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Built to Spill: The Regional Consequences of Gasoline Sanctions on Iran

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Iran's Achilles heel, goes the mantra of many Washington hawks, is its dependence on imported petrol – the result of underinvestment in its energy industry during three decades of sanctions. While the country is a net oil exporter, Iran's domestic refining capacity lags, forcing the Islamic Republic to import roughly a third of its daily petrol needs from abroad and ration consumer fuel purchases.

The US Congress is currently considering a bill, the Iran Refined Petroleum Sanctions Act, which would exploit this weakness by penalising companies and individuals that import petrol into Iran or invest in its domestic oil and gas infrastructure. The rosy logic behind the sanctions bill, which currently enjoys majority support in both houses of Congress, is not new: the hope is that ordinary Iranians, squeezed at the petrol pump, will pressure their recalcitrant leaders to halt uranium enrichment, embrace Israel and stop their unpalatable activities in Iraq, Lebanon and elsewhere in the region. That, or Tehran will lash out frantically in response, which will lead to an international consensus for even tougher sanctions – or worse.

Opponents of the bill have already pointed out many of its flaws: for starters, Iran could seek investments from Russia and China to build new refineries. Beyond that logistical loophole, it is also the case that Iranians generally support the country's nuclear programme – and even if they didn't, forcing Iran's increasingly authoritarian government to reverse course would require months, if not years, of struggle and bloodshed. Sanctions against oil-producing nations often starve business and civil society, while the continuing flow of oil profits to the state leaves the targeted regimes more, rather than less, powerful – Saddam Hussein's reign in Iraq being the best example.

But even this litany of concerns about the efficacy of sanctions leaves aside a critical issue: the potentially disruptive consequences for the wider region. America, the world's

most prolific user of economic sanctions, conceives of them as narrowly directed measures against the target state – the impact on neighbouring states rarely registers in Washington. But sanctions, particularly on consumer products with mass demand like petrol, tend to produce distortions in regional trade dynamics that can have political repercussions. Powerful incentives are generated to meet demand for the sanctioned products, inside and outside of the targeted state, creating economic imbalances in the region and political tensions with the state that has imposed the sanctions. And in the case of petrol sanctions on Iran these consequences are likely to be acute, given the long and storied history of trade relations across the Gulf.

Consider the following thought experiment. Assume the sanctions act is passed by Congress and signed into law by President Obama. Let's also assume that, contrary to the loopholes outlined above, US pressure on oil companies and other states does indeed manage to double or treble the price Iran pays for its petrol. What are the regional repercussions?

First, Iran would almost certainly begin industrial scale efforts to import (read: smuggle) petrol from wherever it can; with their high subsidies on petrol, which keep consumer prices artificially low, GCC states will be the most likely targets. The effects might be felt most severely in Oman, where petrol is cheaper than bottled water, and in the UAE; both countries maintain patterns of commerce with Iran that date back centuries. Filling the fuel needs of 65 million Iranians – while taking advantage of subsidies intended for domestic consumers – will stretch GCC government coffers, producing a range of political and economic stresses that could force cuts in social spending or energy investment.

This cross-Gulf smuggling trade will start slowly at first – petrol-filled Coca-Cola bottles thrown into a dhow's shipping crate – but it will quickly become sophisticated and institutionalised. In Iran, financial and political gains will accrue to the most efficient smugglers. American statements have long identified the Revolutionary Guard as key players in sanctions-busting trade in all types of goods, not just those related to Iran's nuclear programme. The paramilitary group has experience in operating aircraft and ships, setting up front companies and other related activities – positioning them to move easily into the petrol trade if sanctions are passed. Since much of the smuggled petrol will be coming across the Gulf, the Guards will seek to secure shipping in the waterway and might try to expand networks inside Gulf States themselves.

If the United States is serious about choking off Iranian petrol imports, it will need to coordinate policy extensively with GCC states to stop this informal cross-Gulf petrol trade. This will prove difficult due to the sheer amounts of money involved, and also because of the trade dynamics that sanctions regimes produce. Recent work by the Harvard University researcher Bryan Early demonstrates that friends of the sanctioning state are in fact more likely to trade in violation of sanctions because of the security

afforded by the alliance; in the case of the GCC and Iran, Washington may be reluctant to put too much pressure on its Arab allies to help enforce the sanctions regime, lest it jeopardise its valuable strategic partnerships in the Gulf. Historically, then, the desire to preserve security ties has trumped imperatives of sanctions enforcement. This dynamic could change, of course, but at the cost of strained relations between America and the Gulf States – as well as an increase in internal GCC tensions over Iran between countries like Qatar and Oman, which remain friendly with the Islamic Republic, and those, like Saudi Arabia, which do not.

New sanctions would also accelerate brain drain and capital flight from Iran. The Iranian Rial is dropping precipitously in the face of falling oil production – a trend that can only continue if Iran’s energy sector is starved of investment. This could, of course, benefit the UAE – as a hub for trade, services, capital and talent, the Emirates stand to benefit from many types of regional instability, and if implemented, the proposed sanctions make it likely that more Iranians of means will decide to move themselves and their money to Dubai. But the wider consequences remain unpredictable: an exodus across the Gulf could, in fact, bolster the Iranian regime by removing many of its domestic opponents.

It is not clear exactly how the sanctions would be implemented; the current draft legislation seems to provide for financial penalties for individuals and companies, while some critics have described it as a “blockade,” giving the implication of military enforcement. Either way, taking material steps to cut off petrol, the lifeblood of a state’s economy, is an act of war. States respond to such acts in fundamentally unpredictable ways, but history tells us that wars tend to escalate, last longer and cost more lives than participants expected at the outset.

Proponents of further sanctions against Iran have sometimes couched their arguments in terms of the security of America’s Gulf allies, but the GCC states, home to a considerable American military presence, would also become potential targets for Iranian retaliation. Iranian leaders have in the past made direct threats against Gulf States to this effect, while analysts have often contemplated the possibility that Iran will use mines, or small boats, to cut off trade in the Straits of Hormuz, through which 90 per cent of Gulf oil exports travel.

If the worst of these outcomes does not come to pass, a partially successful effort at cutting off Iran’s petrol imports and domestic refining capacity could offer limited gains to some specific parties. Qatar, for example, would benefit from Iran’s absence as a competitor in world natural gas markets; the UAE could gain from an exodus of Iranian wealth and talent to Dubai, and regional trading families stand to profit from the lucrative trade in black market petrol. But these isolated benefits would accrue to the few at the expense of heightened geopolitical risk for the many. Iran would very likely

seek to secure petrol supplies across the Gulf, which would increase the risk of a miscalculation that triggers a disastrous wider conflict.

At present, the US Congress seems determined to lay down a tough line – hoping to maintain a credible threat of “crippling sanctions” if Iran refuses to cooperate. Yet precious little thought seems to have been given to the feasibility of implementing the sanctions or to the costs that such a programme would impose on America’s allies in the Gulf. In the worst case, the petrol sanctions – framed as an attempt to avoid war with Iran – might have precisely the opposite effect.