Renewing the Iran Sanctions Waivers (Part 2): Energy and Afghan Trade

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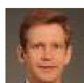

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Brief Analysis

Washington should phase out the oil waivers carefully and prevent Chabahar port from becoming an escape valve for Iran.

This PolicyWatch is the second in a two-part series on how Washington should handle the upcoming waiver deadlines. Part 1 examined ***(https://www.washingtoninstitute.org/policy-analysis/view/renewing-the-iran-sanctions-waivers-part-1-nuclear-activities)*** *the U.S. waiver toolkit and how it applies to Iran's nuclear program.*

Of the nine nations that have received waivers exempting them from U.S. energy sanctions on Iran, the one with the most at stake is Iraq. Starting last November, Washington has given temporary waivers allowing Baghdad to purchase natural gas and electricity on three occasions, once for forty-five days and twice for ninety days. These have been conditioned on the country developing a plan for **reducing its dependence on Iranian supplies (https://www.washingtoninstitute.org/policy-analysis/view/designing-win-win-economic-policies-in-washington-and-baghdad)** . That requirement aligns with Iraq's longstanding goal of installing more power generation capacity, as well as capturing the gas it wastes through flaring in order to provide fuel for power plants.

Accordingly, rather than approaching the waiver issue as a matter of Iran policy, the Trump administration would be better served framing it as a means of helping Baghdad achieve its own energy objectives more quickly. The government has already made much progress in capturing flared gas with help from Shell's nearly $2 billion investment in the Basra Gas Company, but further progress has been blocked by continued imports from Iran and stubborn bureaucratic obstacles.

SOME OIL WAIVERS STILL HAVE TEMPORARY VALUE

While the Iraqi power sector is highly regulated, its oil supplies are traded by companies on the free market. This fits poorly with a model in which secret U.S. waivers regulate how much oil a given country can import from Iran.

The situation is different for the eight nations evidently granted 180-day oil waivers last November: China, Greece, India, Italy, Japan, South Korea, Taiwan, and Turkey. Secretary of State Mike Pompeo has just announced that these waivers will not be extended once they expire on May 2; when they were granted last November, the decision was based on concern that oil markets would be perturbed without them, perhaps spiking prices to Iran's considerable benefit.

Yet world crude prices are up by about 40 percent since their December lows and could rise further this summer as demand grows. Saudi Arabia and the United Arab Emirates have pledged to increase output; if they raise production to the levels agreed by OPEC in late 2018, that would bring an additional 0.8 million barrels per day (mb/d) to market, wholly making up for the loss of Iranian oil (Tehran will presumably continue exporting at least a fraction of its current 1 mb/d even if all waivers expire). At the same time, oil markets are tight, and U.S. gasoline prices could go up just as Americans hit the road on summer vacations. Had the administration granted one more round of waivers and waited until next November to let them expire, it could have counted on additional pipeline capacity bringing more than 1 mb/d of Texas oil to market. In all, the global market should be better supplied at year's end unless production collapses in other key countries besides Venezuela (e.g., Libya and Algeria bear watching).

That said, the arguments for ending the waivers are certainly understandable. Firms in at least two of the countries receiving them—Greece and Italy—have not used them at all, so canceling those would have no significant economic impact. South Korea and Japan were already adjusting to the prospect of no Iranian oil last year, so ending their waivers should not disturb markets. Indian, Chinese, and Turkish firms have good alternatives to Iranian oil. So why extend these exemptions, even temporarily?

The challenge in letting all waivers expire immediately is how to preserve crucial political cooperation with the affected countries, particularly the latter three. Among the many issues that Washington wants their help with, each country is positioned to facilitate the U.S. agenda on Iran: Turkey by cooperating with restrictions on Iran's use of the U.S. dollar, India by preventing the regime from using Chabahar to skirt restrictions on other Iranian ports, and China by strictly monitoring nuclear material used in Tehran's redesigned Arak facility.

In July 2018, Supreme Leader Ali Khamenei's official website expressed support for President Hassan Rouhani's warning that "if Iran's oil is not exported, no regional country's oil will be exported." Specifically, Rouhani's words were described as "important remarks that reflect the policy and the approach of [Iran's] system." Rouhani then repeated the warning in December. U.S. officials should take note of such threats, carefully reviewing plans for the unlikely possibility Iran tries to make good on them. Besides the military component, those plans could include making up for potential closure of the Strait of Hormuz by releasing 4 mb/d from the Strategic Petroleum Reserve and helping Persian Gulf countries urgently expand their pipeline capacity. Currently, Gulf oil exports total 15 mb/d (5.9 mb/d Saudi, 3.4 Iraqi, 2.3 Kuwaiti, 2 Emirati, .25 Qatari, .20 Bahraini, and 1 mb/d in overall natural gas liquids), but pipelines carry only 7 mb/d of that amount (4.8 Saudi, 1.5 UAE, .7 Iraqi).

CHABAHAR PORT

The waiver for the Iranian port of Chabahar has been almost completely off the radar screen, but it requires careful handling. Located in eastern Iran on the Arabian Sea, Chabahar is less than 600 miles from the Afghan border, which is closer than any major Iranian city. In announcing the exemption for the port and a proposed railroad to Afghanistan last November, the State Department spokesperson said, "This exception relates to reconstruction assistance and economic development for Afghanistan," the exact language in section 1244(f) of the Iran Freedom

and Counterproliferation Act.

The exemption is of particular interest to India. The company India Ports Global Limited manages Chabahar port, and New Delhi is investing $500 million to develop it as a route for trade with Afghanistan. Indian officials have also pledged to donate 1.1 million tons of wheat to Afghanistan, and seven deliveries have already been made through Chabahar.

A waiver to permit such food trade certainly serves U.S. interests, as would allowing Afghanistan to import refined petroleum products from Iran. Pakistan has long used its central role as a transit country to Afghanistan as a lever for pushing Washington to ignore its tacit support for the Taliban. Helping India broaden the transit options would likely feed Pakistani paranoia about its enemy's ambitions in Afghanistan and curtail assistance to the Taliban.

So far, Chabahar is little used for Iranian trade; last year, it handled only 2.1 million tons, or 2 percent of the country's overall trade, while its maximum capacity is only 8.5 million tons. Yet Chabahar has a fifty-four-foot draft, making it the lone Iranian port suitable for the 250,000-ton ships used so widely for international trade. Thus, Washington should consider locking the door before the horse bolts, specifying that the waiver is restricted either to the port at its present size or to Afghan trade alone.

NEXT STEPS

As with the nuclear issue, the debate about energy and port waivers would be better informed if all of them were published. While the current waivers have served U.S. interests, they would work better going forward if they were appropriately revised. Ending the oil waivers runs some risks in terms of keeping energy markets stable and ensuring continued international cooperation on other areas of Iran policy. As for the Chabahar port waiver, it should be restricted so that it does not become an escape valve for Iran. Finally, Baghdad's gas and electricity waivers should be tweaked to fit within a tight timetable for Iraqi energy independence.

Patrick Clawson is the Morningstar Senior Fellow and director of research at The Washington Institute. ❖

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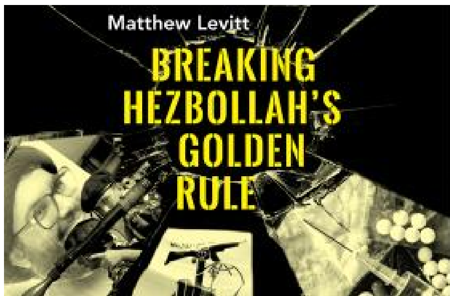

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