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India struggling to cope with sanctions on Iran

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Summary

India has been struggling to cope with the recent round of sanctions imposed by the United States and European Union against Iran. Although New Delhi's official position states that it would comply with UN mandated sanctions and not unilaterally imposed ones, India has cut its oil imports from Iran thereby earning itself a waiver from the United States. But now it has to overcome the EU ban on insurance cover for tankers carrying Iranian crude as well as find innovative means to continue trading with Iran which continues to be an important source of energy.

The West's pressure on Iran to terminate its uranium enrichment programme is now targeting the Islamic Republic's economic lifeline—its oil exports—which, despite decades of sanctions, has seen the country remaining defiant. In 2011, thanks to high oil prices, Iran managed to earn US $100 billion by selling 2.2 mbd (million barrels a day). However, the country may now be facing a more difficult situation following the US- and EU-imposed sanctions that will come into effect on June 28 and July 1, respectively.

While the US sanctions will punish those entities, governments as well as companies and financial institutions that are doing business with Bank Markazi, Iran's Central Bank, and effectively prevent them from accessing the American financial system, it is the sanctions imposed by the European Union that has the potential to hit the Iranian economy harder by targeting the shipping industry. Besides banning new contracts on petroleum imports from Iran starting July 1, 2012, and placing restrictions on foreign trade, financial services, the energy sector and technologies, the EU sanctions also include a ban on the provision of insurance and reinsurance by European insurers to Iran and Iranian-owned companies, which essentially means that Europe's insurance companies will not insure any vessel carrying Iranian crude from July 1, 2012.

After the US sanctions were announced in March 2012, a number of countries terminated or drastically cut down on their imports of crude from Iran. 10 EU countries and Japan were thereafter granted a waiver by the US from the sanctions. India, which was earlier sourcing around 12 per cent of its imports from Iran, cut it down to around nine per cent. As a result, on June 11, 2012, the Obama Administration included India along with six other countries, namely South Korea, Malaysia, South Africa, Sri Lanka, Turkey and Taiwan, in its list of countries that were granted a sanctions waiver, albeit for 180 days only. Referring to the sanctions, Secretary of State Hillary Clinton said,

> "Today's (June 11) announcement underscores the success of our sanctions implementation. By reducing Iran's oil sales, we are sending a decisive message to Iran's leaders: until they take concrete actions to satisfy the concerns of the international community, they will continue to face increasing isolation and pressure."[1]

A glaring exception in the list of exemptions was China, which imported around 22 per cent of its oil from Iran in 2011. While China had cut its import of Iranian crude by more than 30 per cent during the first four months of 2012, the decline was due to a contract dispute between Sinopec, the largest purchaser of Iranian crude, and the National Iranian Oil Company, and not because of the American sanctions threats. However, according to reports, China has subsequently increased its Iranian crude offtake which is close to its

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[1] "Regarding Significant Reductions of Iranian Crude Oil Purchases", Statement by Hillary Rodham Clinton, US Department of State, June 11, 2012, www.state.gov/secretary/rm/2012/06/192078.htm.

2011 imports. In fact, according to some analysts, Beijing has been the largest beneficiary as it has managed to get a steep discount on its Iranian imports. Moreover, although Washington is currently negotiating with Beijing to accede to further cuts in their imports from Iran, there are doubts whether it will eventually impose sanctions on China, given its concern over Chinese trade retaliation. According to some analysts, the reason for China's non-exemption is bound up in the US' domestic politics and President Obama's bid to deflect any criticism from political opponents, particularly at a time when an anti-China wave is increasing in a recession-hit country whose trade balance is highly skewed in favour of China. Recently, the US Administration imposed import duties on renewable energy products from China and also announced the setting up of a Trade Enforcement Unit to investigate unfair trading practices in China and some other countries. If re-elected, Obama has the power to delay enforcement if he concludes that they are disrupting the oil market, or he can issue China a waiver for national security reasons and on the grounds that not only did China cut its Iranian oil imports earlier, but it had played a constructive role in the nuclear talks with Iran as well as voted for UN sanctions against Iran, despite the fact that it had reservations about the effectiveness of the sanctions. In the event of his losing the 2012 elections, Obama can alternately leave the decision to his successor.

So far, Iran is not displaying any signs of compliance with US and Western pressure tactics to stop enriching uranium to 20 per cent purity. However, despite the Iranian leadership's attempt at putting up a brave face, the economy is suffering with oil revenues projected to be around $67 billion as against $100 billion the year before.[2] The country's crude oil exports have dropped by some 28 per cent in April 2012 alone, that is, from 2.5 million barrels a day (mbd) in 2011 to between 1.2 to 1.8 mbd—a decrease of at least 28 per cent—causing revenue losses of around $10 billion since April. The revenue loss has been exacerbated by the drop in international oil prices, which are around 25 per cent less since April 2012.

