced plans to halt or reconsider investments to expand production, including PSA Group, owner of French automakers Peugeot and Citroen.
- Manufacturers, such as German conglomerate Siemens and Italy's Danieli, with contracts to upgrade infrastructure or supply industrial equipment, plan to halt projects or new orders.

These corporate decisions increase the likelihood that Iranian leaders will judge that the economic benefits are insufficient and that they will decide to leave the accord.

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

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