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The Implications of Sanctions for the Iranian Oil Market

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EXECUTIVE SUMMARY: Senior officials in the Trump administration have indicated that the sanctions recently imposed on the Islamic Republic were intended to significantly change its behavior. This declaration is inconsistent with its granting of an exemption to the eight countries – particularly China and India – that make up the bulk of Iranian oil exports. The administration's decision reflects, among other things, the desire to avoid a shake-up in global oil prices and a pragmatic approach that allows room for maneuver for countries that are not ready to immediately halt their purchases of Iranian oil. However, the decision is being interpreted by Tehran as a sign of weakness and an achievement for Iranian foreign policy.

On November 5, the Trump government imposed wide-ranging sanctions on the Islamic Republic of Iran in order to bring about a change in the revolutionary regime's radical orientation. This round of sanctions places severe restrictions on a wide range of corporations, financial and commercial entities, organizations, and private individuals both in Iran and abroad.

The focus of the sanctions is the Iranian energy market, with an emphasis on oil exports, which is the country's main source of income. The assumption is that constraining Iran's oil revenues will significantly harm its economic stability and thus force it to change course and return to the negotiating table, this time under new conditions.

On November 2, US Secretary of State Mike Pompeo said the administration's purpose was to [deprive the regime of the revenues with which it spreads death and destruction around the world](#). However, this goal is inconsistent with the decision to grant temporary exemptions to eight countries, including [China and India](#) – Iran's two biggest oil consumers.

The eight countries that have been temporarily exempted are Italy, Turkey, Greece, Taiwan, China, India, South Korea, and Japan. This decision reflects a desire to avoid a shake-up in world oil prices and a pragmatic approach that allows room for maneuver for countries that are not ready or able to immediately stop their purchases of Iranian oil. The decision also reflects the administration's "carrot and stick" approach, which it employs to maintain balance in the international arena and to obtain the cooperation of weightier countries such as China, India, and Turkey.

A day before the sanctions were imposed, the Islamic Republic marked the 39th anniversary of the takeover of the American embassy in Tehran. During the demonstrations, which were punctuated by chants of hatred against the US and Israel, the government attempted to convey that Iran will be able to withstand the sanctions.

Notwithstanding that show of belligerence, it is perfectly clear that the establishment grasps the ramifications of the sanctions for the Iranian economy, indicators of which have been visible ever since Trump announced the departure of the US from the nuclear agreement. Moreover, the economic turmoil caused by the sanctions imposed on Iran during the Obama administration is still engraved in the Iranian collective memory, though at that time, its oil exports did not fall below 1 million barrels per day.

At the time of writing, Iranian oil exports are estimated at 1.6 million barrels per day, but in the 10 months since the beginning of the year (January-October), the daily average was about 2 million barrels. This is due to export volumes of [2.1 to 2.6 million](#) barrels per day between February and July of this year. Bloomberg data on the world oil market show that in 2017, Iran ranked sixth in the world, with an income of about [\\$40 billion](#).

If Iran's decision-makers can manage to maintain an average export of 1.2 million barrels per day, they will be able to cope with the threat to the sector. Therefore, the decision to allow the eight countries, particularly China and India, to continue to purchase Iranian oil for the time being is a boon to the Iranian side.

The Americans' "stick and carrot" policy of imposing sanctions but granting a temporary exemption to eight Iranian customers is being interpreted by Tehran as a sign of weakness and a victory for its own foreign policy. While Trump succeeded at bringing the ruler of North Korea to the negotiating table, the Iranian arena is different. The leadership in Tehran hopes that Trump will not win another term, and is willing to tighten the country's belt until the next US elections. It should also be remembered that in effect, the revolutionary regime

has been under American sanctions since the time of its inception; hence its perception that it can overcome the burden of sanctions.

China, the world's largest oil consumer, is a key element in the Iranian regime's ability to withstand sanctions. According to OPEC, China's crude oil consumption will reach 13 million barrels per day by the end of 2019. Beijing purchases the largest share of the Iranian oil market, making it a vitally important ally. Moreover, Beijing and Tehran have joint ventures in many fields, including commercial, security, and geopolitical areas.

The inclusion of China and India, which collectively account for about 65% of Iranian oil exports, on Washington's list of exemptions is inconsistent with Mike Pompeo's statement that Washington's goal is to paralyze Iranian oil exports. In September, the volume of aggregate purchases by China and India stood at about 1.05 million barrels a day out of a total of 1.6 million. It appears, therefore, that despite the decline in the volume of Iranian oil exports, the volume of exports has not yet fallen to the critical level of fewer than 800,000 barrels a day since the date of publication of the resolution on the return of sanctions.

As part of Iran's bid to preserve its oil revenues, a wide range of purchase proposals, ranging from barter transactions to cash-based payments, have been proposed to circumvent the limitations on the banking system. Tehran recently announced that it was going to sell a million barrels of oil on the energy exchange in an effort to open the oil market to private investors. Of the million barrels, 280,000 were sold. While that result did not meet Tehran's expectations, it will maintain the trend even at the cost of a significant reduction in oil prices.

Turkey is another of the eight countries that have been temporarily exempted from the sanctions on the Iranian oil trade. Turkey, like China and India, is central to Iranian interests, and cooperation with Ankara – despite the regimes' differences – is vital to Iran's survival of the sanctions. During a visit by Iranian President Rouhani to his Turkish counterpart last September, they decided to increase their economic cooperation in order to deal with the sanctions. Among other attractions, Iran has high hopes of eventually supplying gas to Europe through Turkey.

Washington's lifting of restrictions on the port of Chabahar is also helpful to Tehran's efforts to circumvent the sanctions regime. The port was opened on the premise that assistance should be provided to countries suffering an economic crisis. However, the freeing up of the port – which allows goods to move from India to Afghanistan through a ground corridor in southern Iran – two days after the imposition of sanctions on Iran's seaports reflects a lack of consistency on the part of the US administration.

It should be remembered that during the sanctions imposed on Iran during the Obama administration, the Revolutionary Guards managed to exploit their control of the seaports to circumvent the restrictions and maintain Iranian oil trading through alternative routes. The oil smuggling axis has led more than once to arrests for corruption and money laundering, such as the high-profile arrest of Babak Zanjani.

Iran's struggle to overcome the challenges it faces in the current round of sanctions is forcing its leaders to seek alternatives to prevent economic collapse. Experience shows that Iran will strive to circumvent the sanctions with the help of states, commercial entities, and individuals acting on its behalf. The Americans' exemption of the Group of Eight states, particularly China and India, will encourage Tehran to thwart the sanctions and will not lead it to the negotiating table.

Moreover, the prevailing Iranian political reality dictates that any attempt on the part of Rouhani to hold a dialogue with the US could delegitimize him in the eyes of his domestic opponents and perhaps those of the Supreme Leader as well.

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