Neither is this Iran's only problem. Inflation is running high—official figures put it at about 20 per cent, although observers say it is much higher—and the Iranian currency (*rial*), has been devalued by nearly 50 per cent since the beginning of the year. Mahmoud Bahmani, the head of Iran's Central Bank, while stating that the country was facing an "absolute economic war", admitted that the situation was much more difficult under the constraint of international sanctions than an actual war.[3]

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2 Una Galani, "Iran's oil sanctions are just beginning to hurt", *Reuters*, June 13, 2012, http://blogs.reuters.con/breakingnews/2012/06/13/irans-oil-sanctions-are-just-beginning-to-hurt/

3 Shahram Ahadi, "Iranians feel the impact of sanctions", *Deutsche Welle*, June 18, 2012, www.dw.de/dw/article/0,,16034463,00.html.

How India is dealing with the sanctions?

New Delhi has been struggling to cope with the US and EU sanctions on Iran. While officially India has said that it would comply only with UN mandated sanctions and not unilaterally imposed ones, it has cut down its imports of crude from Iran. It has, or has committed to cut, oil imports from Iran by 11 per cent to 310,000 barrels a day (b/d). To compensate for the loss in Iranian crude, India has asked Saudi Arabia for another 100,000 b/d of crude.[4] However, New Delhi is quick to state that the import cuts were related more to payment issues as well as impending insurance sanctions, rather than US/EU pressure.

With regard to the payments issue, after the Reserve Bank of India's diktat in December 2010 to importers that the Asian Clearing Union (ACU) route that was hitherto used for making payments would no longer be available to them, Indian refineries have been scrambling to find alternative means to pay for Iranian crude. Subsequently, India was making payments to Iran through Turkey's Halkbank, though this was considered precarious after Halkbank refused a BPCL application. The issue was resolved after Iran agreed to accept rupee payments up to 45 per cent of the value of oil exports through the Kolkata-based UCO Bank, while the rest would be paid in Euros through Halkbank.

To further facilitate such payments, the two countries have agreed to increase the basket of Indian exports to Iran to correct the huge trade imbalance which is heavily skewed in Iran's favour. The money that will be paid into rupee accounts in UCO Bank will be used by Iranian importers to pay for Indian products. It was reported that both sides have signed agreements amounting to around $3 billion for rice, wheat, soymeal and pharmaceutical products.[5] Moreover, the Finance Ministry has agreed to exempt Indian importers from paying the 40 per cent withholding tax required for purchase of crude from Iran, thereby making imports cheaper. The exemptions would be effective from April 1, 2012.[6]

Although the payment issue is being addressed, India now has to deal with the EU insurance ban as Indian insurance companies lack the financial capacity to cover the risk. Lack of P&I (Protection and Indemnity) insurance cover may see all shippers refusing to carry Iranian crude. The P&I Association is a 13-member (one American, one Japanese,

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4 Lianna Brinded, "Iran Sanctions Forces India To Demand Extra OPEC Oil: Will Rebalance Prices", *International Business Times*, June 15, 2012, http://www.ibtimes.co.uk/articles/352734/20120615/energy-oil-iran-india-opec-saudi-arabia.htm.

5 Biman Mukherji, "India Clears Iran Payments Move", *Wall Street Journal*, June 20, 2012, http://online.wsj.com/article/SB10001424052702304765304577477842414532850.html.

6 "Rupee payment for Iranian crude oil exempt from tax", *Business Standard*, June 19, 2012, http://business-strandard.com/india/news/rupee-payment-for-iranian-crude -oil-exemptdtax-/477808/

and the rest European) non-profit insurance association that provides cover to its members, namely ship-owners or charterers, by pooling their resources to meet each others' third-party liability losses. They cover 90 per cent of the world's vessels, including India's. From July 1, 2012, when the sanctions are scheduled to be imposed, shipping companies will lose access to this market. Most shipping companies are unwilling to operate on the India-Iran oil route without adequate sovereign cover, which, till now, only the Japanese government has agreed to provide. On June 20, 2012, the Japanese lower house passed a bill, which, if signed into law, will become effective from June 27, 2012, allowing insurance cover of up to $7.6 billion per tanker carrying Iranian crude oil bound for Japan in the event of any accident.[7] This decision was taken to prevent any escalation in import costs.

