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THE EU'S SANCTIONS REGIME AGAINST IRAN IN THE AFTERMATH OF THE JPA

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SUMMARY

Four months after the E3+3 agreed an interim deal on Iran's nuclear programme, critics who warned that limited sanctions relief offered to Tehran would undermine the sanctions architecture have been proven wrong. All parties, including EU member states, have maintained pressure exerted on Iran through the sanctions regime. Although European companies are interested in the Iranian market, they still overwhelmingly fear the chilling effect of sanctions and have remained reluctant to do business with Tehran. In fact, Iran's economic recovery and integration into the global financial system has been less than envisaged, mostly due to the difficulties faced by the EU in practically implementing part of the limited relief granted in the interim deal.

Iranian President Hassan Rouhani is likely to face increasing domestic criticism for making too many concessions and will struggle to keep up Iran's side of the nuclear pact if the incentives obtained through the engagement with the six powers remain limited. The EU should therefore work to overcome the challenges faced in fully implementing its obligations under the interim agreement. Otherwise, it will be perceived by Tehran as being unable to deliver on sanction relief in light of a final deal, not unlike the United States. At a critical moment in the negotiations between the E3+3 and Iran, this could risk undermining the six powers' diplomatic leverage over Tehran.

Since an interim agreement was signed between the E3+3 (France, Germany, and the United Kingdom, and China, Russia, and the United States, also known as the P5+1) and Iran in November, European companies have demonstrated their interest in re-entering the Iranian market. Under the Joint Plan of Action (JPA), in return for Iran's commitment to limit the most sensitive parts of its nuclear activities, the E3+3 granted Tehran some "limited, targeted, and reversible" sanctions relief. Since then, many European companies, particularly those that operated in Iran before the sanction regime, have visited Tehran. The initial activism of European firms has been seen by some as a sign that these concessions to Iran undermined the leverage of the E3+3 in talks with Tehran.

This policy memo argues, however, that the JPA has not so far translated into new openings for economic relations between Iran and the EU countries, nor did it cause the collapse of the international sanctions regime against Iran. It argues that the real concern is that the EU's failure to practically implement part of the limited sanctions relief included in the JPA package could undermine Iran's confidence in the ability of the E3+3 to deliver in light of a comprehensive agreement. This could in turn make it harder for the Rouhani administration to constructively pursue talks with the E3+3.

EU sanctions against Iran

Since the referral of the Iranian nuclear dossier to the United Nations Security Council (UNSC), in March 2006, the EU and the United States have pursued a dual-track strategy combining diplomacy and economic pressure. While sharing American concerns about Iran's nuclear ambitions, EU member states were reluctant about isolating the country economically and politically, given the comparatively stronger economic ties and Iran's geographic location at Europe's periphery. Until 2010, the European Council limited its measures to implementing all UNSC resolutions within the European territory, targeting persons and entities linked to Iran's nuclear programme, and subjecting them to travel restrictions and asset freezes.¹ But from 2010 onwards, the EU joined the US in increasing pressure on Iran through "comprehensive" unilateral restrictive measures that went far beyond the scope of the UNSC resolutions. In June 2010, the EU introduced its first set of unilateral measures against Iran, for the first time targeting activities not directly related to the Iranian nuclear programme.² Over time, EU sanctions have become nearly as extensive as those of the US.

Between January and October 2012, Brussels ratcheted up sanctions against Iran, adopting measures targeting Iran's energy and financial system, hitting the country's financial capacity by curtailing the revenues coming from the energy sector, and isolating its financial system with the aim of "strongly increas[ing] pressure on the Iranian government".³ The Foreign Affairs Council imposed a full import embargo on Iranian crude oil and petrochemicals; froze the assets of the Iranian Central Bank within the EU; banned companies in Europe from providing insurance for shipments of oil or petrochemicals from Iran; cut off all Iranian banks blacklisted by the EU from the Society for Worldwide Interbank Financial Telecommunications (SWIFT); banned all transactions between European and Iranian banks, unless authorised in advance; and barred imports of Iranian natural gas and the trade of diamonds and precious metals with Iran.⁴

Until 2010, European countries were Iran's major trading partners. In particular, prior to the entry into force of the oil embargo in 2012, EU purchases of Iranian oil amounted to nearly 600,000 barrels per day – roughly 90 percent of total goods the EU imported from the Islamic Republic. Greece, Spain, and Italy respectively imported more than 10 percent of their total oil consumption from Iran. EU exports of

machinery, transport equipment, manufactured goods, and chemicals accounted for about a third of Iran's total imports. Since 2010, a majority of Western firms have divested from Tehran and European trade with Iran in non-oil-related sectors has also been drastically reduced.⁵ Against this backdrop, the JPA raised the hopes of European businesses that Iran's market could soon be accessible again.

