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IRAN OIL AND SANCTIONS

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The US violation of the Joint Comprehensive Plan of Action, announced last week, has been portrayed as a reimposition of sanctions on Iran. It is also an imposition of extraterritorial sanctions on the EU, China, India, and any other buyer of Iranian oil. Iran has missed many chances to use its energy resources strategically. Now its economic survival depends on maintaining some unlikely diplomatic and commercial alliances.

For almost two and a half years, from January 2016 until now, Iran enjoyed many of the benefits of sanctions relief. It could export its oil and receive payment, albeit with practical difficulties. But during this period, in which the United States consolidated its newfound "energy dominance," Iran overplayed its hand and thought it had infinite time. On the positive side, Iran restored oil production to presanctions levels and commenced gas exports to Iraq.

But on the negative side, Iran failed to attract much energy investment, even when conditions were at their most favorable. The country was far too slow in unveiling its new Iran Petroleum Contract (IPC), and when it did, potential investors complained that the terms were unattractive.

The IPC is a significant improvement on the old buyback terms, which featured fixed maximum rates of return, inflexible development plans, and all the technical risk borne by the contractor. But still, its fixed-fee model lends itself to protracted zero-sum haggling and gives the investor insufficient flexibility in development or share of the upside. The Petroleum Ministry has failed to adjust to the shift in the global market caused by the rise of shale and the fall in oil and gas prices, as well as to competition for new deals from players such as Abu Dhabi, Brazil, Mexico, and even recently Iraq.

Russia's politicized yet profitable policy should have demonstrated to Tehran how to use its natural gas resources strategically, but Iran has stumbled into shortsighted haggling. Its deal to export to Oman has deadlocked over price, and now Muscat will not need the gas for some time. Exports of 10 BCM per year could have earned in the order of $2 billion annually, but more importantly, it would have driven another wedge between GCC members.

Talks with India's ONGC over development of a gas field also foundered on terms, with the dispute leading to a fall in Indian oil imports from Iran. One small contract for what would have been Iran's first liquefied natural gas exports was canceled in February after criticism from parliamentarians. Gas exports to neighboring countries would have created strategic dependence—

the one country Iran has exported large amounts of gas to, Turkey, had to pay for it in the gold-for-gas trade so illuminated in the trial in New York involving intermediary Reza Zarrab.

Iran should have signed a dozen or more field development contracts in a year, as even war-torn Iraq managed to do in 2009; locked in European, Chinese, Russian, Indian, and other firms; and made American companies jealous of missing out. Higher oil exports would have made Iran more influential in OPEC and more important to its customers. In July 2017, Total and China National Petroleum Corporation (CNPC) signed for Phase 11 of the South Pars gas field, and in March, Russian state firm Zarubezhneft agreed to develop two relatively small oil fields. But these were the only two deals Iran made with foreign firms.

ENI of Italy and midsize and smaller European firms such as Austria's OMV, Spain's Repsol, Wintershall of Germany, and Norway's DNO have all been in lengthy negotiations. Gazprom Neft (Russia), Sinopec (China), Inpex (Japan), and Pertamina (Indonesia) are also contenders. The greatest prize, the tender for the giant Azadegan and Yadavaran oil fields on the Iraqi border, has stretched out indefinitely. Meanwhile Iraq, despite its own political problems and relatively unattractive terms, is developing a cluster of large fields that represent the geological continuation of these Iranian resources.

The West Karoun area, which includes Azadegan and Yadavaran, is already 180 kbpd behind target, while the South Pars oil field, an extension of Qatar's Al Shaheen, has been discussed with Total but under local development has reached only 20 kbpd out of a planned 140–150 kbpd. The delays to these two projects alone are costing Iran $6 billion or more annually in lost exports. Again, even more valuable than the money would have been the locking in of exports to companies that carried out the field developments; extra clout in OPEC—Iran could have driven a harder bargain if its production capacity were higher; and its heightened importance in the world market, which would have made it more painful to sanction. Gaining commitment from any of the interested foreign firms has just become much harder.

This general failure reflects a mix of protectionist and "resource nationalist" sentiment; moves by insiders and Revolutionary Guard–linked entities to hold on to their privileged position in the energy sector, entrenched by the previous sanctions; attempts by hardliners to derail any success by the Rouhani administration; and the Iranian negotiating style, which is tactically tough but loses sight of the strategic objective. The Iranian hardliners maintained from the start of the deal—correctly, as it turns out—that the United States could not be trusted to maintain its side of the bargain, but the hardliners were themselves to a large degree responsible for Iran's missing the window of opportunity to strengthen itself.

That window has half closed in the period since Donald Trump's inauguration and particularly since his refusal to recertify Iranian compliance on October 13, 2017, following Trotsky's formula of "no war, no peace." Until yesterday, the United States failed to live up to its commitments but without openly withdrawing, making financial institutions extremely wary of engaging with Iran. Oil companies with significant US exposure, such as BP, were deterred from engaging seriously on investments.

