European sanctions against Iran in perspective

One might think sanctions represent a novelty in European foreign policy, and yet, they have been employed by European states since the 1980s and increasingly by the Union since the early 1990s. Europe has developed a sanctions' policy vis-à-vis a range of countries, geographically close and far, and for a variety of reasons, from human rights' violations to terrorism and weapons of mass destruction’s proliferation. After the international embargo imposed against Iraq in 1991 and its catastrophic humanitarian consequences (the death of 500,000 children), Europe and the international community have shifted from “comprehensive” to “targeted” sanctions: the former isolate the whole country in the often misguided hope that the regime will want to avoid a humanitarian catastrophe or that the population will rebel; the latter supposedly rise the costs of non-compliance for the sanctioned government, while keeping at a minimum the impact on the local population.

Iran is the first country against which the EU has developed a sanctions’ policy out of weapons of mass destruction (WMD) concerns, starting in 2006. In 2010, departing from previous policies, Europe has adopted “comprehensive” sanctions, in addition to targeted ones, taking a toll on the country as a whole and attempting to diplomatically and financially isolate it. Earlier this year, this coercive approach has been further reinforced with an oil embargo, to be fully implemented next July.

Sanctions have been part of the European agenda in dealing with Iranian nuclear ambitions since 2006, when Europe framed a dual-track approach, combining the supposedly mutually reinforcing pressure and dialogue. Since then, the EU

Abstract

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The paper examines the old and new sanctions' legislation, it provides an analysis of the nature of economic relations between European countries and Iran and explores the potential political and economic impact of the oil embargo. It concludes by showing how, despite publicly endorsing dual-track diplomacy, leaving the door officially open to dialogue, Europe is mostly limiting incentives and increasing pressure on the Iranian regime, in line with American political preferences. This very two conditions, however, might hamper any chance for a peaceful settlement of the nuclear standoff and also be a costly policy for European struggling economies.

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(*) The opinions expressed herein are strictly personal and do not necessarily reflect the position of ISPI.
Council implemented all United Nations Security Council (UNSC) Resolutions with regard to the Iranian nuclear program. In the past five years, these sanctions have been targeted, consisting of restrictive measures against officials and organizations linked to the nuclear program. However, while until 2010 Europe refrained from imposing punitive measures beyond the UNSC ones, in the past two years “comprehensive” sanctions have taken center stage, with the Union hitting the energy and financial sector, banning the import of crude oil and blacklisting most of Iranian banks.

Traditionally skeptical about a purely coercive approach, the EU used to consider economic sanctions a dangerous tool, potentially harming its own interests – both economically and diplomatically – without necessarily producing the desired results. This assessment changed in July 2010, when the EU espoused a tougher approach, introducing economic sanctions in its strategy. Because of the relevance of EU-Iran economic ties, US under secretary of Treasury Stuart Levy pressured the EU to impose sanctions framed on the US unilateral legislation, the CISADA. The newly adopted European legislation was seen as central for the success of the American coercive approach, as it was meant to prevent the Iranian government from circumventing the UN and US sanctions, further isolating it.

On January 23, 2012, EU foreign ministers unexpectedly approved a new set of sanctions against Iran, de facto imposing an oil embargo. The legislation represents a qualitative shift, given that until December 2011 few deemed it likely that Europe would coalesce around the US request for measures targeting the import of crude oil from Iran.

In November 2011, by adopting an oil boycott on Iran, the UK seemed to be the only country inclined to follow suit the American wishes. As a consequence, the country’s relations with the Islamic Republic immediately deteriorated with the assault at the British Embassy in Tehran and the suspension of bilateral diplomatic relations. Such drastic developments, together with the new International Atomic Energy Agency (IAEA) report, have progressively led all other EU countries to approve an oil embargo on Iran. Within European strategic calculations, the looming prospects of a military conflict, either initiated by Israel alone or in accordance with Washington, have likely changed the cost-benefit analysis of those member states reluctant to endorse costly sanctions. The explanation of this behavioral shift is probably based on a mix of factors, including US pressures, the fear of an Israeli-Iranian war, the fear of regional destabilization and of a nuclear arms race in the Middle East, and lastly the European desire to show that it is able to play on the hard security table, distancing itself from a purely soft power talk.

5 For a list of the UNSC Resolutions addressing Iran’s nuclear program, http://www.isisnucleariran.org/documents/unsclr/.
12 The new Report by IAEA Director General Amano indicated a potential military dimension to the Iranian nuclear program. This report has been used by advocates of a more aggressive approach towards Iran as a springboard to justify stepping up the prospects of an embargo.
By doing so, the EU has eventually complied with the US policies towards Iran and thereby repaired a transatlantic rift over how best to handle the nuclear issue.

