

®RF SPECIAL REPORT

JULY 2018

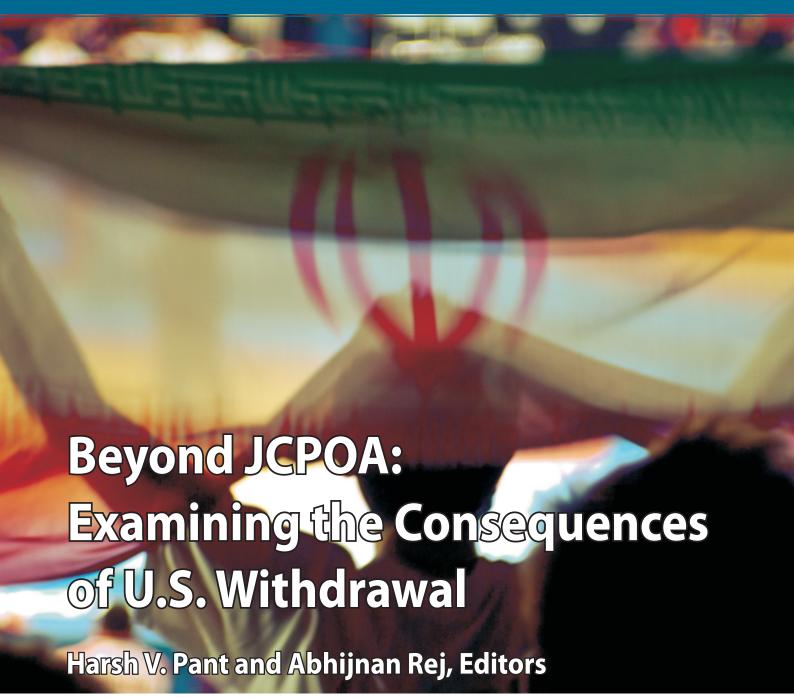


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INTRODUCTION

Harsh V. Pant and Abhijnan Rej

Action (JCPOA), US President Donald Trump finally announced on 8 May 2018 that he would be pulling out the US from the Iran nuclear deal and restore farreaching sanctions aimed at severing Iran from the global economy. The landmark 2015 nuclear agreement was negotiated with Iran by the Obama Administration, along with the other permanent members of the UN Security Council and Germany (also referred to as the "P5 + 1") and the European Union. The stringent provisions contained in the agreement included caps on uranium stockpile and enrichment, control over key nuclear facilities and research and development efforts, the dismantling of a key reactor, and rigorous monitoring and verification processes to ensure the above. In return, JCPOA lifted sanctions on Iran that crippled its economy and halved its oil exports.

Trump, however, had been unconvinced of the nuclear pact, terming it 'insane.' His criticism revolved largely around the fact that the deal limited Iran's nuclear activities only for a fixed period and did not stop the development of ballistic missiles. He was not alone in his view. Israel had revealed 'secret nuclear files' which it said showed Iran had run a clandestine nuclear weapons programme before 2003 and had secretly retained the technological know-how, in breach of the agreement.

For their part, Iranian critics of the JCPOA had pointed out that the US was continuing to push Iran into a tight corner, as financial sanctions and threats of billions of dollars in penalties against banks that dared to do business with Iranian companies or citizens remain in place. The growing resentment against the worsening economic climate, owing to the sanctions, has put the Rouhani government on the back foot, generated a popular backlash, and emboldened the hard-line and conservative faction within the regime.

The world is still struggling to come to terms with the decision of President Trump. Other co-signatories to the JCPOA have vowed to continue to implement the pact though it remains far from clear how the deal can be operational in the absence of the US. Iran's nuclear chief Ali Akbar Salehi has acknowledged that Europe's proposals to salvage the nuclear deal after the US withdrawal from the pact were not satisfactory for Tehran.

The impact of Trump's decision on the JCPOA is being felt as much in New Delhi as in the rest of the world. It is against this backdrop that the Observer Research Foundation (ORF) is publishing this report to examine the implications for India of the US' withdrawal from

the JCPOA through multiple axes – geopolitical, along different geographies, as well as geoeconomic, including the effects of the JCPOA withdrawal on India's economic dealings with Iran and the country's connectivity aspirations.

The report opens with an examination of the effects of the JCPOA on Iran's domestic politics as well as the regional dynamics. Kabir Taneja argues that in terms of domestic politics, the US decision could embolden the conservatives in Tehran and significantly weaken the position of the moderates. He also argues that – more than fears of Iran cheating on JCPOA – it was Tehran's growing regional clout (which could upset the Shia-Sunni balance in the region favoured by Washington) that led to the Trump administration reneging on the JCPOA.

Gautam Chikermane with Ruchbah Rai then examine the pre- and post-JCPOA state of the Iranian economy as well as the India-Iran economic relationship. Noting that the lifting of sanctions following the nuclear deal has had a net positive effect on Iran's output growth, they add a caveat that this has not translated to an improvement in the employment rate, with unemployment increasing in the post-sanctions era. When it comes to New Delhi, Chikermane with Rai raise the intriguing possibility that India's purchase of shale oil from the US could help offset the shortfall from Iran which would follow, should India comply with US sanctions.

In the third chapter, Abhijnan Rej and Aarshi Tirkey ponder the issue of potential secondary sanctions on India by looking at the relevant US legal instruments – both pre-JCPOA sanctions regimes (which the US reverted to on 8 May 2018) as well as newer and apparently unrelated sanctions laws such as the 2017 CAATSA that has a dedicated Iran section. They conclude that, absent waivers from the US, India's plans to acquire stakes in Iranian natural gas fields, build pipelines, purchase crude petroleum as well as develop the Chabahar port – a key Indian connectivity initiative – all stand to be seriously affected.

Kriti Mathur Shah takes up the issue of the Chabahar port in the fourth section. Arguing that Afghanistan stands to be the biggest beneficiary of the port, she points out that the port has allowed Iran to surpass Pakistan as its biggest trading partner. She points to the possibility that if Chabahar was not allowed to be developed further (due to US secondary sanctions), Iran may end up embracing the China-Pakistan Economic Corridor – an outcome that would be unsatisfying both to the US and India.

China's relationship with Iran is examined by Ketan Mehta in his contribution to this report. Noting that China had been a key supporter of the JCPOA, he examines the deep economic ties between the two countries, including Chinese investments in Iranian infrastructure, especially through its Belt and Road Initiative. Mehta also notes that the China-Iran defence relationship is equally deep, both in terms of the arms sales as well as provision of weapons designs from the former to the latter.