European companies and the Iranian market

In the months following the signature of the JPA, Iranian authorities and domestic media emphasised how the provisions included in the temporary deal were paving the way for European and Western investments in the attractive Iranian market, as well as for the establishment of renewed bilateral economic exchanges with the once-favourite partners. At the World Economic Forum in Davos, in January, Iranian Oil Minister Bijan Zanganeh met Western oil and gas executives and the newly elected President Hassan Rouhani tried to encourage investments from international partners in Iran.

Tehran has also taken concrete steps to incentivise trade and foreign investments: besides organising a number of events and expos in Tehran on the energy sector, entrepreneurship, and business options in a post-sanctions regime, Iran has also scheduled a major conference on oil contracts in London for July. This is a widely anticipated event for Western companies, given that, for the first time, Iran will provide details on the revision of old buy-back contracts in the energy sector, in order to attract foreign investment and technology to the oil industry and foster long-term co-operation.⁶

Several EU member states have expressed interest in renewing trade ties with Tehran in the aftermath of the JPA. In particular, firms that operated in Iran before the sanction regime have been particularly keen to explore new business ventures. For example, in February, more than 100 French companies visited Tehran, including major names such as Total, Renault, and Peugeot, which were among the main car manufacturers and spare parts suppliers in Iran before US sanctions targeted the Iranian automotive industry. France signalled the nature of its renewed interest in the Iranian economy by dispatching an economic attaché to the French embassy in Tehran in January, reversing the decision to cut the embassy's personnel after the storming of the British embassy in Tehran in November 2011.

¹ For a list of the EU's restrictive measures against Iran, see "The European Union and Iran", Factsheet, Brussels, 19 November 2013, available at http://eeas.europa.eu/statements/docs/2013/131219_04_en.pdf.

² Author interview with senior official at the French Ministry of Foreign Affairs, April 2013. Council Decision 2010/413/CFSP concerning restrictive measures against Iran and repealing Common Position 2007/140/CFSP, 26 July 2010.

³ Speech of High Representative Catherine Ashton on Iran and its nuclear programme, European Parliament Brussels, 1 February 2012.

⁴ Council Decision 2012/35/CFSP amending Decision 2010/413/CFSP concerning restrictive measures against Iran, 23 January 2012; Council Regulation 267/2012 concerning restrictive measures against Iran, 23 March 2012. SWIFT is a worldwide financial messaging system that enables interbank money transfers. Iranian blacklisted banks are now banned from clearing banking transactions via this system; Council Decision 2012/635/CFSP amending Decision 2010/413/CFSP concerning restrictive measures against Iran, 15 October 2012.

⁵ For detailed figures on trade in goods between Iran and the EU, see http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_113392.pdf.

⁶ The former buy-back agreements, unpopular even before international sanctions hit Iran's economy, required international oil companies to leave a project after its completion, thereby limiting the companies' capability to invest in long-term co-operation.

A German business delegation also visited the Iranian capital at the end of February, exploring ways to boost bilateral ties, particularly in the fields of energy, food, health, engineering, telecommunications, and agriculture. Belgium sent a high-level trade delegation to Tehran in April to explore efforts to move back into the Iranian market and to develop links with the Iranian mining industry. Italy's business community also demonstrated its interest in widening ties and co-operation with Iran: besides sending a 17-member delegation, including CEOs of top companies from the private sector, and organising a Maserati exhibition in Tehran, Italy could also profit from an important meeting held between Eni's chief executive Paolo Scaroni and Rouhani at the World Economic Forum in Davos.

