Iran Sanctions: India's Options

Once again, India is caught in the middle of a conflict between the US and Iran. During the earlier round of sanctions, India had succeeded in deftly manoeuvring through the sanctions regime, keeping its relations with both countries intact, if somewhat bruised. However, with the latest round of US sanctions on Iran, announced on May 8, 2018, and set to be enforced through a wind-down period beginning August 6, and the final withdrawal from the JCPOA from November 4, 2018, India is once again looking at various options to ensure that its relations with both countries, and particularly its energy interests are not affected.

Not only is Iran India's third largest source of crude oil, but both countries have ties that go beyond energy trade. These include India's US$500 investment in developing the Chabahar port in Iran, a strategic factor in its access to Afghanistan as well as with respect to the International North South Corridor (INSTC) which aims to facilitate linkages to Central Asia and Russia.

Although the current US sanctions will be imposed unilaterally, that is, they are not endorsed by the UN, and hence not liable to be adhered to by any other country, the US government has made it clear that any country that continues to do business with Iran will be blocked from accessing the American banking and financial system.

So what are India's options if it is forced to terminate all oil imports from Iran? Alternately, under what circumstances could India continue to do business with Iran after November 2018?

Given that Iran accounts for around 10 per cent of India total oil imports, the immediate factor for New Delhi will be to look at various options to deal with the situation without jeopardising its energy security. Although New Delhi officially maintains that it is not bound to adhere to the new sanctions regime since it has not been endorsed by the UN, the issue of payments will be the most contentious. India's oil imports from Iran will be affected from the end of August 2018, as Iran offers Indian refiners a 60-day credit period on oil sales, and the payment for cargoes loaded from the end of August will be due in November when the second tranche of sanctions will commence. If no agreement on an alternate mechanism for funding is reached, India may cut or stop buying oil from Iran.

This is not the first time that India has faced this predicament. As in the past, India can continue to buy oil from Iran in non USD currencies. If the Europeans do not succumb to US pressure, India can trade oil in euros; alternatively, it can re-introduce the rupee-rial payment mechanism used earlier from 2011 when all payment avenues became blocked after the EU imposed a near complete trade embargo on Iran. The Reserve Bank of India (RBI) also had to cease using the Tehran-based Asian Clearing Union (ACU)1 to handle transactions with Iran, making it more difficult to transfer money to that country. However, in January 2012, Iran agreed to accept payments in India rupees to settle around half of its sales to India. As per the agreement, India paid Iran 55 per cent in euros through the Ankara-based Halkbank (after Deutsche Bank, which India was using to pay Iran buckled under US pressure and stopped clearing payments to Iran). The remaining 45 per cent was remitted in rupees through the Kolkata-based UCO Bank, which did not have any assets in the US and was hence not at risk for invoking any penalties. However, the payments through Halkbank too ceased from February 2013, although 45 per cent of the money continued to be paid through UCO Bank. For the balance 55 per cent, India looked at several options, including paying in roubles and other currencies, but was unsuccessful. Eventually, Tehran agreed to accept payment entirely in rupees, and this mode of payment continued until 2015 when the P5 and Iran agreed on the final agreement.

From 2016, India's oil imports from Iran rose substantially, to the extent that Iran, which had dropped from the position of India's second largest supplier prior to the first round of sanctions to eighth place, it gradually climbed to the third spot – with India being Iran's second largest market.

Of course, much will depend on how the EU nations respond to the US sanctions. In fact, in May 2018, an Indian delegation met French, German and UK bankers to assess how they would deal with the US sanctions. The fact that soon thereafter the State Bank of India (SBI) is reported to have informed refiners that it would not handle payments for the crude from November *unless a new payment route is established* may be a pointer that the euro payment route may not be feasible. Although New Delhi has still not taken an official position on whether to cut imports from Iran and, according to reports, will seek exemptions and is also considering alternate payment mechanisms, including re-introducing the rupee-rial route, it may have to seek alternative sources for its oil.2

Recently, the Iranian *charge d'affaires* at the New Delhi mission, Massoud Rezvanian Rahaghi, warned India that the "special privileges" given to it would end if it tried to replace Iranian oil with supplies from other sources. He further hinted that India's other interests related to connectivity with Iran would also suffer, and called for a need to expedite India's investments and accelerate the execution of projects linked to Chabahar.3 However, a day later, Iran adopted a more placatory note, saying that it would continue to be a reliable energy partner for India and adopt a flexible approach to ensuring secure oil supplies.

It should be noted that, in the recent past, following the JCPOA (The Joint Comprehensive Plan of Action) agreement, relations between India and Iran had not been all smooth sailing. In July 2017, India lowered its imports after Tehran had hardened its stance on granting development rights to an Indian consortium for developing the Farzad B gas field, which was discovered by ONGC Videsh Ltd., and threatened to give the rights to a Russian company. However, after India made a higher counter offer, Iran acquiesced and agreed in principle to buy the gas developed by India; nonetheless, payment differences have continued.

That Iran is worried is evident from the fact that it has been looking for ways to reduce the impact of sanctions on its oil exports. It has announced that, henceforth, private companies would be allowed to export crude through its exchange as against the previous system of allowing only oil products to be sold through its oil and petrochemical bourse.4

Furthermore, Iran may consider trading in China's yuan-denominated crude oil futures on the Shanghai International Energy Exchange, which was inaugurated in March 2018, thereby circumventing any restrictions on dollar-denominated trade and US banks. Although Iranian crude is currently not deliverable into the Shanghai oil contract, this could change in the future. Already, the US decision on re-imposing sanctions on Iran appears to have increased interest in the Chinese oil futures with a doubling of volumes being traded on the exchange after the announcement.5

With regard to alternatives to Iranian oil for India, other oil producers can fill the gap if it stops or cuts its Iranian oil imports. Given India's huge and growing market for oil, it certainly has other alternatives to source its oil imports, and has in fact begun looking at alternate supplies, including from other Gulf producers, Canada and the US. However, it may not get the preferential terms it did from

Iran. These include the 60-day credit for purchases, which incidentally is double the time given by other producers, and the freight discount, which was increased from 62 to 80 per cent recently, albeit on the condition that Indian refineries increased their purchases.6 Moreover, with Iranian oil supplies decreasing in the international oil market, it would impact on prices worldwide, and will add to India’s ballooning oil import bill. It is in this context that in a recent interview India’s oil minister, Dharmendra Pradhan, had said that potential suppliers should recognise India’s huge and growing market when negotiating terms.7

Eventually, whatever decision the government takes, will be based on ensuring that the country’s energy needs are not jeopardised, which includes gaining access to oil without further hurting its energy security or economy.

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