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The Second Round of Sanctions against Iran: The Impact on Iran and the Global Oil Market

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The second round of United States sanctions on Iran began in early November 2018, with what President Donald Trump described as "the toughest sanctions regime ever imposed." The current phase of sanctions is intended to upset the oil market, Iran's primary source of revenue. Thus, the effectiveness of the sanctions will be measured largely by the scale of the revenues the Iranians collect from their oil. It also depends on the ability of the United States to bring the scale of Iranian oil exports to "zero" and maintain sustainable oil prices, counter to Iranian expectations. However, a change in Iranian policies is not guaranteed even if the sanctions succeed financially. In the past Iran withstood extremely heavy pressure, including harsh sanctions that it failed to circumvent, without conceding on fundamental policies. Moreover, in the aftermath of the nuclear deal and the lifting of sanctions in 2016, Iranian foreign currency reserves rose to 100 billion dollars. These can allow the Iranian regime to survive financially even after the temporary sanction waivers granted by the US to eight countries expire. In any case, it is not certain that those countries will cooperate with the US administration and cease importing oil from Iran. At present the road to "financial ruin," as promised by President Trump, is very long indeed.

The second round of United States sanctions on Iran began in early November 2018, with what President Donald Trump described as "the toughest sanctions regime ever imposed." In May 2018 the Trump administration announced its withdrawal from the nuclear deal with Iran (JCPOA), reached three years earlier under the Obama administration. The first phase of sanctions began In August 2018, and included a ban on the sale of dollars on international markets to Iran and Iranian companies, as well as the purchase and sale of Iranian rials outside of Iran and the sale of gold and precious metals to Iran. The administration also imposed bans on the sale of civilian aircraft and cars to Iranian companies.

The current phase of sanctions is intended to upset the oil market, Iran's primary source of revenue (oil revenues made up nearly 70 percent of national revenues in 2017). In June 2018, Iranian Deputy Oil Minister Habibollah Bitaraf said that state oil revenues for 2017 reached $50 billion; the current sanctions are intended to cut into those revenues. The US also forbids buying or selling any oil-related products from Iranian oil companies. In addition, the new round includes bans on international financial transfers by Iranian banks and cuts them off from the SWIFT system. Additional sanctions were levied in aviation, banking, and marine shipping, and over 700 entities and individuals were blacklisted, far more than the 400 affected by the sanctions levied by the United States against Iran from 2012-2015. Sanctions are also imposed on additional products not included in the Obama-era measures.

In the Obama years, the price of oil exceeded $100 a barrel, and sanctions had almost no effect on those high prices. In fact, precisely in those years the price of oil began to fall dramatically due to factors completely unrelated to the Iranian issue, including a relative slowdown in China and new American oil production technologies. The JCPOA provided an additional spur to falling prices. The global oil market today is substantially different from what it was in the Obama era. Indeed, following the American withdrawal from the nuclear deal and the implementation of the second round of sanctions, there were doubts across the world whether sanctions would spark a rise in oil prices and become be a double-edged sword for the United States.

Until the withdrawal from the nuclear deal, Iranian oil represented 5 percent of all oil production and exports worldwide. This figure has been on a steady downward trend since the US left the nuclear deal. Today, both in terms of exports and in terms of production, Iranian oil is less relevant worldwide than it was in the year 2012, and the new sanctions are introduced in a totally different economic climate than what existed in 2012. World oil exports are greater than ever, thanks to advanced technologies, and American exports are larger than they were. Today more than 100 million barrels of oil are produced per day in the world, diminishing the influence of Iranian oil. Likewise, relative declines in developing markets in general and in China specifically have led to lower demand. In addition, the United States is working in conjunction with Saudi Arabia, and already several months ago asked the Saudis to produce more oil to compensate for the shortfall in Iranian oil. In October, Saudi Arabia produced 10.7 million barrels a day – an increase of more than half a million barrels since the American withdrawal from the nuclear deal. The Saudi regime's involvement in the October murder of journalist Jamal Khashoggi may even impel the Saudis to ask the Americans to interfere in worldwide oil prices (despite Saudi claims that an overly low price is not in their interest and that they may consider cutting capacity). Both the United States and Russia produce far more oil today than ever before, setting a record high of 11.3 million barrels a day in the month of October. It is therefore no surprise that the price of oil today is lower than it was at the time of the US withdrawal from the nuclear deal in May ($75 per barrel) and significantly lower than the average price per barrel in the year 2012 ($112 per barrel).

In this climate, the US ability to substitute for Iranian oil appears sustainable. President Trump has stated that he intends to bring Iranian oil exports to zero. Can the US indeed stop Iranian oil exports? The "temporary" waivers granted by the White House to eight countries – India, Turkey, China, Japan, Taiwan, South Korea, Italy, and Greece – mean that Iranian oil exports will still reach at least a million barrels a day. Second, the Iranians are confident in their own ability to continue to export oil. On the day the second round of sanctions began, Iranian President Hassan Rouhani declared, "Today, Iran can sell its oil and will do so across the world." These are not simply empty words by Rouhani, and appear to be based on Iran's past successful circumvention of sanctions. Already in October this year the Iranian regime used two techniques it had used to sell oil between 2012-2015; the first is smuggling and under-the-radar sales, which involves Iranian oil tankers turning off their transponders to become difficult to detect. The second method is to smuggle the oil overland to neighboring countries – Turkey, Pakistan, Afghanistan, and Russia. Russian smuggling networks help transfer oil deliveries from Iran to Syria; inter alia these oil transfers help Iran finance Hezbollah and Hamas operations.

In addition, the European Union seeks to circumvent financial sanctions by building a bypassing payment mechanism (a special purpose vehicle or SPV) to allow European firms to continue doing business with Iran. This track is not relevant to large firms (including large banks) that already exited Iran; its importance is first and foremost political, as part of the European effort to ensure Iran continues to participate in the nuclear deal. The common assessment is that even the SPV, which is presently faltering due to the refusal of the countries involved to host it, will not restore the business relationships between those firms and Iranian companies.

The effectiveness of the sanctions will be measured largely by the scale of the revenues the Iranians collect from their oil. It also depends on the ability of the United States to bring the scale of Iranian oil exports to "zero" and maintain sustainable oil prices, counter to Iranian expectations - deflating the October 16 declaration by Iranian Vice President Eshaq Jahangiri that the increase in oil prices would compensate for the decline in export volumes. The latest steps by the US administration seem to indicate a simultaneous combination of both components of the operation – quantity and price. On the one hand, the administration is working to gradually lower oil imports from Iran by the eight largest consumers, and on the other is encouraging other producers (primarily Saudi Arabia, Russia, and the United States itself) to increase capacity. The gradual change will allow Iran to reconsider its position in the renewed negotiations before sanctions tighten.

A change in Iranian policies is not guaranteed even if the sanctions succeed financially. Iran's leadership believes that the Trump administration is interested in regime change in

Tehran, not in a new agreement. In the past Iran withstood extremely heavy pressure, including harsh sanctions that it failed to circumvent, without conceding on fundamental policies. Moreover, in the aftermath of the nuclear deal and the lifting of sanctions in 2016, Iranian foreign currency reserves rose to 100 billion dollars. These can allow the Iranian regime to survive financially even after the temporary sanction waivers granted by the US to eight countries expire. In any case, it is not certain that those countries will cooperate with the American administration and cease importing oil from Iran. At present the road to "financial ruin," as promised by President Trump, is very long indeed.