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Iran: Rising Power in the Middle East
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"The JCPOA and the status of the 5+1's commitments"

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A BRIEF OVERVIEW OF THE SANCTIONS

Years before the UN sanctions, the United States imposed sanctions on Iran following the hostage crisis in 1979, blocking all Iranian Government property in the United States.[1] Since then, the objectives of U.S. sanctions against Iran have evolved over time. Most of the initial 1979 sanctions were lifted at the end of the hostage crisis and assets were released following the Algiers Accord. Based on the Accord, the U.S.-Iran Claims Tribunal was established to arbitrate cases as the result of break in relations between the two countries in 1980. All private claims were settled by 2000. In 1991, George H. W. Bush Administration paid $278 million to Iran settling part of the Foreign Military Sales (FMS) cases of Iran against the United States. In January and February 2016, U.S. settled some more cases for FMS paying Iran $400 million for the balance and $1.3 billion in accrued interest. Due to regulations limiting Iran's access to U.S. Dollars, the payments were sent in cash provided by European banks.

In mid-1980s, the United States began imposing new sanctions against Iran for strategic reasons, including prohibition of weapons sales and all U.S. assistance to Iran. In 1995 and 1996, President Clinton and United States Congress imposed additional sanctions on investment in energy sector,[2] imposing penalties on any third country firms investing more than $20 million a year in the development of Iran's oil and gas fields.[3] The U.S. Administration also banned U.S. trade and investment in Iran.[4] In 1997, U.S. companies were prohibited from knowingly exporting goods destined to Iran through other countries.[5] During the subsequent years, the sanctions were considerably expanded to include contracts to lead the construction, upgrading, or expansions of energy projects; sale of gasoline; provision of equipment or services for oil, gas and petrochemical production; transporting Iranian crude oil; insurance or reinsurance for Iranian oil entities including National Iranian Oil Company (NIOC) and National Iranian Tanker Company (NITC); and purchases of Iranian bonds. The U.S. sanctions on Iran's energy sector were also expanded to other Iranian industries aimed at preventing foreign investment in Iran. Many foreign firms from Europe, Asia, Russia and China were penalized and fined for violating the above-mentioned sanctions. In 2010, the U.S. trade ban against Iran was codified and a full ban on imports of Iranian nuts, fruit products, carpets, and caviar were reinstated.[6]

The UN Security Council, starting as of 2006, took up the question of the Iran nuclear file, and passed its first resolution on the case, under Chapter 7 of the UN Charter, and demanded that Iran suspend all enrichment related and reprocessing activities.[7] Iran rejected the Security Council demand and the first nuclear-related sanctions against Iran were imposed. The Security Council decided that the sanctions will be lifted once Iran meets the demands of the Council and fulfills the requirements of the

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[1] Executive Order 12170, November 14, 1979.
[2] Executive Order 12957, March 15, 1995.
[3] The Iran and Libya Sanctions Act (ILSA), signed by President Clinton on August 5, 1996, later in 2006 retitled to Iran Sanctions Act.
[4] Executive Order 12959, May 6, 1995.
[5] Executive Order 13059, August 19, 1997.
[6] Section 103 of the Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010 (CISADA, P.L. 111-195).
[7] Security Council Resolution 1696, on July 31, 2006.

IAEA Board of Governors.[8] The sanctions banned the supply of nuclear-related materials and technology to Iran and froze the assets of individuals and companies related to the program. Six more Security Council resolutions strengthened the global sanctions and monitoring regime against Iran.[9]

As demanded by the United Nations Security Council resolutions, the European Union, Switzerland, Australia, Canada, Japan, South Korea and others drafted internal regulations imposing sanctions against Iran. The sanctions by the European Union were mostly initiated in 2007 after the UN Security Council nuclear-related resolutions. In summary, the UN resolutions resulted in sanctions and restrictions in the following Iranian sectors:

- Nuclear (including monitoring movement of individuals involved with the nuclear program)
- Arms, military and defense
- Energy and petroleum
- Financial and banking services (restricted activities of Iranian banks and financial institutions, including prohibition on the opening of Iranian banks on UN member states territory; freezing assets of Central Bank, named entities and individuals, banks and the national shipping line; cutting off connection to electronic financial system of SWIFT for all Iranian banks; and preventing financial institutions from opening offices and accounts in Iran)
- Shipping & Transportation (restricted activities of Iranian shipping enterprises and aircrafts, including inspection of cargo and denying services to Iranian vessels involved in prohibited activities)
- Insurance (including shipping insurance for cargo to/from Iran)
- Trade, investments and other economic activities

