ARCANUM

Arcanum in the news

WALL STREET JOURNAL

KILLING IRAN'S ENERGY INDUSTRY

January 3, 2011

By Mark Dubowitz

The Reserve Bank of India has opened up a major new front in the global effort to tighten the economic screws on Tehran. Under pressure from the United States, the Indian central bank last week blocked domestic buyers of Iranian oil from making payments through the Asian Clearing Union. But further measures, and time for them to work, will still be needed to convince Iran to abandon its nuclear weapons program.

While oil sales to India can still clear through commercial banks, they will be more transparent, subjecting them to scrutiny under financial sanctions laws enacted by the U.S., the European Union and a range of Asian countries. And many international banks will not get involved at all, given the potential penalties. Every bank CEO is aware of the almost $2 billion in fines levied by the U.S. government against some prominent European banks for violations of U.S. laws against business with Iran.

This has Tehran worried: Crude oil sales are the lifeblood of the regime's power, constituting 80 percent of Iran's export earnings and 24 percent of its GDP. Tehran has reacted angrily, with the National Iranian Oil Company refusing to settle Indian oil trades outside the ACU.

In recent years, the U.S. Treasury Department watched with dismay as the Asian Clearing Union evolved into a major facilitator of trade with Iran. Established in Iran in 1974 under the auspices of the United Nations, the ACU's mandate is to "facilitate payments among member countries," which include Iran, India, Bangladesh, Bhutan, Nepal, Pakistan, Sri Lanka, the Maldives and Burma.

Using the ACU, an Iranian entity can buy a foreign product or service using Iranian rials, which are subsequently transferred to the Central Bank of Iran, and then to the central banks of other members in the proprietary clearinghouse currency, the "Asian Monetary Unit." Once money reaches the ACU, foreign banks have almost no way of knowing where it came from, and Iran can use those banks to do business with U.S. institutions. And naturally, any country in the ACU can apply the procedure in reverse to buy Iranian oil.

The Indian government decision to shut off the ACU as a clearing-house for oil trades is only one part of a bigger effort. The Europeans have already cut tech transfers to and future investments in Iranian oil and natural gas, severely damaging Tehran's ability to sustain current production. The Iranian energy industry is now in a slow-motion death spiral. To accelerate its demise, the Obama administration should take a number of other steps:

• It should greatly intensify the "hassle factor" in buying Iranian crude by exposing the role of the Islamic Revolutionary Guard Corps in the crude-oil export supply chain - and then strengthening U.S., E.U. and other laws prohibiting commerce with the Guards to sanction foreign enterprises involved with them. Apart from the regime's standard apologists, there is almost universal distaste for the IRGC, especially in the wake of the vicious crackdown on Iran's democratic opposition following Iran's June 2009 fraudulent election.

The U.S. Treasury Department's recent decision to sanction the Pars Oil and Gas Company, which is an IRGC front company involved in gasoline trading and the development of some of the largest oil and natural gas fields in the Middle East, is a good example. Mapping out the Iranian crude oil supply chain to identify further designation targets - and then identifying which international companies are doing business with the IRGC - will greatly complicate Iran's energy planning. Few international companies would welcome front-page stories about their business ties with the regime's brutal stormtroopers.

• Using U.N. Security Council Resolution 1929, which establishes the nexus between Iran's cash-generating energy sector and the sanctioned nuclear program, the United States and its allies should pass additional measures to prohibit long-term purchase contracts for Iranian oil. Large, up-front cash payments by foreign companies for Iranian oil also can be banned. Both measures can help starve the Iranian energy industry.

• Washington and the EU should introduce measures to sanction any shipping company, insurance company, or financial institution that provides support to an Iranian oil trade or any pipeline project (and its participating partners) transporting Iranian oil. As crude oil buyers find it increasingly difficult to use banks and clearing houses, they will seek alternative sources.

• Washington should bar the participation in any U.S. energy deal (shale and offshore leases, for example) of any company that buys or facilitates the purchase of Iranian oil. India's Reliance Industries Limited, for example, decided to terminate its shipments of gasoline to Iran in June 2009, more than a year ahead of new U.S. refined petroleum sanctions measures. The company likely had U.S. natural gas shale projects in mind, like its $1.7 billion dollar Marcellus shale deal in the Appalachian basin made in April 2010 and its $1.3 billion investment in Texas in the Eagle Ford shale project in June 2010.

These and other punitive measures could significantly reduce the Islamic Republic's ability to continue exporting 2.2 million barrels of oil per day, about 2.5 percent of daily world demand. With oil prices around $90 a barrel and predicted to rise, Washington needs an incremental approach, implemented rapidly, that does not spook the oil markets and drive up prices, thereby inadvertently enriching the Iranian regime.

The market needs a signal that increasing oil supplies from Iran's competitors will dull the effect of less Iranian crude being traded. Provided the United States and its allies can get more oil on the market-for example the Iran-loathing Saudis could increase production, or President Obama could lift the moratorium on offshore oil rigs in the Gulf of Mexico-then the world oil market would have considerably more elasticity.

These sanctions need time to work. The near-miraculous attack of the Stuxnet virus on Iran's centrifuges and the untimely deaths of key Iranian nuclear scientists may have bought the administration that time, and further strengthened those who want to use economic sticks to beat back Iran's nuclear aspirations.

Iranian crude oil sanctions are the next logical step-especially after the U.S., EU, Japan, South Korea, Australia, and Canada have targeted energy investment in, and technology transfer to, the Iranian energy industry, and Washington has cracked down on Iran's refined petroleum imports. Companies active in the Iranian crude oil market that want to be ahead of the next sanctions curve might want to start looking for alternative suppliers.