The large number of foreign delegations' visits to Tehran in the weeks after the JPA's implementation alarmed the advocates of strong sanctions against Iran, particularly those in the US Congress, who argued that the interim deal's concessions were skewed in Iran's favour. Fearing that Europeans – who until 2010 had benefitted from privileged economic relations with Iran – would rush back into the Iranian market as a consequence of the six-month deal, they warned that the modest JPA sanction relief was leading to a rapid erosion of the international sanctions regime and undermining the E3+3's critical financial leverage on Tehran to reach a final nuclear deal.⁷

To assuage their fears, US officials such as the Treasury's Under Secretary for Terrorism and Financial Intelligence, David Cohen, privately and publicly warned international companies not to rush into re-dealings with Tehran, highlighting that economic relations with Iran were not moving towards normalisation as a result of the JPA.⁸ In fact, however, despite the modest relaxation of EU sanctions following the interim nuclear deal and notwithstanding the interest demonstrated by EU companies for returning to the Iranian market, the interim deal has not created new openings for EU trade with Iran – nor is there any sign of an erosion of the international sanction regime in place against Tehran.

What has changed and what has not

Under the JPA, which was meant to buy time towards a comprehensive agreement, the US and EU relaxed some of their unilateral sanctions in return for a commitment by Iran to scale back parts of its nuclear programme. On 20 January, the Foreign Affairs Council formally committed to suspend, over the six-month timeframe of the interim agreement, part of the EU sanctions against Iran implemented between 2010 and 2012. This included:

- The prohibition on the import, purchase, or transport of Iranian petrochemical products.
- The prohibition on trade in gold and precious metals with the government of Iran, its public bodies, and the Central Bank of Iran.
- The prohibition on the provision of insurance and transport to current customers importing Iranian oil (China, India, Japan, the Republic of Korea, Taiwan, and Turkey) provided they maintain their current average amounts of purchases.

The JPA also increased by tenfold all the EU authorisation thresholds for transactions on non-sanctioned trade, including personal remittances, healthcare, and agricultural or humanitarian purposes, such as food and medicine.

To enable the implementation of the temporary sanctions relief described above, the US issued limited waivers to its regulations on Iran that have a secondary impact on third countries.⁹ In addition, it suspended the ban on supplying aircraft spare parts to the Iranian civil aviation industry and temporarily exempted the car industry, which was subject to sanctions in July 2013 and had particularly impacted European car companies. The JPA provisions also included the release of \$4.2 billion of previously frozen Iranian assets from oil sales, which will be released in eight instalments of about \$550 million each. US authorities estimate that sanctions relief under the JPA could amount to a total of approximately \$7 billion – \$4.2 billion in unfrozen assets and the rest generated by renewed trade.

The JPA offers European companies few opportunities to resume doing business in Iran. The relaxation of sanctions could mostly benefit the petrochemical and automotive industries, together with oil tankers insured under rules governed by European law (95 percent of the world's tanker fleet) that can now resume carrying Iranian oil for current importers. But Europeans have not even been able to take advantage of the limited opportunities provided by the interim agreement. Most restraints on dealings with Iran remain in place, which reduces the firms' incentives to re-establish links with Tehran. In addition, new contracts have to be fully executed – including all aspects of transactions, delivery, and receipt of payment – by 20 July or they could be subject to sanctions. Given that it is still unclear whether a final agreement will be reached or if the JPA will be extended for six additional months, European companies are reluctant to undertake any business with Iranian partners.

⁷ Senate Foreign Relations Committee, Hearing on the Iran Nuclear Negotiations, 4 February 2014.

⁸ Author interview with senior trade lawyers at Clyde & Co and W Legal, February 2014.

⁹ These include waivers to sections of the National Defense Authorization Act of 2012 (NDAA), the Iran Threat Reduction and Syria Human Rights Act of 2012, the Iran Sanctions Act (ISA) of 1996, and the Iran Freedom and Counter-Proliferation Act of 2012.

Furthermore, the measures adopted in the energy sector only allow transportation from Iran to its six current customers of oil and do not include any suspension of the ban on investment in the country's oil and gas sector or the prohibition on EU purchases and import of Iranian oil. Therefore the sector in which the EU member states had highest percentages of imports from Iran up until 2012 is still curtailed from business opportunities. Even in the automotive or petrochemical sectors, the interim deal has provided only minor improvements in overcoming the commercial challenges that European businesses face in getting paid by Iran.

The general ban on all transactions between European and Iranian banks, which strongly impacts dealings with Iranian credit and financial institutions, allows EU entities to engage with Iranian banks only if a transaction is explicitly authorised in advance by relevant national authorities. However, a transaction that involves dollars, an entity subject to an asset freeze or inserted in the Specially Designated Nationals List (SDN), still qualifies as sanctionable conduct, regardless of the type of goods. Such issues significantly limit the ability and willingness of European businesses to get back to the Iranian market.