IMPACT OF THE SANCTIONS ON IRAN

The intention behind the sanctions was to penalize Iran for lack of cooperation with the demands of the Security Council resolutions, and in the final analysis, exerting severe economic pressures on the Iranian economy, with the ultimate hope of forcing the Iranian government into an agreement. Indeed, the sanctions against Iran were unprecedented in IAEA history for a member of NPT. Iran faced challenging social and economic effects as the result of the sanctions. Iran's access to products needed for the oil and energy sectors was reduced and many oil companies withdrew from Iran. As the result of reduced access to efficient technologies, Iran also experienced a decline in oil production. With tightened sanctions and extension of the EU ban to ship insurance, major supertanker companies stopped loading Iranian cargo. The insurance ban affected 95% of the tanker fleet. As a result, Iran faced problem in finding customers for about 25% of its oil exports. While the level of oil export in December of 2011 was about 2.2 million bpd, it dropped to 860K bpd in September 2012. The result was a considerable increase in the rate of inflation due to sharp drop in revenues and sudden massive drop of local currency's value. Iran's oil income was further reduced by the increasing costs of obtaining its revenues sidestepping sanctions imposed on Iran's access to banking transactions.

After the Iranian banks were cut off from SWIFT, Iran was forced to accept only cash or gold, making it very difficult to sustain an economy dependent on exporting oil. Moreover, restrictions were imposed on the exports from Iran, limiting its access to further revenues. International companies were also reluctant to do business with Iran for fear of secondary sanctions imposed by the United States which meant losing access to U.S. markets. The actual effects of these measures put together meant more expensive basic goods for people in Iran and huge profits for enterprises friendly with the powers

[8] Security Council Resolution 1737, on December 23, 2006.
[9] Security Council Resolution 1747 (March 24, 2007), 1803 (March 3, 2008), 1835 (September 27, 2008), 1929 (June 9, 2010), 1984 (June 9, 2011), 2049 (June 7, 2012).

that be, as strong connections were required to get around the sanctions by smuggling. Socially, the effects are still felt in Iran, as the trials for blundering of hundreds of billions of dollars by people close to the previous administration officials are still underway.

With growing structural problems in its economy and massive mismanagement of the previous administration, Mr. Rouhani was voted into office in 2013 on the campaign promise of giving the priority to economic growth and progress. The new positive outlook of the Rouhani Administration – spearheaded by Minister Zarif – resulted in limited sanctions relief on November 24, 2013 (JPOA), and delivered the landmark nuclear agreement with the 5+1 countries after two years of diplomatic negotiations.

COMMITMENTS BY 5+1 FOR SANCTIONS RELIEF

The United Nations Security Council in its Resolution 2231 (July 20, 2015) unanimously endorsed the Joint Comprehensive Plan of Action (JCPOA). The resolution provides for the termination of the provisions of previous Security Council resolutions on the Iranian nuclear case. Member States are obligated under Article 25 of the Charter of the United Nations to accept and carry out the Security Council's decisions. The 159 page JCPOA is a very complex document. All nuclear-related sanctions against Iran were to be removed when the agreement took effect in January 2016.

In its latest report to the Parliament (Majlis), the Government of Iran noted that since the implementation day, many of the commitments by 5+1 have been implemented and there is a steady improvement in the overall situation:

1. Iran had received back most of its funds blocked by the sanctions. **There are still some minor interruptions in the financial transfer and exchange due to limitations on Iran's access to the US Dollar.**
2. The banking relationship between Iranian and foreign banks have improved, **but obstacles remain**. Smaller banks in Europe with limited US operations have already started cooperation. **But, the larger banks in Europe and Asia with considerable US operations are not yet assured of financial and regulatory penalties by the US if they resume their operations with Iran.**
3. The cooperation of the central bank in Iran with the central banks of the European countries has started and is improving. Due to limitations on Iran's access to US Dollar, countries such as **Japan and South Korea are awaiting further clarification from US Treasury before normalizing their relationship.** At the moment, they transfer their local currency to European banks to be paid in Euro to Iran.
4. The sanction on connectivity of Iranian banks to SWIFT network has been removed and normal operations have been resumed.
5. The issuance of LOC between Iranian and foreign banks have been normalized, reducing the heavy reliance of Iranian importers and exporters on obtaining services from banks in Dubai.
6. Bank accounts for receiving the revenues for the sale of oil and petroleum products have been opened in many countries, reducing the heavy costs borne by Iran while sanctions were in place.
7. The export insurance issues with European companies have been resolved and normalized.
8. OECD reduced Iran's risk factor by one point in the last three months, and is expected to reduce it by another point, making it 5 at the end of October, reducing the costs for trade and investment.
9. The obstacles in insuring Iranian ships carrying oil, petroleum products and other exports have been removed and they are now in the process of being insured by major European companies. The initial obstacles on this issue were removed by a special license by OFAC.

