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The Plan for the Economic Strangulation of Iran

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In-depth Report: IRAN: THE NEXT WAR?

It is said that there is more than one way to skin a cat. It seems that United States is trying to skin this cat –Iran- in anyway that it can, including economic strangulation.

While people are concerned with Iraq and the gathering armada in the Persian Gulf, United States has been quietly carrying out a not so covert economic war against Iran.

Since the 1979 revolution in Iran, the country has been under constant US unilateral sanctions. "The first U.S. sanctions against Iran were formalized in November of 1979, and during the hostage crisis, many sanctions were leveled against the Iranian government. By 1987 the import of Iranian goods into the United States had been banned. In 1995, President Clinton issued Executive Order 12957, banning U.S. investment in Iran's energy sector, followed a few weeks later by Executive Order 12959 of May 6, 2000, eliminating all trade and investment and virtually all interaction between the United States and Iran." [1]

Despite the sanctions Iran continued to attract foreign investment and technical cooperation for its energy sector. Countries such as France, Italy and others took advantage of absence of the American competition and tried to fill the gap. However, the threat of American retaliation kept the investment way bellow the desired levels. It only allowed Iran to continue to keep its oil export at its OPEC determined quota level.

The Economic Choke-point: Oil & Gas

> "According to the Oil and Gas Journal, as of January 1, 2006, Iran held 132.5 billion barrels of proven oil reserves. This figure, which includes recent discoveries in the Kushk and Hosseineih fields of Khuzestan province, means Iran holds roughly 10 percent of the world's total proven reserves. The vast majority of Iran's crude oil reserves are located in giant onshore fields in the south-western Khuzestan region near the Iraqi border. Overall, Iran has 40 producing fields – 27 onshore and 13 offshore. Iran's crude oil is generally medium in sulfur and in the 28°-35° API range."[2]

There is no doubt that Iranian economy is driven by oil. Oil revenues constitute over 70 percent of its total export earnings and 50 percent of its GDP. Iran's oil revenues were $32 billion in 2004, $45.6 billion in 2005, and according to Iran's National Oil Company international affairs director, Hojjatollah Ghanimifard, will reach $52 billion by the end of the Iranian calendar year (21 March 2007).

Iran currently produces about 4 million barrels of oil per day, of which only 2.5 million barrels are exported with the remaining 1.5 million barrel being consumed internally. According to the latest report (26 Dec 2007) by the National Academy of Sciences of the

United States (NAS), if the current increase in local Iranian oil consumption continues and the current decline in oil production is not stopped, then by 2015 Iran's oil export will decline to zero.[3] According to this and other reports Iran needs to invest about $2.5 billion a year just to stand still. Iran is not running out of oil, but needs money to maintain old fields and bring in the new fields online.

The existing major oil fields in Iran are: Ahwaz (1958), Aghajari (1936), Gacchsaran (1937) and Marun (1963). These four fields together, during their highest output, produced almost 4.5 million barrel of oil per day. All four reached their peak in late 60s to mid 70s. According to Mathew R. Simmons by 2003, these 4 oilfields' combined production were reduced to 1.7 million barrel per day. [4]

The current US strategy is to starve the Iranian oil and gas industries of new investments, thereby reducing the Iranian government's revenues which are hoped will in turn reduce Iran's ability to maintain not only its armed forces, but also the government's social obligations to its people (subsidies, salaries, etc.). It is hoped that this combined with international isolation and (with the help of Saudi Arabia) a reduction in oil prices (OPEC crude basket price: $51.25 per barrel on 8/1/07) will not only cripple the Iranian economy, but also (possibly) lead to a regime change. All attacks on the economy was being presented under the guise of stopping Iran from developing WMDs, and in particular Nuclear weapons.

The attack on Iranian economy started in earnest in early 2006. United States began putting considerable pressure on international banks and financial institutions to cut their ties with Iran. Countries also were pressured to reduce their economic contact with Iran. For example beside the usual behind the scene warnings and threats, in September 2006, the US treasury secretary M. Paulson Jr, used his first meeting of world finance chiefs as a venue for the Bush administration's mission to isolate Iran.