The Indian government is also now weighing several options to manoeuvre around the ever-tightening sanctions, including the provision of sovereign guarantees to oil tanker operators, similar to Japan. At the same time, Indian refineries which are planning to lift around 173,000 b/d for the fiscal year April 2012 to March 2013 from Iran, including state refineries such as MRPL and HPCL (IOC has decided to stop all imports from Iran from July) are also seeking permission from the government to lift cargo on cost-insurance-freight (CIF)) basis as against the current freight-on-board (FOB) basis which is mandatory for state-owned importers. This would allow Iranian shippers to provide insurance cover. Even though, in theory, domestic reinsurer General Insurance Corporation-Re has stated its willingness to provide $50 million cover per ship, for which it is awaiting permission from the Insurance regulator, IRDA, it is only a fraction of the required $120 million liability provided by the P&I club.[8]

Iran's private tanker operator, National Iranian Tanker CO (NITC), has stated its willingness to provide cover and keep up supplies through the $1 billion insurance coverage it has on its own fleet. NITC is largely owned by Kish P&I, a private company, but which relies on state-owned Central Insurance of Iran as its reinsurer.[9] However, although NITC does own around 39 vessels, and theoretically it can ship around 1.8 mbd—which is more than Iran is currently exporting—more than half of the company's fleet of tankers has been detailed for storing Iranian surplus crude.[10] Moreover, although no

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7 Japan passes law to insure Iran oil imports", *Reuters*, June 20, 2012, www.reuters.com/articles/2012/06/20/us-oil-japan-iran-idUSBRE85J09Y20120620.

8 Amrutha Gayathri, "China, Japan And India Find Ways To Import Iran Oil Bypassing Sanctions", *International Business Times*, June 21, 2012, www.ibtimes.com/articles/354780/20120621/iran-crude-oil-iaea-insurance-eu-sanctions.htm

9 "Iran tanker firm says it insured despite sanctions", *Tehran Times*, June 13, 2012, www.tehrantimes.com/economy-and-business/98722-iran-tanker-firm-says-it-insured-despite-sanctions

10 "Oil market shrugs at imminemet Ian tanker insurance ban", Reuters, June 18, 2012, http://in.reuters.com/articles/2012/06/18/us-iran-oi-exports-idINBRE85H05820120618

restrictions have been imposed on NITC as yet, US pressure groups that are campaigning against Iran's nuclear programme are mounting pressure on survey companies that supply safety certificates for ships to dock at foreign ports, to terminate contracts with Iran, thereby limiting the number of foreign vessels that are willing to load Iranian oil at Iranian terminals. Even with Asian organisations now stepping in to provide the classification certificates, including the Korean Register of Shipping and the China Classification Society, the political pressure may see the number of Iranian vessels supplying oil coming down in the days ahead.[11] In the meantime, Iran is storing crude oil on tankers. According to reports, Iran added about 10 million barrels of floating storage recently with about 17 supertankers and seven Suezmaxes holding crude, with another estimated 25 million barrels being kept in onshore tanks.

Nevertheless, the Indian maritime administration is mulling over a proposal to set up an Indian Protection and Indemnity (P&I) Association for coastal ships. The plan is to form an association of owners of small and medium sized ships that are operating on the coast initially and then later cover larger vessels, with a higher premium. The Indian P&I association will provide insurance cover to these ships by collecting a fixed premium, and will go for 100 per cent reinsurance. While theoretically, nothing prevents Indian ship-owners to form their own P&I association, they have a combined 10 million gross registered tonnage, that is, just one per cent of global capacity. However, the government can facilitate the formation of an Indian P&I Club by involving its insurance companies, at least in respect of ships bringing crude from Iran.[12]

Whither oil prices?

Currently, the oil market is sanguine about the lost Iranian barrels due to a combination of lower offtake by developed countries because of the continuing recession as well as increased production by Saudi Arabia, rather than the US-EU sanctions. This has led to lower prices with Brent ruling around $91 a barrel. This has had an impact on producers with some in favour of maintaining or even cutting production from the current 31.5 mbd, instead of increasing output to make up for the Iranian exports, in order to ensure price levels are around $100 a barrel. According to the International Monetary Fund (IMF), however, Iran requires oil prices to be around $117 a barrel in order to balance its budget which has been set at $462 billion.[13]

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11 Benoit Faucon, "Iran's Oil Ships Sail Into Troubled Waters", *The Wall Street Journal*, June 24, 2012, http://online.wsj.com/article/SB10001424052702304898704577482350310816514.html?mod=googlenews_wsj

12 Crossing the insurance hurdle, *Business Line*, May 27, 2012, www.thehindubusinessline.com/opinion/editorial/article3462523.ece?homepage=true

13 "Iran feels sanctions pain as oil income slumps", *Reuters*, June 11, 2012, http://in.reuters.com/article/2012/06/11/iran-oil-revenues-idINL5E81178K120120615.

At the recent OPEC ministerial meeting held in mid-June, where the Iranian representative clashed with his Saudi counterpart on the latter's increased output, members expressed concerns over falling oil prices and authorised the OPEC president to decide upon holding an extraordinary meeting after consultations with other members if oil prices fell further.[14]

However, it will be interesting to see what happens when the economies rebound, and demand for oil picks up. Will the increase in Saudi production be able to prevent prices from going up? If not, will governments, including the European ones, be able to withstand the pressure to lift sanctions or will they allow Iranian exports to resume?

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[14] "Governor: OPEC Members Oppose Increase in Production" *Fars News Agency*, June 20, 2012, http://english.farsnews.com/newstext.php?nn=9013082956.