10. Iran is getting back its old oil and oil products customers, and new customers are being added. The export of oil rose from less than a million BPD in December 2015 to more than 2.2 million BPD in September 2016. In the past 5 months, the oil production has returned to its pre-sanctions level of about 4 million BPD. All issues relating to oil-related equipment belonging to Iran but not delivered due to sanctions have been resolved.
11. Exports of petrochemicals have increased by close to 40%.
12. More than 700 individuals, companies, planes and ships have been removed from the sanctions blacklist.
13. Sale of parts and services for non-military planes has been authorized. On September 21, OFAC issued licenses to Airbus for delivery of 17 and to Boeing for delivery of 80 airliners. The French-Italian Company ATR waits for its OFAC license to sell 20 turboprop aircrafts to Iran Air. It is still not clear how the aircraft purchases will be funded and financed through major European banks.
14. Export of carpet and food items from Iran to the United States has been authorized.
15. All nuclear-related sanctions by other countries, such as Australia, Canada and Japan, have been removed.

CHALLENGES

<u>1 – Explicit license by U.S. Treasury</u>

Impact of U.S. primary sanctions against Iran beyond “nuclear issue” is of major concern to major international financial institutions. Small and medium-sized international banks and financial institutions do not have the means or experience for financing large projects such as purchase of airplanes or development of infrastructural projects. Such financing could generally be done by major international banks, which thus far have been reluctant to resume normal banking and currency exchange relations with Iran without explicit legal clarification and license from OFAC. They are concerned with possible punitive measures and retaliatory US penalties if they resume their cooperation with Iran without proper US government assurances. As reported, major international banks have paid in the order of $15 billion in penalties to the US Treasury for their cooperation with Iran in the past and therefore appear to be quite concerned about similar U.S. penalties in future.

Iran believes that the current atmosphere of distrust and concern by the major international banks has been created by the United States and more efforts are needed to create a positive atmosphere. Iranian officials point out that paragraph 24 of the JCPOA requires the United States to remove any restrictions that prevent Iran from obtaining the full benefits of sanctions relief. The State Department claims that legal authorization has been issued by the President, but OFAC contends that they cannot issue a general license to banks for their cooperation with Iran. Claiming undue delays by the U.S., Iran has called for issuance of individual licenses to the international banks and financial institutions if OFAC cannot issue a general license. OFAC asserts that issuing individual authorization and license will depend on many factors. Claiming the process to be time consuming, OFAC has not yet issued any individual license to major international banks. Moreover, European banks are also concerned with the outcome of the US presidential and congressional elections and do not appear to proceed without explicit assurances from the United States.

<u>2 – International banking standards</u>

Iran has been isolated from the international banking system for more than 10 years, creating new challenges for the Iranian banks and financial institutions. During the past ten years, international banking standards and regulations have changed considerably. Iran is in the process of modernizing its financial regulations to comply with modern international banking standards, including those on money laundering. The Ministry of Economy and Finance in Iran has been consulting with Financial Action Task Force (FATF) to update its laws meeting the required standards. Cooperation with FATF has recently become a high-profile contested political issue, including at the Majlis, and is keenly pursued by the same politician and political currents opposed to JCPOA and President Rouhani.

3 – Access to US Dollars

Most of international financial transactions are done with US Dollars, requiring the transactions to be cleared through the US banking system. Since the primary sanctions remain in force, Iran is barred from using US Dollars, making it more difficult for its trade with other countries. Additionally, Iran has experienced problems in obtaining its funds in U.S. Dollar from other banks. Last month, State Department tried to resolve the situation with a temporary lift of the current regulations to give a short period for the transfers to take place. But, the news leaked and the administration decided not to pursue it at the time.

During the nuclear negotiations, there were three exceptions to maintaining primary U.S. sanctions against Iran. These included sale of civil aircrafts and export of carpets and food items to the United States. Iran had asked to include the primary financial sanctions in the agreement, but the U.S. side disagreed. However, as stipulated in the JCPOA, the U.S. is obligated to remove all obstacles for the proper implementation of the sanctions relief. Earlier this year, U.S. Treasury Secretary suggested licensing foreign clearing houses to acquire US dollars, facilitating transactions with Iran.