If China is one rising power that seeks to engage with Iran, Russia is the other. Kanak Gokarn and Himani Pant, in their chapter, note that Russia's arms sales to Iran is less a matter of ideology and more of commerce: Russia continues to arm Iran's rivals such as Turkey and Saudi Arabia. They, however, also raise the possibility that "geopolitical advantages may override business logic," with both Iran and Russia finding alternative ways to continue their commercial transactions: after all, the Russian quest for a multipolar world necessarily involves a strong Iran.

Britta Petersen then examines Iran's relationship with Russia's *bête noire*: Europe. Describing Trump's decision to withdraw from JCPOA "a matter of great discomfort to Europe" – given the investments of France and Germany in securing the deal – Petersen frames his decision as the latest American salvo in the escalating trans-Atlantic spat. In terms of commercial dealings between Europe and Iran, she observes that European businesses had remained apprehensive of Trump's position on the JCPOA right from the time he was elected, and had factored it in their decision to cautiously observe the onground situation before investing heavily in Iran.

Rakesh Sood writes the penultimate analysis in this report, examining the consequence of the US withdrawal from the JCPOA on the global non-proliferation regimes. He raises the possibility that with sanctions begin reinstated, there would be tremendous domestic pressure in Tehran to terminate its verification obligations according to the JCPOA. Sood also points out that should Iran withdraw from the Nuclear Non-Proliferation Treaty and commence uranium enrichment, it would spell the death knell for an agreement that is increasingly looking outdated and outmoded.

The report concludes with an enumeration of key policy lessons and recommendations for Indian policymakers.



Iran President Hassan Rouhani

n impending collapse of the JCPOA could have significant repercussions for domestic politics in Iran, which is a complex web of multiple interest groups. These range from religious families to wealthy business people, led by the precarious relationship between the democratically elected, moderate government of current president Hassan Rouhani and the conservative-revolutionist camp of Supreme Leader Ayatollah Khamanei, who remains the ultimate authority.

Iran has a strong sense of protecting the ideals and spirit around which it constructed the revolution of 1979 that ended the rule of Western-backed Shah Mohammed Reza Pahlavi. The ideals of the revolution, orbiting around the protection and freedom of the seat of Shiite Islam, are non-negotiable, despite Tehran's long-standing claim otherwise. Concessions around these ideals were required and, in a rare diplomatic coup, achieved for the JCPOA negotiations to succeed. However, these were to be weaved in concert with Iran's regional geo-political policies that largely work around achieving the containment of influence by its enemies, namely, Saudi Arabia and Israel.

For both Riyadh and Jerusalem, a nuclear Iran is an unacceptable prospect, despite it being long suspected that Israel has (or has access to) nuclear weapons. The victory of Trump made Israel and Saudi Arabia strengthen an unusual, covert alliance against the Shiite state (Saudis do not recognise the state of Israel), and aggressively sell it to an already anti-Iran White House. This tactic has worked well so far for Israeli Prime Minister Benjamin Netanyahu and Saudi heir apparent Mohammed Bin Salman, despite deep opposition by traditional American allies, NATO and even within the White House, which eventually saw the ouster of officials such as former Secretary of State Rex Tillerson.

Rouhani's victory in Iran's elections in 2013 was a blessing for the international community, paving the way for a coalition of moderates and centrists that replaced the conservative and vehemently anti-US government of Mahmoud Ahmadinejad. At this time, US-led sanctions had crippled the Iranian economy, leaving a vast population under the age of 30 unemployed and on the edge. In a rare instance, this forced the Ayatollah to concede and support negotiations with the West over their nuclear programme.

The success of the nuclear agreement saw the tactical opening up of the Iranian economy, which in turn had a multi-fold effect on the country's domestic politics. Interests that collaborate with the Islamic Revolutionary Guard Corps (IRGC), which is controlled by the Ayatollah, own a significant mass of Iranian businesses, whether directly or indirectly, as in most cases. Despite the opening up of the economy following the removal of sanctions as agreed in the JCPOA, Iran has continued to pour money into increasing its regional clout, specifically in theatres such as Syria where Shiite militias now control large swathes of territory, including multiple military bases that they helped secure from the hands of the Islamic State (ISIS). A considerable amount of state funds, in the meantime, have bypassed benefiting the Iranian people and re-starting the economy.

The main argument for Trump to have taken the step is the fear of Tehran's plans for regional dominance supposedly gained from the waiving of the long-standing sanctions. Indeed, Iran already has a stable presence in Iraq and a strong foothold in Syria, apart from building clout by supporting the Houthi militias in Yemen. There is also a prevailing political and electoral narrative in Lebanon via Hezbollah. Concerns over nuclear transparency, in fact, do not top the list for going against Iran; after all, the JCPOA has put in place enough checks and balances to hold the government of Rouhani to task and mechanisms to barter further control of nuclear output with economic benefits. The pressure point remains in the inability of the West to control Iran's means to fund its insurgencies—these insurgencies have managed to expand for a good part of the last decade despite the sanctions being in place.

While the consequences of a complete disintegration of the JCPOA will be felt globally, much of the brunt will have to be absorbed by Rouhani. Iran today continues to face

sporadic, largely disorganised protests against the lack of jobs and economic opportunity, despite the period between 2015 and 2018 being open to global trade and multi-billion dollar agreements between corporate entities of US, Europe and Iran.⁶ To put it in perspective, in May, an Iranian judiciary spokesperson said that their security forces will "resolutely confront" any protests against the state after people took to the streets in the town of Kazeroon. The official gave it a spin that such gatherings can be exploited by the "US and other enemies". Rouhani himself has to walk a tightrope, and earlier this year in January, he sided with the narratives of the protests, saying people were not only worried about the economy, but had concerns over the societal and political direction of the country as well, such as the amount they spend on funding groups such as Hezbollah and the bulging costs of Shiite expansionism. This can be translated as Rouhani hedging the risk between his office and the Ayatollah.