The next gathering in March 2012 of the IAEA Board of Governors, presided by Italy, will assess how to deal next with the Iranian nuclear program, probably confirming previous assessments and not disclosing additional findings or evidence. The full EU enforcement of the embargo will likely depend on the outcome of the March IAEA meeting, as much as on the assessment of the political and economic costs associated to the boycott. The new measures include a ban on the import, transport and purchase of Iranian crude oil, petroleum and petrochemical products, as well as a freeze on the assets of Iran’s Central Bank and a ban on the trade of diamonds, gold and other precious metals to Iran. In addition, the new sanctions prohibit EU countries to export key equipment and technology for the petrochemical sector to Iran or to Iranian business abroad. The idea is to target Iranian oil exports, accounting for about 70% of government’s revenues.

On sanctions, the EU stands as a diplomatically unified front, with some differences on the intensity and timing of the advocated measures. British Foreign Secretary William Hague often argues in favor of sanctions as the last alternative able to deter both a military escalation and a nuclear Iran. Similarly, Germany has come to accept the idea that sanctions are a deterrent of last resort and has progressively hardened its stance. The idea that sanctions are the best tool leading to an unbearable isolation and that a military attack would provoke a rally around the flag effect among the Iranian public opinion has likely motivated this gradual shift. France has traditionally supported this view and strongly fears an Iranian military nuclear program, sharing British and American overall assessments about the necessity for the international community to do everything it can to avoid that prospect, even keeping the military option on the table. Out of normative concerns, Sweden, which has supported the EU policy course, has not refrained from cautioning against the risks of adopting useless or counter-productive moves, underlining the importance of a thriving diplomatic track, a position previously held by former High Representative Javier Solana and by former British Foreign Secretary Jack Straw.

Mostly out of ideological affinity with American perceptions and despite the significant economic investments in the country, its energy dependence and its historically positive diplomatic relations, Italy has supported both tracks of European diplomacy, sharing the view that in absence of fruitful negotiations, a coercive mode can help avoid a military confrontation. In a more realpolitik fashion, Greece has tried to water down the last round of sanctions. Athens cannot separate diplomacy from its economic considerations: not only does it get a third of its oil from Iran, but the Iranian oil comes with credit facilities which no other supplier would offer. Needless to say, the cancellation of

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13 In its latest report on Iran’s nuclear program, the IAEA claimed that although it «continues to have serious concerns regarding possible military dimensions to Iran’s nuclear program», could not identify any breakthroughs. S. PETERSON, IAEA report on Iran: Serious Concerns on nuclear program, in «Christian Science Monitor», 24 February 2012, http://www.csmonitor.com/World/Middle-East/2012/0224/IAEA-report-on-Iran-serious-concerns-about-nuclear-program.


these contracts would have devastating effects on the fragile Greek economy. Hence the EU decision to phase in the last sanctions, giving existing contracts the possibility to run until July and permitting countries heavily dependent on the crude imported from Iran to find alternative suppliers.

Economic considerations come into play also with regard to the effect that sanctions will have on the Islamic Republic and its behavior: both the EU decision to implement the embargo and the February 2012 threat by Tehran of suspending the supply of oil to Europe have already impacted upon the price of oil, causing economic destabilization and a severe currency devaluation (since January 2012, the Iranian rial lost almost half of its value against the dollar).

EU-Iran economic relations before and after the adoption of sanctions

In 2010, before comprehensive sanctions were implemented, Iran was the 25th largest EU trading partner, whereas European countries were Iran’s major trading partners. EU exports – machinery, transport equipment, manufactured goods and chemicals- accounted for almost a third of Iran’s imports, between 10 and 11.3 billions euros.

EU Imports, based almost exclusively on fuels and mining products, accounted for somewhere between 9.4 and 15.9 billion euros. EU imports – with the exception of Iranian crude oil until 2010 – have severely decreased since the implementation of sanctions. Oil represented around 90% of the total EU imports from the Islamic Republic and 18% of total Iranian oil exports.

