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U.S. to Toughen Sanctions on Iran under Defense Authorization Act

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On December 15, the U.S. Senate voted 86 to 13 in favor of the National Defense Authorization Act for Fiscal Year 2012 for tougher anti-Iran economic sanctions including an effective oil export embargo on Iran. The bill passed the House of Representatives by an overwhelming majority on the previous day. It will be signed into law by President Barack Obama.

Behind the tougher anti-Iran economic sanctions, Iran’s tensions with the international community, including the United States, over Iran’s nuclear weapons development have grown since November. A turning point came on November 8 when the International Atomic Energy Agency issued a report indicating “evidence” of Iran’s nuclear weapons development. On November 21, the United States, Britain and Canada came up with their respective additional economic sanctions on Iran. On December 1, the European Union made its decision on anti-Iran sanctions. In Iran, demonstrations against Britain's tougher sanctions developed into a riot, leading to an attack on the British embassy in Tehran on November 29. Iran's tensions with the United States and Europe have escalated fast over the tougher economic sanctions. The U.S. Congress's approval of the tougher anti-Iran sanctions indicated the United States' very tough stance against Iran.

What are key points of the anti-Iran sanctions in the defense authorization act? They include a measure to prohibit foreign banks from settling transactions in U.S. dollars with their U.S. counterparts if they deal with the Central Bank of Iran (CBI) and other Iranian financial institutions. Foreign banks that must maintain dollar-based settlements in the United States may have to terminate deals with the CBI and other Iranian banks in order to avoid the prohibition. The problem is that the measure could lead to an effective embargo on Iranian oil exports. As Japanese banks settle crude oil imports at the CBI, their settlement of crude oil imports at the CBI may conflict with the U.S. law and their dollar-based settlements in the United States may be prohibited. Then, they may have to avoid oil transactions with Iran in order to continue dollar-based settlements in the United States.

At present, President Obama has yet to sign the bill into law. Given the current conditions, however, he is expected to sign the bill for its enactment in the near future. Then, the following steps may have to be taken with certain conditions met before the law actually brings about the stringent Iranian oil embargo. The future focus of attention would be whether these conditions could actually be met.

- Within 60 days after the act's enactment and every 60 days later, the Administrator of the Energy Information Administration together with the Treasury Secretary, Secretary of State and the Director of National Intelligence, will report to Congress on prices and other conditions of oil supply from other countries than Iran.

- Within 90 days after the act's enactment and every 180 days later, the president, based on the above mentioned reports, shall decide whether oil supply from other countries than Iran would be sufficient.
- If the president decides that such oil supply is sufficient, the prohibition shall be imposed on foreign banks that will have settled oil transactions with Iran in U.S. dollars 180 or more days after the act's enactment, with the following exceptions.
- The sanction will not be imposed on banks from foreign countries that will have substantially reduced oil imports from Iran in the period toward the presidential decision (exemption).
- The president may waive the imposition of sanctions for up to 120 days (and may renew the waiver) if the waiver is identified as vitally significant for U.S. national security.

In this way, developments regarding the oil market, crude oil purchases from Iran and U.S. national security will become decisive factors behind the run-up to the actual embargo on Iranian oil exports.

Nevertheless, the U.S. steps can effectively impose a stringent embargo on Iranian oil exports. While future developments cannot be predicted, we can expect that the Iranian oil embargo, if implemented, would have a substantial impact. This is because Iran is the world’s fourth largest crude oil exporter, with its exports totaling 2.24 million barrels per day in 2010. The impact may depend on various combinations of embargo measures including embargo scales and exemptions. In the worst case where Iranian crude oil is lost in the international oil market under a complete embargo, it would be difficult to cover the loss. Even Saudi Arabia with the world’s largest surplus oil production capacity may have physical difficulties covering such large loss and be forced to make a very difficult political decision in the face of an actual Iranian oil embargo. If Saudi Arabia expands oil output substantially to cover the loss of Iranian crude oil exports, the global surplus oil production capacity may fall substantially to sharply increase the sense of a tightening supply-demand balance in the international oil market.

Since Asian countries including Japan are major importers of Iranian crude oil, the supply-demand balance is expected to tighten particularly in the Asian market. Crude oil imports in 2010 totaled 430,000 bpd for China, 360,000 bpd for Japan, 290,000 bpd for India and 200,000 bpd for South Korea. The four Asian countries absorb about 60% of Iran’s oil exports. The Iranian oil embargo is a serious issue for Japan and South Korea that give priority to their respective bilateral relationship with the United States. While the urgent challenge for the two countries is their coordination with the United States, they may have to pay attention to what actions China and India will take. I am interested in how China and India would respond to the Iranian oil embargo issue and how their crude oil imports from Iran would change. If an actual Iranian oil embargo tightens the global oil supply-demand balance and destabilizes the international oil market, we may have to pay attention to the two emerging oil importers’ market actions as a factor that could accelerate the market destabilization. In the event of oil supply shortages and market destabilization, the International Energy Agency may implement internationally coordinated market stabilization measures. Then, wide international cooperation and collaboration including China and India may grow more important.

The Iranian oil embargo issue also entails Iran’s possible countermeasures, its growing political and military tensions with neighboring countries over nuclear arms development, and other problems that we cannot ignore. Developments regarding the Iranian oil embargo issue could affect not only Iranian oil exports but also the Persian Gulf situation and the security of oil and gas exports from the region. We see uncertainties in U.S. domestic arguments over the issue, various considerations regarding the U.S. presidential election, Iran's responses, the attitudes of Iranian oil importers subject to the U.S. sanctions, and moves of other Arab oil exporting countries and Israel. Therefore, the fate of the Iranian oil embargo issue may become one of the largest factors affecting the international oil and energy situation in and after 2012.

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