The biggest worry over the JCPOA today is the possibility of losing the moderate-centrist stronghold in Tehran, without which negotiations with Western powers in the future will likely hit a deadlock. Despite the challenges facing the Rouhani government, its recent electoral victory in 2017 has added weight to its global outreach to negotiate Iran back into the global economy. Rouhani also remains the best bet for dialogue and the possibility of back-channel negotiated ceasefires across the region with Saudi Arabia and Israel.



or the Islamic Republic of Iran, oil is a GDP-threatening export addiction. Iran holds the world's fourth-largest proved reserves of crude oil amounting to 12.9 percent of global proven crude oil reserves, after Venezuela, Saudi Arabia, and Canada and is home to the world's second-largest proved reserves of natural gas after Russia. The 8 May 2018 US pull-out will make Iran bleed, as fossil fuels contribute more than 53 percent of the country's exports, and account for close to 15 percent of its US\$440-billion GDP. The US sanctions come at a time when Iran is trying to diversify its way out of its oil addiction and increase its non-oil exports to 15 percent of GDP by 2020, as part of its Sixth Development Plan targets.

Following the lifting of sanctions in 2016, Iran experienced a rise in GDP growth rate from -1.3 percent in the previous year to 13.4 percent. ¹⁶ This was followed by a consistent decline in inflation from 34.7 percent in 2013 to 9.0 percent in 2017. ¹⁷ This, though, has not caused a discernible ripple effect in the job sector because of the volatility of economic growth. The unemployment rate has increased since, from 10.6 percent in 2014 to 13.1 percent in 2017. ¹⁸ To create jobs, Iran's non-oil economy needs to take off. ¹⁹ Expanding its non-oil

economy would also unlock the country's growth potential and diversify from dependence on a single commodity, with its automotive sector well positioned to be one of the frontrunners.

India, for its part, is the world's third-largest consumer of oil, with 85 percent of its crude oil and 34 percent of its natural gas requirements being fulfilled by imports. These proportions are expected to jump five-fold by 2040 and will represent a quarter of the total increase in global energy consumption over the period. In 2016, India imported 215 million tonnes of crude oil and at 13 percent, Iran stood third among India's biggest oil suppliers, after Saudi Arabia and Iraq at 18 percent each.

Table 1. India's imports of petroleum oils and oils obtained from bituminous minerals crude from Iran

	2010- 2011	2011- 2012	2012- 2013	2013- 2014	2014- 2015	2015- 2016	2016- 2017	2017- 2018
From Iran	9.2	11.6	9.6	8.4	7.0	4.3	8.9	8.9
Growth (%)	-9.6	26.2	-17.6	-11.9	-16.6	-38.2	107.9	0.8
India's total import of commodity	92.7	134.2	144.5	143.6	116.4	65.9	70.7	87.4
Growth (%)	19.5	44.8	7.7	-0.6	-18.9	43.4	7.3	23.6
Share of Iran (%)	9.9	8.7	6.6	5.9	6.1	6.5	12.6	10.3

Except where specified, all values in billion dollars

 $Source: Department\ of\ Commerce,\ Ministry\ of\ Commerce\ and\ Industry$

Apart from rising oil prices that benefit the world's most organised cartel—the powerful OPEC (Organisation of Petroleum Exporting Countries), of which Iran is a member—and large global commodity market speculators, the US' political move has economic consequences. In today's globalised world, these consequences afflict not only one country, Iran, but its trading partners, from France and Germany that are rebelling against the move, to Russia and China that will use it to strengthen their own geopolitical and moral presence in the rebalancing of world power.

With the imposition of sanctions on Iran, India is left with two options: either find other avenues of oil imports or risk facing the US sanctions. As far as India's oil imports from Iran go, the sanctions will compel it to import from other arms of the OPEC cartel, which are set to benefit from rising crude oil prices that were up by one percent in 18 days to US\$78.34 on 27 May 2018 from US\$77.60 on 9 May 2018.²³ Or, it could mean a greater dependence

on shale from the US. This knee-jerk rise reflects the short-term nature of markets and has begun to put pressure on the world's two fastest-growing and largest oil-importing large economies, India and China. In the longer time horizon, however, the US shale growth could swing the market back into surplus.²⁴

Table 2. India-Iran Trade

	2010-	2011-	2012-	2013-	2014-	2015-	2016-	2017-
	2011	2012	2013	2014	2015	2016	2017	2018
Export to	2.5	2.4	3.4	4.9	4.2	2.8	2.4	2.7
Iran								
% Growth	34.6	-3.2	39.0	48.4	-16.1	-33.3	-14.8	11.8
Import from	10.9	13.8	11.6	10.3	8.9	6.3	10.5	11.1
Iran								
(including oil)								
% Growth	-5.4	26.3	-15.9	-11.0	-13.2	-29.9	67.5	5.8
Total Trade	13.4	16.2	14.9	15.3	13.1	9.1	12.9	13.8
between Iran								
and India								
% Growth	0.2	20.8	-7.8	2.3	-14.1	-31.0	42.2	6.9
India's Total	619.6	795.3	791.1	764.6	758.4	643.3	660.2	768.9
trade								
% Share of	2.16	2.04	1.89	2.00	1.73	1.41	1.95	1.79
Iran in India's								
Total Trade								

Except where specified, all values in billion dollars

Bilateral trade between India and Iran has increased since the JCPOA was formed but as the growth of oil imports is significantly declining, India also imports fertilisers, organic chemicals and plastics. However, these add up to less than US\$1 billion. Besides, the US sanctions may not impact them, as Minister of External Affairs Sushma Swaraj stated that India will abide only by the United Nations' sanctions and not by those of "any country". How that stance plays out in the larger scheme of things remains to be seen. After all, at US\$74.3 billion, the US is India's second-largest trading partner after China and one with which it had a US\$22.9-billion trade surplus.

^{*} Source: Department of Commerce, Ministry of Commerce and Industry



The South Pars Oil Field

extensive sanctions to check Iran's lucrative energy sector. Most of these measures are primary sanctions, and comprise of asset freezes, trade embargoes and prohibition on US citizens and companies from engaging with Iran. However, some of these measures impose "extra territorial" or "secondary" sanctions, i.e., penalise third-country firms that are involved in Iran's energy sector. These can potentially penalise Indian companies with exposure to US financial institutions, and prohibit loans from US financial entities. There are two pathways through which Indian institutions could be affected by such secondary sanctions.