Iran has almost forty years' experience of surviving various kinds of sanctions. The US action makes attracting investment much harder—visible steel on the ground is more likely to draw unwelcome attention, and financial sanctions make it hard to pay for. In the absence of foreign investment, Iranian oil production can be expected to decline over time as field maturity takes its toll. Petrochemical plants will stand half-finished; gas output will again struggle to keep up with demand.

But Iran does have options to keep its oil exports flowing, the most immediate task. It has already ramped up exports to sell as much as possible and establish a high baseline before sanctions come into play. The United States has demanded rolling reductions in purchases by all countries, with waivers conditional on immediate cuts. The gutting of the American sanctions team, other trade squabbles, and the rift the White House's unilateralism has opened up in the Atlantic make Tehran's task easier this time. European sanctions on shipping and insurance will presumably not be reimposed, though reinsurance could be a problem. Rising oil prices and growing current account deficits for Turkey and India in particular encourage customers to keep taking Iranian crude, with South Korea saying it would seek waivers.

So far, Iran has been maintaining a tough face and not offering any special conditions to Japanese buyers, for instance. But as sanctions bite, it will act as it did in 2012–15, offering discounts and extended payment terms up to 90 days, though of course at some financial pain. It will accept payment in rupees and yuan and barter trade. These measures will lure China, India, and Turkey in particular. Higher oil prices, already in evidence, will partly cushion some loss of exports. Iran will deploy its array of front companies, use its own tanker fleet (the largest in the Middle East), disguise ship names and locations, and conceal crude origin by blending with that of other countries. And it could employ low-profile ways to interfere with the oil production of neighbors, including sabotage and cyberattacks.

As long as Iran continues to comply with the JCPOA, Tehran has accidentally achieved a diplomatic feat worthy of Metternich, lining up Brussels, London, Moscow, and Beijing against Washington.

As far as interests go, the position of Russia is ambiguous. As a major oil exporter itself, it benefits from higher prices and a reduction in Iranian competition. It will also appreciate that Iran's large-scale entry into the world gas market is delayed yet again, as it has been since the 1960s. However, even if Moscow is chafing within the confines of the (N)OPEC deal, it would not wish to see the deal end either—with Saudi Crown Prince Mohammed bin Salman having talked of a 10- to 20-year agreement, Moscow had gained valuable leverage both over the world oil market and the Gulf Arab states. But a sharp loss of Iranian production is likely to collapse the Vienna Group's framework, as Saudi Arabia and others will have to deploy their spare capacity to prevent a price spike and give the Trump administration economic relief.

Iranian wariness of Russia dates back to the anger over lost territories that led to the 1829 mob killing of Russian ambassador Alexander Griboyedov. But Tehran will have to hope that Russia's newfound military and political foothold in the Middle East—and their cosponsoring of genocide in Syria that enabled it—are important enough for Moscow to risk a deeper confrontation with the United States.

In contrast, it cannot expect much in the way of open hard assistance from Beijing, but commercially China will be much more important. Russia, under financial sanctions itself and short of cash, has previously offered logistically implausible oil swaps as a way of evacuating Iranian crude. But China has the appetite for oil itself. Of course, Chinese refiners will seek steep discounts, and Iran complains of the overpriced and third-rate goods it procures in return.

As in the previous sanctions period, Chinese companies will be the main investors in oil-field development, while being in position to dictate the pace of development. Chinese companies were not very popular in Iran during the 2012–15 sanctions; CNPC was expelled from its South Pars project for nonperformance, while Sinopec clung to its work in Yadavaran. Both companies eventually shied away from major breaches of US sanctions. But at least in maintaining its oil imports and picking up cheap Iranian barrels spurned by Europe or elsewhere, China this time will be bolder and willing perhaps to have some expendable companies shut out of the United States.

More widely, both Beijing, which launched its "petro-yuan" oil contract in March, and Russia are aware of the imperative to develop resilience to US sanctions. The Shanghai contract has problematic features for international traders, such as the lack of yuan convertibility, and has struggled to attract liquidity. This crisis may be too early for it, but the attraction to China of using its own currency and its own financial system for oil imports is gaining salience. At a time of looming trade wars, reliance on a rival will appear increasingly risky.

Brussels, too, faces the tricky task of responding to US attempts to halt Russia's Nord Stream 2 gas pipeline to Germany. Still, even with the deployment of its blocking regulations to prevent the application of extraterritorial measures, it is going to be difficult for the EU to shield its companies, which have to put their commercial interests first.

Iran can keep going economically for now, under likely less stringent pressure than in 2012–15. And that gives more time for complex and potentially dangerous ramifications to play out in Iran itself, across the Middle East, and internationally.

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