As previously mentioned, the new round of sanctions puts a great pressure particularly on some countries. In addition to the Greek market, Spain and Italy – the largest European buyers of Iranian crude – buy slightly more than 10% of their crude from the Islamic Republic, accounting for 6-8% of Iran’s total crude oil exports to the EU. Rome imported slightly less in 2011, due to governmental moral suasion intended to discourage further investments and reduce economic exposure in the country. Several important Italian industries maintained a presence in Iran, among them Danieli, Ansaldo, Fiat and FATA. The energy giant ENI, in particular, has invested over $3bn in Iran and still needs to recover half of it by 2014, under the guise of oil supplies. Such condition enabled ENI to get a waiver from the EU. The debate over the economic implications of the embargo on these Mediterranean countries, once the legislation will enter into full swing remains to be ascertained. European oil traders and refiners are already looking at alternative suppliers. The Gulf Cooperation Countries (GCC), Saudi Arabia, the United Arab Emirates (UAE) and Kuwait, in particular, together with Russia and Libya are considered so far the best candidates. However, Saudi Arabia prefers to

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21 On 19 February 2012, Iran suspended the export of oil to the UK and France, still threatening a similar retaliation measure towards other EU countries.
24 In 2010, the EU imported 471,000 bbl/day of crude oil from Tehran, which accounted for 5.7% of total oil imports to the EU. The International Energy Agency estimates that the European embargo will lead to roughly 600,000 bbl/day of oil being removed from the European market.
27 S. MUFSON, Oil prices Iran are increasingly source of concern, in «Washington Post», 13 January 2012.
sell its crude to booming Asian economies, because of higher selling prices. Similarly, Russia, Europe’s top oil supplier, is more focused on capturing valuable market shares in Asia. Even if Libyan oil might be back to pre-war levels by the end of 2012, it will be a costly alternative (Libya’s crude is light and sweet, while the Iranian mainstream exported oil to Europe is heavy and sour\textsuperscript{28}, which will require a costly switch). Europe’s refiners are therefore losing sleep over the potential consequences of the EU embargo, which might engender or accelerate refinery closures in Europe. Piero de Simone, head of Italy’s refiners’ lobby, warned that Italy risks the closure of five refineries and Europe risks having to close seventy\textsuperscript{29}.

On the other hand, it could be fairly quick for Iran to find alternative outlets for its crude. As many analysts have pointed out, the European oil embargo presents an excellent opportunity for Asian countries. Currently, about two-thirds of Iran’s crude oil is exported to Asia, with one-fifth exported to China, and 10-15% sent to each of Japan, India and South Korea.

There is still no clear indication of how the abovementioned countries intend to react to the new EU legislation. Depending on how the behind-the-scene discussions will develop, Asian countries could pursue their economic interests or follow the West. If they decided to circumvent sanctions, particularly the financial ones targeting Iran’s Central Bank, they could simply pay for the Iranian oil with the local currency rather than with the dollar. A precedent has been set by India, with which Iran agreed for 45% payments in Rupees through an Indian bank that does not conduct trade with the US.

**Winners and losers of the new European coercive policy**

The EU decision on the oil embargo has generated an ongoing debate on the consequences on the Iranian nuclear issue, as well as on the international energy market.

Many believe that, as a consequence of the new sanctions, China will get high rebates for Iranian oil, which would then be sent to the European Union itself. China’s national oil company has several projects in Iran to develop oil and natural gas fields\textsuperscript{30}, and despite having supported the UNSC Resolution 1929 – partially complying with CISADA – China is already the Islamic Republic’s third largest oil client\textsuperscript{31}. China might even be able to pay Iranian oil in non-convertible yuans, which Tehran will then be obliged to use to buy Chinese goods\textsuperscript{32}. This, in turn would further weaken the Iranian manufacture sector.

Moscow, itself in a delicate political situation and approaching presidential elections, will attempt to capitalize too\textsuperscript{33}. Russia is now the world’s largest oil producer, pumping 10 million barrels a day and exporting 7 million a day, mostly to Europe and Asia. The increased price of oil has brought higher revenues for the Russian government, which has spent them to buy dissent through a patrimonial-rentier approach, i.e. subsidizing domestic energy consumption and curbing inflation\textsuperscript{34}.


\textsuperscript{29} Another industrial sector which will struggle due to the Iranian embargo is the shipping industry. Carrying Iranian oil would invalidate ships’ coverage against risks such as spills and collisions, spreading the effect of sanctions beyond the EU member states.


\textsuperscript{31} Its first provider is Saudi Arabia, providing 20% of China’s imported crude.


\textsuperscript{33} A.E. KRAMER, West’s clash with Iran is a windfall for Russia, in «International Herald Tribune», 17 February 2012.

\textsuperscript{34} Ibidem.
The diplomatic crisis and the ongoing economic warfare are therefore likely to provide increased energy revenues for Russia and additional market shares in Iran for China.