First, investments by companies (both US and foreign-based) to the tune of at least US\$20 million in one year in Iran's energy sector can trigger sanctions under the Iran and Libya Sanctions Act (ILSA, P.L. 104-172) and the Comprehensive Iran Sanctions, Accountability, and Divestment Act (CISADA, P.L. 112-158). The term "investment" is defined widely and includes responsibility for development of petroleum resources, equity and royalty

arrangements, additions to existing investments, pipelines, and construction, upgrading and expansion of energy projects.²⁹

Presently, India has planned several oil and gas development projects, and pipeline projects in Iran. India is interested in developing two Iranian natural gas fields, namely, the Farzad-B gas field (located in Tehran)³⁰ and the South Pars field (shared between Iran and Qatar). It is believed that the proposed investment for these projects could run into billions of dollars, with estimates for Farzad-B gas field placed at around US\$6.2 billion which clearly crosses the US\$20-million investment threshold.³¹ Similarly, Indian investments towards the Iran-Pakistan-India pipeline (IPI) and the Middle East to India Deep Water pipeline (MEIDW) stand to be affected due to the re-imposition of sanctions.

Second, US sanctions also target the purchase of Iranian crude oil. Though no direct sanctions have been imposed on such purchases, the US requires measures on mechanisms that importers use to pay for oil from Iran. Executive Order 13622 and Section 1245 of the National Defense Authorization Act (NDAA, P.L. 112-81) impose sanctions on foreign banks that have processed crude oil transactions, by restricting activities on their existing US accounts and prohibiting the opening of new accounts.³² The principal mechanism through which the US seeks to achieve this objective is by preventing foreign banks from dealing with the Central Bank of Iran (CBI) when it comes to making petroleum payments.³³

Currently, several Indian private and public sector companies purchase crude oil from Iran. The payment pathway that Indian refiners use to pay for Iranian crude is the following. Indian companies pay the State Bank of India (SBI) that then transfers the funds in euros to the Europaisch-Iransische Handlesbank (EIH) in Germany that, in turn, transfers the funds to Iran's National Iranian Oil Company. While the EIH is on the Office of Foreign Assets Control (OFAC) database, it was removed from the secondary sanctions list following the JCPOA which allowed non-US entities (such as the SBI) to use it as a conduit to do business with Iran. Following the US pull-out from the JCPOA, the EIH will be put back on it, with the consequence that the SBI will not be able to use EIH to transfer Indian funds to Iran. It goes without saying that other formal banking mechanisms to pay for Iranian oil will also face similar difficulties. For example, an Iranian account in Indian rupees with, say, the SBI will expose that bank to direct US secondary sanctions.

In addition to these JCPOA-related re-impositions, the recently-enacted Countering America's Adversaries Through Sanctions Act (CAATSA), through Title I, imposes sanctions to specifically target Iran's support for terrorism-related activities, WMD and ballistic missiles programme. (It is important to note that CAATSA was passed into law before the US decision to withdraw from JCPOA.) Under Section 105 of CAATSA, the main target for US sanctions is the Islamic Revolutionary Guard Corps (IRGC). The IRGC has been subject to sanctions before, under provisions of six Executive orders.

However, there are three main differences between the previous IRGC sanctions and the newly enacted CAATSA provisions. The most pertinent among these is the fact that CAATSA also empowers the administration to extend these sanctions to any "foreign persons" that are deemed as "officials, agents, or affiliates" of the IRGC.⁴⁰ The extension of sanctions to such "foreign persons," especially companies or entities, could amount to secondary sanctions. While the conditions for determining "foreign persons" have not been provided under any legislation or executive order, generally, designated individuals and entities have been known to act for or on behalf of, or provide support to the IRGC. However, the absence of a definition of what constitutes a foreign official, agent or entity of the IRGC gives great flexibility to the US administration to make these determinations.

One potential Indian entity that could come under the crosshairs of Section 105 of CAATSA is the Indian Ports Global Private Limited (IPGPL) – a state-owned joint venture of the Jawaharlal Nehru Port Trust and the Kandla Port Trust. In May 2016, IPGPL and an Iranian company, Arya Banader, signed a bilateral contract to develop and run the Chabahar port. ⁴¹ (For background on this port, see the chapter by Kriti Mathur Shah in this report.) Arya Banader does not figure in the OFAC database, so IPGPL seems to not have run afoul of any US regulations.

However, in December 2017, news reports emerged that suggested that that project was contracted to Khatam al-Anbia (KaA), an IRGC-affiliated entity that is subject to stringent sanctions. Notably, OFAC notes that doing business with KaA will attract secondary sanctions. These news reports also noted that one of the subcontractors of KaA was an (unnamed) "state-run Indian company." One presumes—given that IPGPL was specifically tasked with the development of Chabahar port—that this unnamed company is either IPGPL or a special-purpose vehicle created by it. It remains unknown how this Indian company, as a KaA subcontractor, has avoided secondary sanctions. Whatever the case may be, with the new provisions of CAATSA Section 105—and its unspecified definition of "foreign affiliates"—Indian firms involved in the development of Chabahar port (which seems to be managed in significant parts by IRGC-controlled entities) would have to tread cautiously so as to not be designated as such.



Chabahar Port | Photo: Amirhossein Nikroo — Wikimedia Commons/CC BY-SA 3.0

he United States' decision to pull out of the JCPOA and fear of new sanctions on Iran threatens the development and operation of the Chabahar port. The Tripartite Agreement signed by Iran, India and Afghanistan in May 2016 envisioned the development of Chabahar as a transit hub that would help connect landlocked Afghanistan to the Indian Ocean. The port's development is expected to be a game-changer for the region, particularly Tehran and Kabul.

The initial trilateral agreement to develop Chabahar to facilitate regional trade and transit was signed over a decade ago. It was only after India's construction of the road from the border town of Zaranj to the Delaram in Afghanistan and the signing of the JCPOA that the Chabahar port project took off. According to the agreements, India has to develop, equip and operate two berths at Chabahar, with a capital investment of US\$85.2 million and a revenue expenditure of US\$22.5 million on a ten-year lease. India has also extended a US\$150-million line of credit for the project. In October 2017, the first consignment of one million tonnes of wheat was shipped to Afghanistan from India via Chabahar. Two

months later, the first phase of the Shahid Behesti port (out of the five phases planned) was inaugurated. The port's capacity of 8.5 million tonnes is equivalent to that of all northern ports in the country, and its ability to dock large container ships makes Chabahar Iran's only deep-water port. ⁴⁵

The biggest beneficiary of the port project has been Afghanistan as the development of the port is the landlocked country's first big step towards expanding connectivity. India's plan to construct highways, railway links and other transportation routes in Afghanistan and in Iran, will help Kabul bypass Pakistan and give New Delhi strategic access to the war-torn country. Without any access to the ocean and shipping routes, Afghanistan has remained dependent on Pakistan's Karachi port for its exports. However, mutual mistrust, border closures, fluctuating custom tariffs and political tensions between the two countries have drastically affected trade and transit. Pakistan has successfully used its advantage of being Afghanistan's transit route as a bargaining chip to show Kabul the cost of superseding Pakistan.⁴⁶