Additionally, EU officials and member states are committed to fully maintaining the current architecture of sanctions against Tehran and to avoiding a potential dismantling of the international coalition that implemented sanctions against Iran over the last four years.¹⁰ It is a shared view among EU officials that the imposition of any new sanctions legislation against Iran during the negotiating timeframe would be a direct violation of the JPA and hamper any chance to reach a final settlement with Tehran on the nuclear issue.¹¹ At the same time, the EU continues to fully implement the measures already in place and European companies are compelled to abide by existing legislation. In a surprise move, the EU even re-imposed its restrictions and asset freezes on the Iranian firms and banks that won an appeal against sanctions in the European Court of Justice last year.¹² In short, halfway through the six-month nuclear deal between Iran and major world powers, fears that the interim deal could induce EU companies to rush back into the Iranian market, weakening the sanction regime, have not been realised.

The aim of visits to Tehran by European businesses was mostly to make contacts and to assess the state of the Iranian economy in order to position themselves for future openings if and when sanctions are lifted in the aftermath of the JPA.¹³ European commercial delegations to Tehran want

to secure a share of the markets in anticipation of a post-sanctions regime and fear that the legislation in place might favour US businesses over European ones in re-establishing economic ties with Iran.¹⁴ But there is so far no record of any new contracts being signed between European companies and Iran.¹⁵ Rather than scaremongering about the unlikely collapse of the sanctions regime against Tehran, the real concern should be the failure to enforce some of the limited concessions granted under the JPA, which risks hindering the six powers' diplomatic leverage over Iran.

The challenge for the EU

Despite fears that limited sanctions relief would erode the sanctions regime, Iran has seen less economic benefit than it was promised from the interim nuclear agreement – largely because most European banks still believe they may face punishment for any accidental breach of US sanctions and are therefore unwilling to risk re-engaging the Islamic Republic. In particular, they worry that they may face huge fines or be denied access to the American financial system for any kind of transactions conducted with Iranian banks and entities.¹⁶ Even though the US government has granted waivers in its regulation against Iran, European companies are still hesitant about establishing links with the Iranian financial system and do not want to risk the wrath of the US Treasury.¹⁷

As a result, Iran is experiencing severe difficulties in obtaining even the limited sanction relief established under the JPA. These difficulties illustrate the practical challenges of delivering money to a country largely isolated from the global banking system. Iran's ability to secure and withdraw the \$4.2 billion in unfrozen oil revenues, which were promised in instalments under the interim deal, was delayed.¹⁸ Meanwhile, despite the tenfold increase of EU authorisation thresholds under the JPA, European financial institutions are still largely avoiding authorising even legitimate trade and humanitarian transactions with Tehran.

The isolation of Iran's banking system has also caused the failure to establish the financial channel, agreed on as part of the JPA. The E3+3 committed to select specified foreign

14 George Parker, "US 'bullying' UK banks and hindering legal trade with Iran", *Financial Times*, 26 March 2014; Tim Hetherington and Andrea Shalal, "Testing detente, US firms move to sell jet parts to Iran", *Reuters*, 21 February 2014, available at <http://uk.reuters.com/article/2014/02/21/iran-usa-aircraft-idUKL6NoLQoZ220140221>.

15 Author interview with senior European officials, March 2014.

16 Kenneth Katzman, "Iran Sanctions", Congressional Research Service, 31 May 2013, available at <https://www.fas.org/sgp/crs/mideast/RS20871.pdf>. Specific sections of the Comprehensive Iran Sanctions, Accountability, and Divestment Act (CISADA) and the NDAA legislations enacted by Congress have an extraterritorial effect which has had a noteworthy impact on European businesses.

17 Author interview with Bijan Khajepour, managing partner at Atieh International and contributor to Al-Monitor, and with Samuel Cutler, policy advisor at Ferrari & Associates, March 2014. Jonathan Saul and Parisa Hafezi, "Western banks cold-shoulder Iran trade finance scheme", *Reuters*, 13 March 2013, available at <http://www.reuters.com/article/2014/03/14/us-iran-trade-banks-idUSBREA2D1M220140314>.

