Iran-South Korea Humanitarian Trade Requires U.S. Assurances

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Brief Analysis

Tehran is pressing Seoul regarding the billions in Iranian oil revenues held by South Korean banks, creating an opportunity to expand the U.S. humanitarian trade mechanism.

On July 21, South Korea's Foreign Ministry summoned the Iranian ambassador to lodge a complaint over Tehran's heightened rhetoric regarding access to funds frozen in South Korea. The week before, Iran's Foreign Ministry spokesperson had accused Seoul of having a "master-servant relationship" with Washington, while the governor of the Central Bank of Iran (CBI) had previously threatened legal action to access the funds, which Tehran says it plans to use for humanitarian purchases.

Although the U.S. government authorized use of the funds for such purposes in February, South Korean banks appear hesitant to move forward without **additional U.S. assurances (https://www.washingtoninstitute.org/policy-analysis/view/sanctions-relief-isnt-necessary-to-assist-irans-coronavirus-response)** —a reluctance compounded by the $86 million fine that U.S. regulators levied on the Industrial Bank of Korea (IBK) in April for failing to identify large-scale Iranian money laundering. With COVID-19 cases on the rise again in the Islamic Republic, Washington should work with Seoul to ensure that trade for medicine, equipment, and other humanitarian items moves forward—albeit with strict oversight.

FROZEN FUNDS, FROZEN TRADE

According to the chairman of the two countries' joint chamber of commerce, South Korean banks hold between $6.5 and $9 billion in Iranian revenues from oil sales to Seoul. Under U.S. sanctions waivers between 2013 and 2015, and for a brief period following the reimplementation of sanctions in late 2018, trading partners were able to continue importing Iranian oil as long as they held the revenue in accounts that were denominated in local currency (in this case the won), and used it solely to finance bilateral trade. By the time the Trump administration ended the oil waivers in May 2019, Seoul had already halted energy trade with Tehran, and the CBI's won-denominated accounts at the two institutions used for such transactions—IBK and Woori Bank—were largely inactive.

Despite months of U.S.-Korean consultations on permissible trade with Iran, humanitarian exports and overall trade between the two countries has been minimal. A $500,000 shipment of pharmaceuticals in May appears to have been a one-off, executed under the U.S. general license issued in February. South Korean officials have said they want to establish a mechanism similar to the Swiss Humanitarian Trade Arrangement (SHTA), which Bern and Washington inaugurated in January after more than a year of negotiations in order to ensure "transparency into humanitarian trade with Iran." But Tehran is increasingly desperate to access its foreign reserves and has been pressuring Seoul to provide access immediately.

STRAINED ECONOMIC AND FINANCIAL RELATIONS

Before international sanctions on Iran intensified, South Korea was one of the country's largest trading partners outside the Middle East and its fourth-largest oil customer. Following the 2015 nuclear deal, bilateral trade reached $12 billion in 2017, including $4 billion in South Korean exports. Yet these exports dropped to under $300 million last year and have totaled just $90 million in the first half of 2020, according to Korean customs data.

Nonetheless, Tehran is still interested in Seoul's high-quality goods, particularly pharmaceuticals, consumer electronics, and appliances, including those with medical uses. For their part, Korean firms have sought to maintain a presence in Iran and secure future market access despite the resumption of U.S. sanctions. Samsung and LG, for example, continued to provide parts, services, and app store purchases to Iranian clients as recently as February, when they withdrew due to U.S. restrictions on Iranian bank transactions.

As in other jurisdictions, South Korean banks fear running afoul of U.S. sanctions. In this April's IBK case, the bank was heavily fined after it failed to identify and report a $1 billion Iranian sanctions evasion and money laundering scheme. Notably, in 2011, American businessman Kenneth Zong and other figures used Iran's won-denominated IBK escrow accounts to finance sham trade transactions, with fronts in South Korea, Iran, and the United Arab Emirates converting the money into U.S. dollars before wiring it to Iranian officials across the globe. Zong was indicted on forty-seven counts of violating U.S. sanctions; federal and New York authorities also concluded that IBK had failed to establish sufficient compliance systems despite being warned to do so in 2014.

IRAN'S HUMANITARIAN NEEDS

In March, South Korea's Foreign Ministry stated that it was considering a resumption of humanitarian trade after Iranian president Hassan Rouhani wrote to his Korean counterpart, Moon Jae-in, requesting COVID-19 test kits and other support to stem the pandemic. Tehran also blamed U.S. sanctions for obstructing it from obtaining humanitarian goods; in a March 12 letter to the UN secretary-general, Foreign Minister Mohammad Javad Zarif argued that Washington's restrictions had "stymied" Iranian efforts to identify and treat COVID-19 patients.