> "Emerging from a meeting of finance ministers representing the Group of Seven industrialized nations, Paulson said he urged his counterparts to intensify efforts to prevent banks and private companies in their countries from being used as unwitting conduits for financing and materials aiding Iran's ambitions."[5]

Later under pressure from the US some three top Japanese banks: Bank of Tokyo-Mitsubishi UFJ, Mizuho Corporate Bank and Sumitomo Mitsui Banking Corp announced that, in line with US financial sanctions, they will refrain from working with Iran's state-run Bank Saderat of Iran (with 3400 branches in Iran). Recently another major Iranian Bank with some foreign branches is being targeted for freeze of assets and sanctions. "Bank Sepah International Plc (BSIP), incorporated in the United Kingdom, specializes in providing finance and services for international trade worldwide with a particular focus on Iran and the Persian Gulf region, according to its Web site. The bank is a wholly owned subsidiary of Bank Sepah, Iran, which was established in 1925 and is the oldest of the Iranian banks. Bank Sepah has a large network of branches in Iran as well as offices in Paris, Frankfurt and Rome".[6]

The pressure was also felt by Indian and Swiss banks as well. In mid 2006 the State Bank of India (SBI), the only Indian bank operating in Iran (with a token presence) came under intense pressure to quit Iran [7].

Other banks that succumbed to the pressure were USB AG (took over Banco Pactual S.A. in

2006) and Credit Suisse Group of Switzerland (controlling group of other banks such as: Bank Leu, Schweizerische Volksbank, Neue Aargauer Bank, Winterthur, and Donaldson, Lufkin & Jenrette Inc.). UBS AG, Europe's largest bank by assets, also cut all business ties with Iran in January 2006 and met with U.S. legislators in April 2006 about its transfers of U.S. banknotes to the Islamic Republic. Credit Suisse Group, Switzerland's second-biggest bank, also quit Iran in January. Other Banks to quit or restrict their activities in Iran were: ABN AMRO of Holland and London-based HSBC.

These were just a few example of United States' indirect financial pressure on Iran. Governments, companies and financial institutions are under intense pressure to terminate all dealings with Iran. But so far Iran has managed to sustain, albeit with great difficulty, its oil industry and financial institutions functioning.

Iran's Strategy

Iran facing the American financial attack on its oil facilities has been quick to seek other venues for both investment in its oil facilities and financial transactions. Iran facing a increasingly hostile US and Europeans has turned to Russia and China for investment and technical know-how for its oil and gas industries. China has the needed financial muscle and enough thirst for energy to disregard American pressures. China is already investing heavily in Iranian oil fields, securing for itself a portion of the oil and gas reserves. China with 1.3 billion people and fast growing economy is already the second largest oil consumer in the world. If China's economic growth continues, it is estimated that by 2020 China's energy needs will increase by 150 percent.

> "China's expectation of growing future dependence on oil imports has brought it to acquire interests in exploration and production in places like Kazakhstan, Russia, Venezuela, Sudan, West Africa, Iran, Saudi Arabia and Canada. But despite its efforts to diversify its sources, China has become increasingly dependent on Middle East oil. Today, 58% of China's oil imports come from the region. By 2015, the share of Middle East oil will stand on 70%. Though historically China has had no long-standing strategic interests in the Middle East, its relationship with the region from where most of its oil comes is becoming increasingly important."[8]

Last year China signed oil and gas contracts worth over $100 billion with Iran. China is heavily involved in developing the huge Yadavaran oil field. "If completed, the deal will allow China to buy 150,000 barrels of Iranian crude a day at market rates for 25 years as well as 250 million tons of liquefied natural gas. Under an initial agreement signed by the Sinopec Group in October 2004, China could pay Iran as much as $100 billion for the stake and the purchases of oil and gas over 25 years."[9] Interestingly Royal Dutch Shell Plc works as technical consultant for Sinopec on Yadavaran field.

On 25 December 2006, National Offshore Oil Corp of China announced the signing of a $16 billion memorendom of understanding to develop Iran's North Pars gas field and build liquefied natural gas (LNG) plants in Iran. The project is expected to take 8 years to complete.

Russia is also interested to enter the lucrative Iranian oil and gas market. According to Moscow Times, the Russian oil company LUKoil is about to sign a contract for producing oil from Iran's Azadegan field [10]. There are also Russian companies vying for entry into the

Iranian market. “Mashna Uqua Company has offered National Iranian South Oil Company (NISOC) to apply the new technology to improve ROR at one of Iranian oil reserves, the source who wanted not to be identified told the Mehr News Agency. The technology includes the injection of a gel into oil reserve, which prevents rush of water into the reserve and thereby improving the ROR, the source elaborated.”[11]

Russia is also very interested to create a gas cartel, similar to OPEC. Recently a senior Russian parliamentarian called for creation of a producers’ cartel to “stand-up” to the consumers’ cartel.

“It is necessary to form a gas alliance, which could be joined by Turkmenistan, Kazakhstan, Uzbekistan, Russia, Ukraine and Belarus,” the head of the Russian parliament’s energy committee Valery Yazev said Monday, RIA-Novosti reported. “Tomorrow, with the removal of the problem of Iran’s nuclear program, I would also see Iran in this alliance,” Mr Yazev said, speaking at a meeting of the Russian Gas Union industry group, which he also heads.[12]

It is no secret that Russia is using its energy resources to gain maximum commercial and political advantage in its dealing with the EU and others. Gazprom is already a mighty oil giant and is moving fast to become the world’s leading supplier of Gas as well. Russia is trying to monopolise the gas market. The only potential competitor to Gazprom would be Iran. If Russia manages to create a gas cartel with Iran, Europe will become a captive market with few options for its gas supplies.