18 Author interview with senior Iranian officials, Vienna, May 2014. Three of these instalments were already placed between February and March, but Iran could not access them until the end of April. Laurence Norman, Nour Malas, and Benoît Faucon, "Iran Can't Tap Much of Freed Oil Funds", *Wall Street Journal*, 6 April 2014, available at <http://online.wsj.com/news/articles/SB4000142405270230481900457948523153658774>.

10 Author interview with European and EEAS senior officials, March 2014.

11 Under the JPA, both the EU and the US agreed not to pursue new nuclear-related EU sanctions during the six months of validity of the interim agreement.

12 Benoît Faucon and Laurence Norman, "EU Shifts Tactics to Bolster Iran Sanctions", *the Wall Street Journal*, 27 October 2013, available at <http://online.wsj.com/news/articles/SB10001424052702304655104579161780356447634>.

13 Author interview with Michel Makinsky, lecturer at the Poitiers School of Business and Management and part of the French delegation to Tehran.

banks with available funds and non-designated Iranian banks in order “to facilitate humanitarian trade for Iran’s domestic needs using Iranian oil revenues held abroad”.¹⁹ But since the US Treasury and European authorities have provided insufficient clarity and written guarantees, European financial institutions still fear that they would be penalised if they facilitated such transfers. As a result, European banks have so far refused to open letters of credit for Iranian banks, even when they aimed at releasing funds for the smooth delivery of food, medication, and humanitarian goods.

Besides underscoring how much work it will take to unwind sanctions should a final agreement be reached, the current problems faced by Tehran could affect the outcome of the nuclear talks. The failure to practically implement what has been granted to Tehran under the JPA could weaken Rouhani’s standing and undermine his ability to showcase the benefits of reaching a deal with the six powers. It could also undermine Iranian officials’ confidence in the E3+3’s resolve to overcome the difficulties in re-establishing Iran’s financial linkages with the international community and therefore threaten their leverage in negotiations with Iran. Back in March, Iranian Foreign Minister Mohammad Javad Zarif has publicly questioned the West’s willingness “to fulfil its commitments” to implement November’s accord and Tehran might increasingly doubt the E3+3’s ability and willingness to make good on its commitments in any final deal.

It is in fact clear that, if a comprehensive deal is reached, the E3+3 will face even more complex political and technical challenges in providing sanctions relief. Based on what US officials have confirmed to be a phased approach to any sanctions relief under a comprehensive deal, the EU and the US will have to work together to ease restrictions and unwind the sanction regime against Tehran.²⁰ US sanctions can only be terminated on a permanent basis by an act of Congress – which to date has been more inclined to add sanctions on Iran than permit their relief – while the White House can only issue temporary suspensions through time-limited waivers.²¹ The EU, on the other hand, is better positioned to lift its sanctions, since to do so would only require a unanimous decision in the European Council.

Given the expected complications in unwinding sanctions if there is a comprehensive agreement, it is crucial that what has been provided in the JPA package is fully delivered. As Marietje Schaake, a member of the European Parliament, put it: “If we agree to lift sanctions, we have to also make it

practically implementable” and “make sure that we meet our part of the commitment”.²² As the UN report confirmed, Iran has so far complied with the interim deal and fulfilled its part of obligations under the JPA.²³ Should the EU not solve the challenges faced in fulfilling its obligations under the JPA, the risk is that it would no longer be deemed credible in its ability to deliver substantial sanction relief to Tehran – like the US. The consequent domestic pressure on the Iranian negotiators could end up threatening the achievement of the much sought-after and desired comprehensive deal.

¹⁹ Author interview with senior EEAS and European officials, March 2014.

²⁰ US Department of State, Background Briefing on Next Week’s EU-Coordinated P5+1 Talks With Iran, 14 March 2014..

²¹ Of the two types of US sanctions in place against Iran, executive orders could be revoked or amended at the president’s discretion, whereas Congressional ones, which entail a shift in the regime’s policies on matters not strictly related to the nuclear issue, would be more difficult to lift even if Iran met all US demands concerning its nuclear programme. The president can issue a waiver for a period not exceeding 180 days and renew it for 120 days by invoking US national security interests, for as long as Iran respects its commitments and until the president remains in office.

²² Key Capitol Hill Hearings, C-SPAN, 24 March 2014.

²³ According to an IAEA report released on April 17, Iran has so far either diluted or converted nearly three-quarters of its stockpile of 20 percent enriched uranium.

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