On October 7, OFAC issued new guidelines, clarifying the scope of the sanctions, stating that non-U.S. banks can do US Dollar trades with Iran, but transactions should not pass through financial institutions in the United States. Although U.S. had maintained that the sanctions relief measures implemented in January 2016 technically allowed international trade with Iran using U.S. Dollar transactions, non-U.S. bank feared retaliatory actions by the U.S. authorities. It is a signal by U.S. administration that they want the nuclear deal to be effectively implemented. The concern on the Iranian side is that despite the new clarification, major international banks might decide to maintain an over-compliance policy and wait for more consistency in implementation of JCPOA out of fear of punitive measures by other U.S. agencies such as DOJ. Clearing US Dollar transactions without passing through financial institutions in the U.S. will no doubt pose new challenges for major international banks.

FUTURE PROSPECTS

As is well-known, there are forces against the nuclear agreement - in Iran, in the United States, and in countries in the Greater Middle East. Those who benefitted from the previous state of affairs, either financially or otherwise, are willing to do all they can to either totally derail this agreement or, failing that, prevent its effective implementation. In the United States, the political posturing during the presidential and congressional elections restrains the current administration from taking actions to strengthen the agreement. During this contentious election rhetoric, President Obama seems to be reluctant to take further steps before November 8th. Meanwhile, in Tehran those against the agreement and policies of the Rouhani Administration claim that U.S. cannot be trusted to remain true to its commitments. Smooth implementation – and the ultimate success of the agreement will no doubt benefit everybody; Iran and the 5+1, the Middle East region in its entirety, and even the world at large. Its implementation would help improve relations between Iran, and the international community, inclusive of the surrounding region, strengthens stability in the Middle East region, and – also as a corollary, lead to economic growth. A year after the JCPOA was agreed to in Vienna, both United States and Iran issued statements on July 14, 2016, reaffirming their commitments to ensure its success.

Sanctions had severe adverse impact on Iran's economy. Lifting of the sanctions and improving the economic situation constituted one of the main objectives of Iran throughout the negotiations, and still continues to be of paramount importance. However, since January 2016, when the implementation went into effect, the lifting of sanctions has not benefitted Iran's economy as expected. Post-JCPOA, Iran expected to achieve 8% expansion in its economy, given its economic potentials and highly-educated and skilled workforce. However, due to slow return of investors in the absence of OFAC assurances, and low oil prices, IMF estimates the growth to be around 4.5% during the current Iranian calendar year.

The United States is criticized for deterring companies and investors from entering Iranian market. Iran believes that while the legal and political foundations of sanctions have been removed, the United States has fully kept the primary sanctions in force, preventing the practical removal of the secondary sanctions that were to be lifted. The State Department claims that they are implementing their commitments and working on the problems mentioned by Iran. They point out, however, that it would take time to resolve all outstanding problems. President Obama has signed the legal orders to end the nuclear-related sanctions. The European Council of Ministers has also passed the required legislation. But, removing the current negative atmosphere in financial interactions requires positive action by the US Government – by OFAC. Through devising innovative ways to assure the major international banks, OFAC can maintain the momentum of progress and increase the confidence of the international community on the future of this agreement.

For Iran, difficulty in the smooth – and expected – implementation of deal would work against President Rouhani. Congressional actions in limiting Iran's access to economic and financial benefits from this agreement has hurt Rouhani and instead played into the hands of the opponents of the deal. The President has been – and is – criticized for not being able to deliver the expected benefits from the deal limiting Iran's nuclear capabilities. The unfortunate situation is that the conservatives in both Iran and the U.S. have been trying to constrain, to the extent possible, the effective implementation of the hard-won agreement. Rouhani has about eight months before the next presidential election in Iran to demonstrate the tangible benefits of the agreement to the people.

Looking to the future, and in all fairness, it is to everybody's benefit to do all possible to ensure proper implementation of the agreement. Beyond tangible economic and trade benefits, the deal's execution will also serve the aims and objectives of non-proliferation and peaceful resolution of disputes among nations. Its failure, and even lackluster implementation, will instead strengthen the voice and weight of hardliners who favor the maintenance of hostility in the region and against resolving issues through diplomacy. Defending the agreement among the 5+1 and Iran, President Obama said "The choice we face is ultimately between diplomacy or some form of war. Maybe not tomorrow, maybe not three months from now, but soon."[10]

This agreement, an achievement for President Rouhani, is also the most significant foreign policy accomplishment of President Obama, led by Secretary Kerry. For the legacy to be saved and maintained, it needs to be implemented effectively. Even if somehow restrained in taking major actions to this end under the circumstances, Barack Obama will undoubtedly have the opportunity to make it a lasting legacy after the elections and before the end of his term, regardless of who will be the next President of the United States.

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[10] Reuters, "Obama defends Iran nuclear deal as diplomacy winning over war," August 6, 2015, http://www.reuters.com/article/us-iran-nuclear-obama-idUSKCN0QA1MG20150806.