Through Chabahar, however, Afghanistan gains immediate access to international trade and shipping routes. The inauguration of the port in 2017 has allowed Iran to overtake Pakistan as Afghanistan's biggest trade partner, with US\$1.98 billion worth of goods being exported to the country. Iran has also provided special incentives to Afghan investors at Chabahar; 165 out of the 500 companies licensed to operate in Chabahar are Afghan. In addition, Tehran offers an 80-percent discount in export tariffs and a 75-percent discount on import duties to Afghan traders using Chabahar.⁴⁷

In addition, provisions under the Countering America's Adversaries Through Sanctions Act (CAATSA), which targets countries doing business with Iran, North Korea and Russia, will also affect India's energy cooperation with Iran. Iran is India's third largest oil supplier, with New Delhi importing crude oil worth US\$11.1 billion between 2017-18. While Secretary of State Mike Pompeo has urged Congress to provide India with the necessary waiver so that its sanctions on Russia do not affect India's defence relationship with the country, it is unlikely that a similar waiver will be granted for Iran. CAATSA is congressionally mandated and it will be difficult for India to get a waiver unlike in the case of pre-JCPOA US sanctions on Iran. In addition to CAATSA, fresh unilateral sanctions on Iran will affect progress on other connectivity projects such as the International North South Corridor. On the connectivity projects such as the International North South Corridor.

The imposition of fresh sanctions on Iran jeopardises the Chabahar project. Not only do sanctions deter countries and companies from doing business with Tehran, even the threat of sanctions being imposed on financial institutions facilitating business in the country, will result in a pullback in financing for the port. The United States' desire to 'punish' Iran

for its nuclear programme and support for extremist groups in the region, therefore conflicts with Washington's desire for stability in Afghanistan. The Chabahar port has a direct benefit for Afghanistan as it reduces Kabul's dependence on Pakistan roads and transportation networks for its exports. In order for Afghanistan to develop its own economy and reduce its dependence on foreign (read: United States) aid, it is crucial that it finds sustainable and reliable trade routes. Through the Chabahar port, Afghanistan stands to gain new transit and transportations corridors, through which it connects not only with countries in west Asia, but with India and other countries in South Asia as well. The development and use of the port, therefore, directly benefits the US as it helps in strengthening the weak Afghan economy.

The US withdrawal from JCPOA also impacts the relationship Iran shares with its eastern neighbour, Pakistan. The future of the Iran-Pakistan Gas Pipeline project, or the Gas Sales Purchase Agreement, that was signed in 2009 remains uncertain. While Iran has completed the construction of the pipeline, Pakistan has not fulfilled its end of the deal of buying Iranian oil. Given Pakistan's close relationship with Iranian rivals, Saudi Arabia and the UAE, Islamabad has been under pressure to not buy Tehran oil. Under the agreement, Pakistan is liable to pay a fine of US\$1 million per day should it be unable to take gas supplies for Iran. While Iran has offered Turkmenistan the same deal as Pakistan, it remains uncertain that whether or not there are sanctions, Pakistan will be able to buy oil from its neighbour without upsetting its allies.

Although the Chabahar port has been touted as a rival to Pakistan's Gwadar port that is being backed by China, the two ports' 'strategic rivalry' exists only because of the players (China and India) supporting the port. Iran has invited Pakistan and China to use Chabahar and has expressed its interest in joining the China-Pakistan-Economic Corridor (CPEC) as well. Given India's overtures to the United States, and the bureaucratic inefficiencies and delays in finishing Chabahar, chances are high that Iran may embrace CPEC; this will be a major setback for India. A halt to the development of Chabahar will help boost Gwadar's status as an international trading hub.



ne of the likely ramifications of the United States' pull-out from the JCPOA will be China further augmenting its engagement with Iran. China is a party to the JCPOA and in 2017 provided 1.5 million RMB to the International Atomic Energy Agency (IAEA) tasked to monitor Iran's compliance with the accord. While this signifies China's political support to the JCPOA, Beijing has stressed the need for all parties to comply with the accord. Chinese President Xi Jinping was also the first foreign leader to visit Iran following the implementation of the JCPOA in January 2016. 12

Iran, too, attaches considerable importance to its diplomatic relations with China. Following the US withdrawal from the JCPOA, Iran's Foreign Minister Javed Zarif in May 2018 visited China in a bid to muster diplomatic support. This is indicative of China's vital role in Iran's foreign policy in times of estranged relations between Iran and the US. There are several reasons to evince China's role in Iran following the US withdrawal from the JCPOA.

In 2015 (the same year in which the P5+1 and the EU had reached the JCPOA with Iran) total bilateral trade between China and Iran amounted to more than US\$33 billion. It stood at US\$30 billion in 2016. ⁵³ In 2017, the bilateral trade between the two countries grew by 19 percent and reached US\$37.18 billion. According to data from the European Commission, as of 2017, China has an almost 20-percent share in Iran's overall foreign trade. ⁵⁴ Despite US pressure to cut crude oil imports from Iran, China continues to be the top importer of Iranian crude oil. Iran's crude oil export to China for 2017 stood at 571,275 barrels per day. ⁵⁵ The opening of the Shanghai crude ventures in May 2018 gives rise to the possibility that China would now be able to repay for Iranian crude oil in RMB. ⁵⁶ This could possibly reduce the role of the US dollar in Iran's foreign trade. Both sides have also previously resorted to barter trade in the event of Iran's limited access to international banking and finance. Additionally, China enjoys notable presence in Iran's energy sector.