Another net winner of such a tough sanctions policy might be US President Obama, who, as most Democrats, desperately wants to avoid a regional war and fears a preventive Israeli strike on selected Iranian nuclear facilities. Many are starting to depict a looming military confrontation as a black swan severely hampering his chances for a second term. The US President can count on a limited leverage on the Israeli leadership, given the poor relationship with Israeli prime minister Netanyahu, himself running for another term. The main Israeli lobby, AIPAC, has pushed for a new resolution to be passed by the US Congress, just three weeks before the US visit of the Israeli prime minister. AIPAC aims at moving the red line triggering a military strike from considering unacceptable the development of a "nuclear weapon" to considering unacceptable the development of "a nuclear weapon capability", i.e. reaching a degree of uranium enrichment beyond which, should Iran decide to do so, it could produce nuclear weapons. The current discursive and policy shift exponentially enlarges the spectrum of causes for war, since Iran might take a period from two months to a couple of years before reaching the nuclear threshold. This stance ignores the wide support a peaceful nuclear program enjoys among Iranians (over 57%), for reasons of prestige in technical advance and as a symbol of modernity and power, against a much smaller constituency supporting a military nuclear program (around 40%, while 35% openly oppose it). Failing to distinguish between these two perspectives lends credibility to those conspiracy theories arguing that the international community's endgame in Iran is regime change, something Europe has so far always discarded and discouraged, at least on the discursive level.

On the other hand, economically and politically, the net losers of the recently more coercive European approach seem to be both the Iranians and the Europeans. The former will pay a high price for the diplomatic isolation their leadership has provoked, bearing the daily economic costs of biting sanctions. Politically, the EU stance will further damage Iran's quest to be acknowledged as a main regional power. Europeans on their end will have to pay the cost of reduced sources of oil and of rising prices of consumer goods, derailing already struggling economies. Such prospects get even more frightening with the threats of the Iranian regime of cutting oil exports to European countries before sanctions will be fully implemented in July, therefore preventing EU countries to use the "grace period" to find alternative sources of crude. The new sanctions might also have an unintended effect on the approaching Iranian parliamentary elections, with the risks of further radicalizing the current political leadership.

Last week, however, a little sign of hope came with the letter Iranian Foreign Minister Salehi sent to the EU High Representative Catherine Ashton, in response to her October proposal to get back to

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35 To the extent that it has not disavowed the use of unconventional means, ranging from cyber war (Stuxnet, an electronic worm, spied and blocked some Iranian centrifuges last year) to terrorism (targeted assassinations of several Iranian nuclear scientists).
36 E. LUCE, Obama nears his nuclear moment, in «Financial Times», 20 February 2012.
37 The same lobby, together with many within the Republican party, is also advocating a clearer rejection of the right to enrich uranium, despite it being a right acknowledged by the Non-proliferation Treaty of which Iran is signatory.
38 R. WRIGHT, AIPAC and the Push Toward War, in «The Atlantic», 21 February 2012.
40 As previously mentioned, for now Iran cut oil exports to the UK and France which won't cause dramatic consequences given the little dependence of the two on the Iranian crude. However, should Tehran decide to cut oil exports to the countries heavily dependent on its oil before they find alternative suppliers, that would cause major economic instability. Aware of that, Iran is using this threat against the EU to make them rethink their decision on putting an oil embargo.
the negotiating table. Talks in Washington and Brussels are still undergoing to decide how to reply to the apparent Tehran’s intentions to restart dialogue. Much, as usual, will depend on US preferences, and on their influence on the European decision-making.

What is certain is that, while the EU continues to publicly endorse a dual-track diplomacy, leaving the door officially open to dialogue with the Iranian regime, the lack of incentives offered to the country’s leadership for future negotiations, the weak prospects of lifting current sanctions and the American pressures to implement a coercive policy – often interpreted as regime change driven, might hamper any chance for a peaceful settlement of the nuclear standoff. Europe failed so far to advance an appealing negotiating offer, based upon less stringent preconditions and setting the parameters of a political-security agreement with Tehran. By doing so, the EU could more likely see a positive outcome to the nuclear dispute, acquiring legitimacy as a broker among parties. On the other hand, the new wine, – the oil embargo imposed on Iran – packed in the old bottles of comprehensive sanctions, albeit likely to slow down the nuclear ambitions of the country, will have heavy consequences for the EU: further economic destabilization, the loss of its exclusive relationship with Iran, and finally the fading prospects of a peaceful resolution of the nuclear issue.