At the same time, Iran rebuffed U.S. offers of medical assistance, and dozens of governments across the world have successfully sent aid there over the course of the pandemic. In addition, recent reports indicate that the World Bank tentatively approved a $50 million loan for Iran's Health Ministry via the World Health Organization earlier this month, though the funding may face U.S. opposition. Washington also opposes Iran's request for a $5 billion IMF loan, which is currently pending further assessment of the country's debt sustainability and balance of payments needs.

Regardless of Iran's accusations and the ultimate fate of its loan requests, one thing is clear: the country is not self-sufficient in producing medicine or medical devices despite considerable domestic capacity. Iranian firms account for 70 percent of its pharmaceutical market and 30 percent of its medical equipment, but the country must import many of the raw materials used to produce these goods, as well as more advanced pharmaceuticals that it is not able to manufacture at home. Separately, much like other governments coping with the pandemic, Tehran has reported supply chain issues and shortages in test kits, ventilators, and protective equipment. Accessing the hard currency needed to finance such imports is increasingly under the CBI's control, since Iranian exporters must return 70 percent of their hard currency earnings to the bank.

U.S. SUPPORT FOR HUMANITARIAN TRADE

Recognizing the reluctance of firms and financial institutions to work with Iran and the myriad risks they face in doing so, the U.S. government took two concurrent steps last October: introducing a mechanism to ensure enhanced transparency for humanitarian trade, and finalizing a so-called "311 finding" that named Iran as a jurisdiction of primary money laundering concern. Pointing to the country's systematic obfuscation of illicit financial activity **(https://www.washingtoninstitute.org/policy-analysis/view/fatfs-approach-to-iran-should-mix-engagement-with-pressure)** , the framework laid out enhanced due-diligence requirements for firms and financial institutions to engage in allowable humanitarian trade. In turn, Washington committed to provide positive, written confirmation for all such transactions that complied with U.S. sanctions.

Initially, however, only Switzerland took advantage of this framework. The SHTA, finalized pursuant to the mechanism, conducted a "trial" transaction in January for the sale of $2.6 million in cancer and organ transplant medications to Iran. The next transaction did not come until July 27, when Bern announced a non-trial sale of unknown value. In response to this dearth of activity, the Swiss Foreign Ministry explained earlier this month that transactions were being delayed as companies shifted priorities due to the pandemic. For example, the firm Novartis participated in the January sale, but it is now focused on preparing to manufacture a potential COVID-19 vaccine under development by a consortium of U.S. hospitals. As the firm pointed out, the Swiss channel was negotiated well before coronavirus emerged, as a way to "improve Iranian patient access by increasing the predictability and stability of the future supply of medicine to Iran"—it was not designed to respond to a global pandemic.

South Korea's interest in establishing a new, won-denominated channel may help offset this limitation and meet the more immediate needs of the Iranian people and their medical system. As the Zong case demonstrates, banks holding Iranian funds have reason to be cautious, and Tehran will hopefully reflect on how its misuse of some South Korean accounts has clouded the relationship. Nevertheless, if humanitarian trade transactions go forward, the conditions laid out in the U.S. mechanism would apply only to the South Korean firms—they would not require a corresponding Iranian mechanism, unlike the EU-backed Instrument in Support of Trade Exchanges (INSTEX). Establishing a humanitarian channel subject to U.S. Treasury oversight is the best chance to ensure that these trade flows are not exploited, and the United States should work quickly to take advantage of this opportunity.

Katherine Bauer is the Blumenstein-Katz Family Fellow at The Washington Institute and a former official at the U.S. Treasury Department. Kevin Mathieson is a research assistant in the Institute's Reinhard Program on Counterterrorism and Intelligence. ❖

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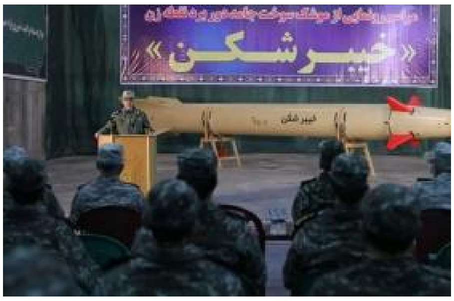

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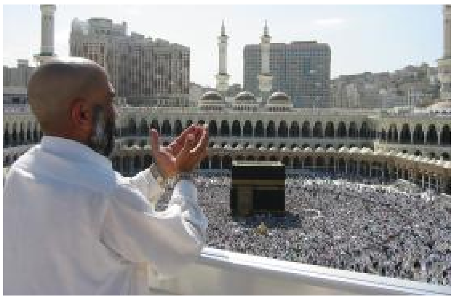

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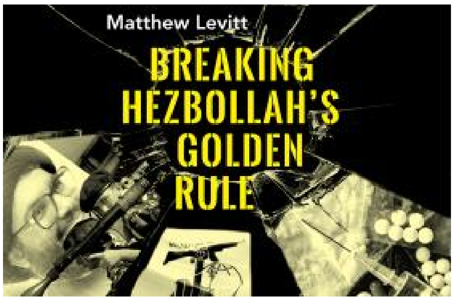

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