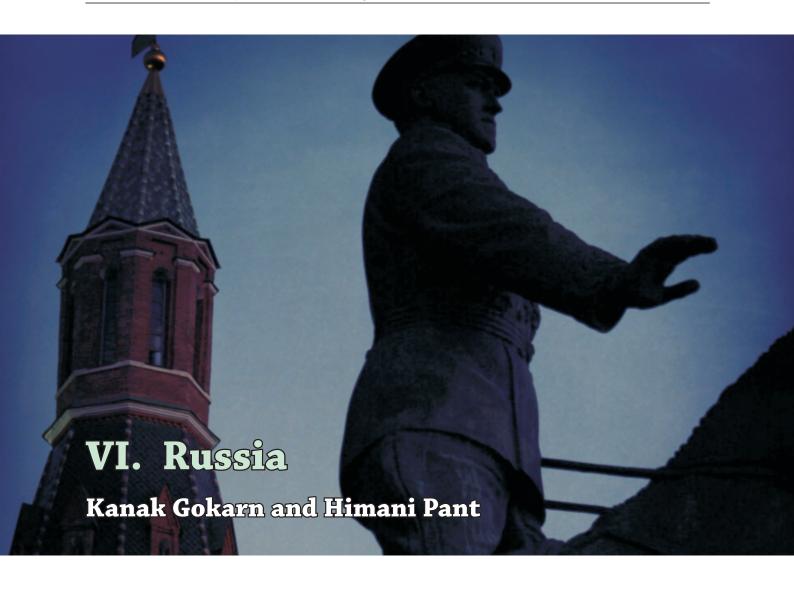
Beijing has jointly invested in Iran's South Pars gas field alongside France's Total. The China National Petroleum Corporation (CNPC) holds a 30-percent share in the US\$4.8-billion contract towards developing the phase 11 of the gas field. With the reckoning of US sanctions on Iran that would specifically target energy firms engaged in Iran's oil and gas sector, the CNPC is touted to assume majority stake in the South Pars project if Total pulls out. While CNPC's total investments to develop the North Azadegan oil field in Eastern Iran could amount to US\$2 billion, China's other oil giant, Sinopec, has also invested US\$2 billion in developing the phase 1 of the Yadavaran oil field. Moreover, by upgrading Iran's ageing crude oil refineries, China has helped the former in reducing its dependency on imported petroleum from other sources.

In line with its Belt and Road Initiative, China continues to address Iran's infrastructure needs. As of 2017, China's Exim Bank has financed 26 projects in Iran and has provided loans worth US\$8.5 billion. The bank will provide US\$1.5 billion to finance the electrification of the 3,200-km long Tehran-Masshad railroad that links Iran's capital with the northeastern city of Masshad. The railroad ultimately plans to establish connectivity between the provincial capital of Xinjiang, Urumqi, and Tehran. Chinese firms have also undertaken some notable infrastructure projects in Iran, including the US\$1.5-billion contract in 1995 to develop the Tehran metro, a US\$1-billion contract to develop the high-speed railway network between Tehran-Qom and Isfahan, the construction of which began in 2015. Iran has also invited China to contribute in the Chabahar port project. More recently, China's ZPMC won the contract for supplying cranes to India Ports Global Ltd. that is engaged in the development of the Chabahar port.

China-Iran relations are not limited to business ties, however elaborate they are. In times when the United Nations (UN) arms embargo precluded Iran from seeking access to modern military hardware, China has emerged a major supplier of defence equipment to Iran.

Media reports suggest that China provided military supplies to Iran via third parties including countries such as North Korea, bypassing the stringent international arms embargoes. Chinese firms also stand accused of erasing serial numbers from the armaments, making it difficult to trace the origin of the defence supplies. ⁶³ According to figures released by the Stockholm International Peace Research Institute (SIPRI), between 2007 and 2017, China provided Iran with US\$316 million worth of arms. 64 China helped Iran establish a plant for the Nasr-1 missile which is identical to the Chinese C-704 antiship missile. Earlier, Iran had received the Silkworm anti-ship cruise missiles from China which were used against the Kuwaiti shipping in 1987. Though difficult to assess, the total value of these transactions is estimated to be as high as US\$10 billion. 65 Iran manufactures the Noor anti-ship missile (that is inspired by the Chinese C-802) and Kowsar anti-ship missile (inspired by the C-801 system). Chinese technology is also evident in Iran's longrange ballistic missiles such as the Sahab 3. China's major defence equipment manufacturer, North China Industries Cooperation (NORINCO) was earlier indicted by the US for having provided Iran with ballistic missile technology and related components. Iran currently operates the Chinese J-7 fighter aircraft (similar to the Russian Mig 21) and is a potential buyer of the third-generation J-10 and the JF-17 multirole combat aircraft.

While the US economic sanctions are likely to have implications for China's investments in Iran, they inadvertently motivate Iran to look out for alternatives for driving its economic growth engine and seeking the much needed investments in its energy and infrastructure sectors. From a long-term perspective, regardless of interruptions, China is likely to stay engaged in Iran's economy, incentivised by the latter's geographical significance, its expansive market, and its enormous energy reserves.



ussia's engagement with Iran has been guided by its interest in seeing the latter remain free of nuclear weapons. It sees Iran as a key power in West Asia, integral for regional security and stability, while Iran considers Russia a counter to the United States and an emerging strategic ally. They have often found themselves on the same side of various issues of common concern; however, some degree of wariness exists. Key areas of cooperation include energy, security and transportation infrastructure.

In the military sphere, Russia has been an important weapons supplier to Iran. However, Russia also supplies arms to Iran's rivals in the region, including Turkey and Saudi Arabia. This shows that its interest also lies in increasing arms sales to developing markets, including West Asia. ⁶⁶ In early 2016, soon after the JCPOA went into effect, its S-300 air defence system was finally delivered to Iran. The US\$800-million contract was signed in 2007, but was suspended in 2010 following international pressure. ⁶⁷ The two parties also began preliminary talks in 2016 over the supply of weapons up to US\$10 billion, including possibly the T-90 main battle tank and the Su-30 fighter aircraft. ^{68,69} The two have

cooperated in Syria: Russia was the first power to be allowed to use Iranian air force bases since 1979, in order to conduct bombing runs. Despite this, sales did not significantly rise after the JCPOA was implemented due to the restrictions placed by the UN and other regional security concerns. The American exit is unlikely to significantly alter the status quo.

