

Iran Braces for New US Sanctions But May Weather the Storm with EU Support



On the eve of renewed sanctions by Washington, Iranian protesters carry placards that mock President Donald Trump, Saudi Arabia's King Salman, and Crown Prince Mohammed bin Salman during a demonstration outside the former US embassy in the Iranian capital Tehran on November 4, 2018. Photo AFP

On 5 November 2018, new US sanctions on Iran went into effect. As President Donald Trump and other US officials stated time and again, the sanctions are supposed to put pressure on Iran by stopping the flow of **oil**, its main source of income, out of the country.

This is the second package of US unilateral sanctions on Iran. The first package was **announced** on 8 May and went into effect on 6 August, after **Trump's withdrawal** from the 2015 Iran **nuclear deal** known as the Joint Comprehensive Plan of Action (JCPOA). Although different arguments have been put forward on the reasons for the withdrawal, most people agree on the aims of the sanctions: they are designed to hurt Iran's **economy** and limit its integration into the world economy. Yet even taking into account the US' stated goals of pushback against Iran's regional influence and diminishing its missile capabilities, the question remains as to whether the sanctions will have the desired results.

When Trump withdrew from the JCPOA, Iran's economy went into a tailspin. The currency plunged to a record low and inflation soared. This volatility continued after the announcement of the first round of sanctions. The **Iranian government** responded by implementing a measured policy aimed at stabilizing the currency via the **Central Bank's direct involvement** in the exchange market on the one

hand and by **cracking down on middlemen** in the exchange and gold markets on the other. Although the currency has been fluctuating ever since, no major shocks have been reported.

With the second round of sanctions, however, Iranians fear economic hardship similar to that experienced under the previous sanctions from 2011 onward. The US strategy of 'maximum pressure' is about keeping Iran in a financial and economic stranglehold until it changes its military and regional policy and conduct. Therefore, pressure will be maintained until Iran agrees to the demands announced by US Secretary of State **Mike Pompeo** in May 2018. In other words, the US wants Iran to adhere to its demands in what in Iran is seen as a surrender rather than a negotiation. Iran's counter-strategy is simple and based on resisting Washington's pressure - an approach in which it has decades of experience. According to Supreme Leader Ali Khamenei, Iran **will not negotiate** with the US at any level. Rather, Iran is betting on other major economies like the European Union (EU), China and India which oppose Trump's sanctions and want to keep the JCPOA alive. The argument is that, unlike the pre-2015 sanctions in which the US led an international coalition of nations against Iran, the Trump administration is today doing the job unilaterally, which is less effective and more bearable for Tehran.

That being said, one needs to take a closer look at the economics of the new sanctions. Oil constitutes roughly 33 per cent of Iran's income, a percentage that has been on the rise since the JCPOA was signed in 2015. Despite a fall in its oil exports in 2018, Iran's revenues have remained high because of rising oil prices on the global market, from below \$50 per barrel to above \$70. As such, Iran's oil income in the first seven months of 2018 were **roughly \$41 billion** even though its oil exports dropped to below 2 million barrels, down from 2.8 million in 2017. Therefore, Iran's oil income, the main target of US sanctions, is still flowing despite the drop in quantity.

The US is counting on this being unsustainable, given the continued decline in Iran's share of the oil market. **China and India**, Iran's biggest oil customers, however, stated their intention to continue buying Iranian oil. Additionally, the EU offered a package in which it will guarantee Iran sales of at least a million barrels a day. Still, if Iran's oil exports drop to 1.3 million barrels a day, its income will drop to **around \$32 billion** next year, from \$45 billion in 2018 and \$55 billion in 2017. Sanctions are therefore already affecting Iran's oil income and will put its economy under further pressure in the future.

At the same time, only 50 per cent of Iran's oil income is included in the budget and used in day-to-day spending. The rest is invested in developing the oil industry (14.5 per cent) and oil-producing provinces (3 per cent) and deposited in the National Development Fund of Iran (NDFI) (32 per cent) for use in economic development projects. Even so, the government (and its budget) has lost almost \$5 billion in 2018 compared to 2017 and will lose \$6.5 billion more in 2019. Theoretically, this can be compensated by reducing the NDFI's share. There have been many instances when the NDFI's reserves were withdrawn in times of need.

The second most important mechanism of Washington's maximum pressure strategy is financial sanctions. US policy is focused on hurting Iran indirectly by targeting those doing business with Iran. While this is intended to impact Iran's trade and commercial activities, here too Iran has gained crucial - albeit occasionally costly - experience in circumventing such sanctions prior to 2015. Additionally, a special purpose vehicle (SPV), which the **EU introduced** in September 2018, is basically a 'clearing house' that allows European companies to bypass the sanctions because it does not require monetary transfers between EU countries and Iran. The SPV is, in fact, the EU's way out for Iran.

In short, Iran's oil revenues are diminishing, its dollar transactions are in jeopardy and it is facing growing economic and political pressure in and outside the country. Yet there are also pros to the

situation. Iran is not alone in confronting US sanctions this time around and is even getting help from the US' closest allies. It also has over \$100 billion in reserves in its Central Bank. Although the country will suffer, it will likely weather the storm. If that happens, then Khamenei's claim that the US' role in the world is diminishing may have merit.