Local Energy Consumption

As was mentioned above, of the 4 million barrel per day oil production about 1.5 million barrel is consumed locally in Iran. Iran has a burgeoning car industry with majority of the cars produced for local market. There are over 3 million cars in Tehran alone; with nearly half of them being dilapidated old gas guzzlers. Each year the country has to import billions of dollars of fuel. Iran’s refineries can only supply 42 million litres of petrol a day, while the demand is for 70 million litres. This means that Iran imports over 30 million litres of petrol a day; something that is costing the country huge amounts of hard currency.

Petrol is heavily subsidised and a gallon of petrol costs only 35 cents. These subsidies have resulted not only in smuggling of petrol to the neighbouring countries but also a major financial drain on the government’s finances. Iran needs to reduce both its consumption and increase its refining capacity.

To increase refining capacity, Iran has begun building new refineries both inside and outside the countries. Iran has planned joint ventures for building refineries in Syria [13], Venezuela [14] and Indonesia [15]. In addition Iran has planned several refineries inside Iran, with the latest being a possible joint venture with Essar of India [16]. To reduce consumption, the government has planned a new petrol rationing system. However, rationing by itself will not address Iranians’ addiction to cheap petrol. The only solution is the normalisation of the prices, which because of the political situation is highly unlikely.

Another major drain on the economy of Iran is its gas consumption. Iran “has one of the most extensive residential heating infrastructures in the world, with homes in the most remote villages warmed toastily with inexpensive natural gas. Total domestic energy subsidies cost $20 billion to $30 billion a year”[17]. Recently, Iran had to stop delivery of gas to Turkey because of a sudden rise in local demand. The government, it seems, has not decided yet if it wants the gas for export, heating homes, creating energy intensive industries or for injecting into the oil wells. But regardless of the choices it makes, the government knows that it can not continue indefinitely with the current level of subsidies.

What now? The current American financial attacks on Iran are being felt in Tehran. These attacks although a recurring theme, has never been as intense as it is now. These attacks will cause some pain in Tehran but will not dissuade the government to abandon its nuclear ambitions. Iran in all likelihood will address (short term) its production problems and will reduce its local consumption by increasing the prices (adding to an already high inflation) and rationing. These attacks do and will hurt Iran, but not to a degree that United States desires. These attacks although sever, can be seen by some in Iran as a blessing in disguise, for it now force the Iranians to address some unpleasant questions with regard to their economy in general and energy consumption and subsidies in particular.

Iran suffers from many economic problems most of which is related to over-involvement of the government in the economy. Some of the financial problems can be attributed to the sanctions, but the majority of the existing economic problems are self-made. Weak management, inefficient use of resources, corruption, red-tapes and myriad of regulations are just a few among many problems that are facing the Iranian economy. These problems were not created by Ahmadinejad, nor can they all be solved by him; however people expect him to address many of these problems. This is what I call Ahmadinejad's Achilles' heel, which I shall address in my next article. Ahmadinejad was elected mainly for his promise of putting more bread on the Iranian tables. With the enormous problems facing him, it is difficult to see how he is going to fulfil his promises to the electorates. Meanwhile Bush administration is bent on regime change in Iran, reducing all chances of a peaceful resolution to the existing US-Iran problems. One would have expected that the recent election defeat would have sent a clear signal to the Whitehouse that the American people want less and not more conflict in the region. But apparently Bush administration is going in the opposite direction. US is continuing to increase its naval presence in the Persian Gulf. The USS John C. Stennis strike group is soon to join the USS Dwight Eisenhower aircraft carrier group and USS Boxer strike force in the Persian Gulf "as a warning to Syria and Iran". Pushing for more stringent UN sanctions, use of unilateral sanctions, increasing pressure on foreign governments to stop dealing with Iran, putting sanctions on Iranian Banks and increasing the size of US navy presence in Persian Gulf are all signs of hostile intentions by Bush administration towards Iran.

It is difficult to see how United States expects Iran to cooperate on Iraq and Afghanistan while being threatened militarily and suffocated economically. It may also all be a negotiating tactics. First show the guns and then negotiate. But in my opinion this is neither a bluff nor a negotiating tactic. Bush administration is behaving like a gambler that has lost everything except his house. Now in one last desperate attempt it is raising the bet to all or nothing. Let us hope that the Democrats will stop Bush before he accidentally or by design start another war in an already volatile region.

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Notes

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