In the sphere of energy, too, their dynamic has aspects of both competition and cooperation. Russia assisted in Iran's civilian nuclear programme before the JCPOA, notably in the construction of its nuclear power plant at Bushehr. A deal for the construction of two additional units was also reached; the preparatory work began in May 2018.72 In the oil and gas sector, several preliminary agreements have been signed. Zarubezhneft is the second foreign entity to enter the Iranian market after the JCPOA, concluding a deal of US\$742 million. 73 In the long term, Iranian fields are more lucrative for Russian companies as Western sanctions hinder the exploitation of unconventional deposits.74,75,76 With the American withdrawal, these projects may be put on hold, or investments diverted to domestic upgrade and exploration. Any potential rise in oil prices at the end of the wind-down period will also depend on the actions of Russia and OPEC and the reactions of China and India, Iran's two largest customers. If they decide to reduce their purchases of Iranian oil, they could come to rely on other suppliers, including Russia. Existing pipeline infrastructure may make increasing deliveries to China easier.⁷⁷ Otherwise, they may opt to enter the Iranian market themselves, leading to competition with Russian companies.⁷⁸

Since Russia has shown willingness to work with Iran over the years, the question is more about the logistics of their dealings. The geopolitical advantages may override business logic. Payments may revert to a barter system, but if other players decide to adopt similar measures, it is unclear what Russia can offer Iran. There have already been attempts to drop the US dollar in bilateral transactions and instead use their national currencies. Russia has been developing its own alternative to the SWIFT system to reduce its vulnerability to US sanctions. Though there has been talk of Iran joining the system, much depends on whether other countries will be willing to recognise and use it. As of now, Iran is still connected to SWIFT. Thus, coordination with China and the EU will be key. There are also talks about integrating the indigenous payments systems of the two countries.

Russia's outreach to Iran fits well within its design of a multipolar world order. It welcomes Iran as a partner in various multilateral fora such as the Shanghai Cooperation Organisation (SCO) and the Eurasian Economic Union (EAEU).⁸³ Iran will also be a crucial partner in achieving a settlement in Syria, even though the two have different priorities: Russia seeks to preserve the Syrian state, while Iran is essentially pro-Assad. As tensions with Israel continue to escalate, Russia may be pushed to balance and possibly mediate the

two sides, as it has already been doing. ⁸⁴ It may ultimately settle for a compromise that may or may not see Assad in power. But a nuclear-armed Iran would destabilise the region and conceivably threaten Russia, owing to its geographical proximity. This assures its commitment to the JCPOA. The American withdrawal may bring Europe and Russia closer and may even lead to some concessions over Ukraine-related sanctions. It will undoubtedly affect the Russian-Iranian relationship, but no critical interests are at stake for Russia in the short term.



Then US President Donald Trump announced in May 2018 his exit from the JCPOA, European leaders were—for once—united in outrage. The President of the European Council, Donald Tusk summed up the European mood in one sentence: "With friends like that, who needs enemies?"

Trump's move has been the latest irritant in a number of escalating unilateral US policy decisions that puts the transatlantic partnership to a vital test. It blatantly ignores security concerns of Europe, for which West Asia is the immediate neighbourhood. The volatile security situation in the region, a nuclear arms-race and a possible war against Iran would directly affect Europe, if only by causing a new wave of refugees to the EU that has already been grappling with the influx of migrants for the last few years.

It is also an assault on the way the European Union sees its role on the world stage. For those who were involved in the long negotiations with Iran, the deal was a masterpiece in diplomacy and proof of the European philosophy that there is virtue in talking. The High Representative of the EU for Foreign Affairs, Federica Mogherini called it the "culmination of 12 years of diplomacy".

Last but not least, the economic interests of European companies stand to be affected. This will most probably lead to a collapse of the deal, but the damage goes well beyond financial losses. Iran has threatened to start enriching uranium again if it can no longer see any economic benefit from the deal that lifted earlier sanctions on the Islamic Republic.

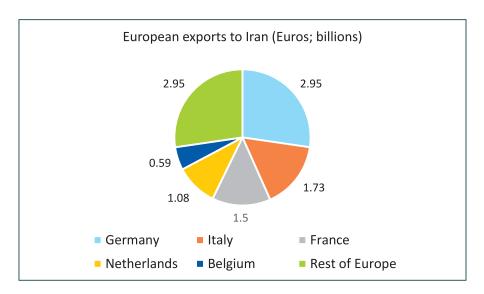


Figure 1 (Source: Austrian Economic Chamber (WKÖ))

The value of trade between Iran and the European Union went up from 7.94 billion euros in 2015 to 21.6 billion euros in 2017, but investments never really soared. A large number of companies from Iran's main European trading partners—Germany, Italy, France, the Netherlands and Belgium—visited Iran during that year, but the time span between inking the deal and its cancellation was rather short. Figure 1 gives a country-wise composition of European exports to Iran.

According to a survey by the International Crisis Group (ICG)⁸⁵ based on interviews with 60 senior managers of relevant international companies, 79 percent said they had delayed their plans to enter the Iranian market even before Trump finally pulled out; 57 percent cited as reasons, fear of existing US sanctions or a snapback of the nuclear ones.

Trump's refusal to re-certify the deal in October 2017 already led to a massive capital flight from Iran. The ICG report published in January 2018 quotes a European banker to have said: For "most of the international banks, the JCPOA is already dead." The financial sector had been strongly affected by earlier US sanctions against Iran when banks had to pay fines of millions of Euros for transgressions.

"Many projects have failed because of difficulties in financing", said Amir Alizadeh, Deputy Head of the German-Iranian Chamber of Trade (AHK) in Tehran. Germany is Iran's largest European trading partner with an export volume of 2.95 billion euros in 2017, which is a mere 0.2 percent of Germany's exports. There are around 100 German companies in Iran but most of them are rather small. One of the biggest ones, the chemical company BASF, has only 78 employees in Iran. ⁸⁶

The main problem for European companies is fear of "secondary sanctions" that include a cut-off from the US financial system for companies who continue to work in Iran. The French energy giant, Total, recently signaled that it would quit a multi-billion-dollar gas project in Iran if it fails to secure a waiver from US sanctions. Earlier, German insurance giant Allianz and the Danish shipping operator Maersk Tankers had announced that they are preparing to wind down their Iran-related businesses.

The EU might come up with some protection for small and medium-size companies that have invested in Iran, as German Chancellor Angela Merkel said. It might also reactivate the "blocking statute" from 1996 that prohibits European companies from complying with US sanctions, as the President of the European Commission, Jean-Claude Juncker announced and allow the European Investment Bank (EIB) to facilitate investments in Iran.

The "blocking statute" was developed to get around the US trade embargo on Cuba, but was never enacted. It would require a lengthy process and the consent of the 28 EU member states. In the end, Angela Merkel will probably remain right when she said that Europe cannot protect its "whole economy" from US sanctions. What seems worse, though, is that nor can Europe protect its security interests, let alone its self-respect.



resident Donald Trump's dislike for the JCPOA— as presidential candidate he had promised to "rip up" the deal in his first day in office ⁸⁷ – is not because Iran has been cheating on its obligations; on the contrary, since 2015, the IAEA has provided ten periodic reports certifying Iran's compliance. Trump's criticism is that the JCPOA is not good enough – he would like the nuclear restraints on Iran to be permanent rather than for only 10 to 15 years as provided under the JCPOA; Iran's ballistic missile programme to be curtailed; and its regional involvement including in wars in Syria and Yemen ended. His argument is that the sanctions relief has provided Iran with US\$100 billion that can be used "as a slush fund for weapons, terror and oppression" in the region.

