EUROPEANS' MAGIC TOOL TO SAVE THE IRAN DEAL

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Following the US withdrawal from the Iran nuclear deal (JCPOA) last May, Trump's administration has progressively re-imposed economic sanctions on Teheran. On November 5, 2018, a new wave of US sanctions was implemented, targeting exports of oil and bank operations, which came in addition to the first set of sanctions in place since August 6. But the consequences of the November sanctions is of another magnitude: Iran will be disconnected from the international financial system, and Teheran will no longer be able to sell its oil – which represents 17% of its GDP. The US agreed to let 8 countries buy Iranian oil for a limited period of time: China, India, Japan, South Korea, Italy, Taiwan, Turkey and Greece. Those countries can have a delay in exchange for a commitment to reduce their imports of crude oil from Iran.

These sanctions are a big challenge for the other signatories of the JCPOA (France, Germany, Russia, China and the European Union), in particular for European countries because of the high economic interdependence with the US. To the risk of secondary sanctions[1], they can now add the impracticability of financial exchanges. Whereas the previous sanctions were targeted selected persons and companies, they are now applied to all financial services related to Iran, making it very difficult for Europeans to keep doing business with Teheran. Surprisingly, this new wave of sanctions also targets humanitarian products (food, medical support…), even if it was not the case of the previous sanctions which applied before JCPOA's signature.

European "SPV"

For France, Germany and the European Union – which participated to the JCPOA's negotiations as a full party – it is crucial to maintain economic relations and trade with Iran to make sure that Teheran keeps doing its part of the deal. So far it is the case, as proved by

[1] "Secondary sanctions put pressure on third parties to stop their activities with the sanctioned country by threatening to cut-off the third party's access to the sanctioning country."
http://www.atlanticcouncil.org/blogs/econographics/ole-moehr-3

the recent IAEA Report published on November 12[2], but Hassan Rohani and Mohammad Javad Zarif, respectively President and Minister of Foreign Affairs of Iran, have claimed that Iran would re-start its nuclear program if the other signatories do not ensure the economic benefits arising from the deal.

To respond to US sanctions, Federica Mogherini announced on September 24 the creation of a “special purpose vehicle” (SPV), a mechanism which allows a barter system with Iran to avoid US primary and secondary sanctions. An SPV is a legal entity created for a specific purpose, that can be used as a funding structure by which all investors are pooled together into a single entity[3]. In the case of Iran, this mechanism is based on demonetization of exchanges through a “clearing house”, to allow Iran to continue selling oil. In practice, Europeans will put a certain amount of money (X) into this SPV, and Iran will put the same amount (X). With the money of the SPV (X+X), Europeans will be able to buy oil, and Iranians, European products. This SPV solution should be implemented by January 2019.

Already at the time of the announcement, President Macron had made cautious remarks about its effectiveness, saying that it would not be enough to offset the effect of the sanctions for big European companies which have close ties with the US. Most of these companies are already gone: Total, Daimler, Peugeot, Renault, Airbus, Deutsche Telekom. Even the Belgium-based SWIFT has put more pressure on Iran: « The move will effectively cut those banks off from the global financial system. Since the vast majority of SWIFT’s transactions are in dollars, it had no choice. »[4] Before the idea of the SPV emerged, France had tried to implement another mechanism with its investment bank BpiFrance, to help European companies to do business with Iran in euro despite US sanctions. But this plan has been “put on hold” since September.

The US’ inflexible response

The US reaction was immediate. On September 25, US Secretary of State Mike Pompeo reaffirmed that the US will not allow any bypass strategy, and John Bolton, the US national security advisor, said that such mechanism could have “terrible consequences”. The Trump administration is following closely Europeans’ moves on this but doubts its actual implementation: “The European Union is strong on rhetoric and weak on follow-through”[5] said Pompeo.

US threats seem to have worked so far, since no European countries has agreed to host this SPV, forcing France and Germany to take the lead - in the hope that it would minimize the risk of US retaliation. But there is a good chance that the mechanism will be reduced to products less strategic than oil – probably humanitarian and food products. “Diplomats said

[2]“IAEA Board Report: Verification and monitoring in the Islamic Republic of Iran in light of United Nations Security Council resolution 2231 (2015)”, 12 November 2018. https://www.iaea.org/sites/default/files/18/11/gov2018-47.pdf

[3]https://www.seedinvest.com/academy/a-special-purpose-vehicle

[4]http://thecorner.eu/world-economy/are-us-sanctions-losing-their-clout/76991/

[5]https://www.cnbc.com/2018/09/27/pompeo-slams-eu-plan-to-avoid-iran-sanctions-disturbed-disappointed.html

the French-German gambit is a “safety-in-numbers” tactic to overcome the refusal of individual EU states to host the mechanism to sidestep the risk of being targeted by the revived U.S. sanctions regime against Iran.”[6]

The possibility that Trump may agree to a new Iran deal is still very unlikely. When the US President met Emmanuel Macron last September for the annual UN General Assembly, he said that a “JCPOA plus” was not an option because the sanction policy pays off and weakens the Iranian economy. Iran already lost 2 billion $ in oil revenues since the first wave of sanctions last May. Washington still expects from Teheran to comply with the 12-point list of demands presented by Mike Pompeo last May, and it’s definitely too early to expect new negotiations.

One foreseeable consequence is that Iran will invest more in its Eastern strategy and enhance trade and business with its Asian partners, in particular Russia, China and India. For instance, a mechanism similar to the SPV will be implemented by South Korea to maintain trade with Iran and ensure returning oil export revenues from South Korea, a mechanism “by which Iran's oil export revenue will be bartered with imported goods," said Hossein Tanhayi, head of the Iran-South Korea chamber of commerce[7].

The SPV does not seem to worry the Trump administration, and even though it appears as a clear attempt from the EU to save the deal, China and Russia might have more economic and commercial strength to impact JCPOA’s future.

[6] https://www.reuters.com/article/us-iran-nuclear-eu/france-germany-taking-charge-of-eu-iran-trade-move-but-oil-sales-in-doubt-idUSKCN1NX2C1

[7] https://www.bourseandbazaar.com/news-1/2018/12/1/iran-hails-oil-for-goods-deal-with-south-korea