Pre-JCPOA sanctions are being re-imposed over the next three to six months which will restrict Iranian oil exports, Iran's ability to trade using the US dollar, and impose sanctions on companies dealing with Iran by blocking their assets and activities in the US.

Trump's decision has been widely criticised by most countries with the exception of Israel and Saudi Arabia. Iranian President Hassan Rouhani has said that unless the deal can be

salvaged by the other partners (France, Germany, UK, EU, China and Russia), Iran will resume its nuclear enrichment programme. So far, diplomatic negotiations have only produced expressions of political support for the JCPOA. Considering that Trump's decision is a unilateral violation of UN Security Council Resolution 2231 adopted by consensus, the fact that none of the other P-5 members have raised it in the Security Council reflects the internal divisions and the limits to a coordinated response. Major European companies like Total and Airbus have already announced reviews of investments that were made under the deal.

The problem is that the US has not offered any alternatives to deal with Iran's nuclear programme, the original reason that led to the JCPOA to begin with. Iran is a non-nuclear weapon state, party to the Nuclear Non-Proliferation Treaty (NPT) subject to full-scope safeguards. It has consistently maintained that its programme is peaceful as it considers nuclear weapons 'haram' and un-Islamic. However, it seeks to develop aspects of nuclear technology, including for power generation, enrichment and reprocessing technologies, subject to IAEA safeguards. Suspicions about Iranian activities including setting up of undisclosed facilities led to the assessment that Iran would soon be able to accumulate (possibly within three months) enough highly enriched uranium to produce one nuclear device.

The JCPOA froze all such activities for 10 to 15 years and imposed additional verification measures beyond full-scope safeguards in return for sanctions relief. It made Iran move from being the most sanctioned country to one whose nuclear programme was subjected to the most rigorous inspection regime. Under current circumstances, since sanctions relief will end, pressures will mount in Iran to terminate its onerous verification obligations. Some hardliners have even called for Iran to withdraw from the NPT.

NPT is the cornerstone of the global non-proliferation regime but its internal inconsistencies are becoming increasingly visible. In terms of its non-proliferation objectives, it has reached the limits of its success. Only three countries have never joined it (India, Israel and Pakistan) and one country has withdrawn from it (North Korea). However, on the disarmament front, the NPT has failed to even begin a negotiation as mandated by Art VI. This growing frustration led more than 120 countries, all parties to the NPT, to conclude a Nuclear Ban Treaty in 2017.

More significant is the fact that since the NPT was negotiated 50 years ago, nuclear technology has matured. To control its spread, major powers have used informal mechanisms like export control regimes to restrict access to nuclear materials and dual-use materials and technologies by hyping up the proliferation threat. More relevant is the fact that during the last decade, major powers have embarked on a process of nuclear modernisation. New reviews indicate that new roles and doctrines for more usable nuclear

weapons are being developed. With growing divergences among major powers, the prospects for arms control have disappeared.

In addition, there are regional issues as well. If Iran recommences enrichment, Saudi Arabia has said that it will seek the same rights from the US, too. The possibility becomes real of Pakistan giving a helping hand in return for Saudi largesse (past and ongoing) especially if the US is willing to turn a blind eye to it (as it did when China proliferated nuclear and missile technologies to Pakistan).

At the heart of the NPT is an inconsistency: it delegitimises proliferation but legitimises nuclear weapons in the hands of five countries. As long as there was convergence among major powers, the inconsistency could be covered but growing divergences and evolving technology make it difficult. The US' exit from JCPOA may just be the last straw that breaks the camel's back.

POLICY RECOMMENDATIONS

Harsh V. Pant and Abhijnan Rej

ndia's approach to mitigating the negative externalities of the US withdrawal from JCPOA should be phased, starting with negotiations with the US and, if this is to not bear fruit, look at other options along with Russia, China, and the European Union.

- 1. India should seek waivers from US secondary sanctions when it comes to the purchase of crude petroleum, as well as development of its natural gas projects in Iran. The strongest case for a waiver for India is that, over the last couple of years, it has indeed reduced its oil imports from Iran. However, it should be prepared to approach the issue as *quid pro quo* with the US. One way through which this can be achieved is through issues linkages: increase in purchase of US shale oil, as well as softening India's positions on US tariffs, in return for sanctions waivers.
- 2. New Delhi should aggressively promote the cause of the Chabahar port in Washington, and link the success of the port projects with that of Trump's Afghanistan policies. The key argument to advance here would be that an active Chabahar will allow Afghanistan to trade with the rest of the world without depending on Pakistan facilitating access to that landlocked country. This, in turn Delhi should argue would considerably reduce the influence of Pakistan in determining the future of Afghanistan. Furthermore, Delhi should sensitise Washington to the fact that, absent India in Chabahar, Iran may be tempted to link the port with China's Belt and Road Initiative, an outcome that is undesirable for the US and its nascent Indo-Pacific strategy.
- 3. Should Indian overtures to the US about Chabahar fail, India should look towards other partners in developing the port. A prime candidate here would be China. Following the Wuhan summit in April, India and China have agreed to jointly develop an economic project in Afghanistan. Therefore, India-China collaboration on Chabahar is not as farfetched as it sounds, especially given the fact that Iran seems to be comfortable with that port being open to China as well.
- 4. If China is one potential partner should the US refuse to play ball with India when it comes to Iran Russia is the other. Russia has remained committed to the idea of promoting alternative institutional structures that undercut US and western dominance. In particular, it has, through BRICS and other fora, proposed the creation of an alternative to the SWIFT payment messaging system. The existence of such an

alternative could mitigate some of the problems caused by US secondary sanctions. India should be prepared to work with Moscow to develop such alternatives.

5. Finally, India should be vocal in its support of the French and German positions on the JCPOA. All said and done, if the net result of the US pull-out from the nuclear agreement is Iran eventually acquiring nuclear weapons, this changes the regional security calculus quite dramatically, and in a way that is to India's detriment. Therefore, India should be willing to partner with EU states to promote the JCPOA. However, it should also be cognizant of the realpolitik of such a stance: India should express support for the EU positions only if it is certain that the US will not make any special concessions for India when it comes to New Delhi's interests in Iran. ©RF

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