India’s Approach to Sanctions on Iran

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I. Introduction

In the past few years, the US-led international economic sanctions against Iran have inhibited Indo-Iranian energy ties considerably. Despite its relatively vast domestic energy sources, India’s impressive economic growth has left it increasingly dependent on foreign energy. In 2010, as the world’s fifth-largest net oil importer, India imported 70% of the oil it consumed. About 10% of these oil imports came from Iran (Fig. 1).

This oil trade makes up the bulk of Indo-Iranian bilateral trade. Whereas, Iran is India’s second largest oil supplier after Saudi Arabia, New Delhi is Tehran’s second largest oil purchaser after China. Indeed, in some months India has bought more oil from Iran than China did.

It’s therefore not difficult to understand India’s well-publicised initial reluctance to announce immediate cuts in Iranian crude imports. Nonetheless, although this gives off the impression that New Delhi will seek to defy U.S. sanctions, this is not borne out by the facts. Even as it publicly condemns U.S. sanctions, the Indian government is reportedly quietly urging the country’s refiners to gradually reduce their reliance on Iranian crude. The apparent contradiction between Delhi’s public defiance of the Western sanctions, and its quiet adaption to them, embodies the complex set of factors India’s leaders face in trying to balance New Delhi’s competing interests with the United States and Iran.

Figure 1

II. Economic Overview

Although the Indian government doesn’t release separate data for India’s oil & gas imports, by looking at the declining trend in the total trade between India and Iran (fig. 2) it can be deduced that international sanctions have significantly impeded India-Iran trade in petroleum over the last three years.

Figure 2:

Trends in India-Iran Bilateral Trade (figures in Million US$)

Year	India’s exports to Iran	India’s imports from Iran	Total trade	Trade balance	Total trade growth rate (%)
2005-06	1187.71	4822.65	6011.36	-3633.94	44.39
2006-07	1490.99	7839.08	9330.07	-6348.09	55.20
2007-08	1943.91				

10889.57

12833.48

-8945.66

37.55

2008-09

2534.01

12376.77

14910.78

-9842.76

16.19

2009-10

1853.17

11540.85

13394.02

-9687.68

-10.17

(Source: Ministry of Commerce & Industry, Government of India)

III. Natural Gas Trade

India gets the bulk of its natural gas supplies from Iran, which holds the world's second largest reserves. Progress in this area has similarly been hamstrung by U.S. pressure and international sanctions. For instance, in light of the Obama administration's opposition, India shelved the much-touted Iran-Pakistan-India pipeline project for transporting gas from Iran to India via Pakistan. U.S. laws such as the *Iran and Libya Sanctions Act of 1996 (ISA)* and now the *Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010 (CISADA)* have further complicated India's ability to obtain natural gas from Iran.

As with the ISA, the CISADA imposes sanctions on foreign companies that invest more than $20 million a year in Iran's energy sector. Consequently, the $22 billion, 25-year LNG deal India's GAIL (Gas Authority of India Limited) and NIGEC (National Iranian Gas Export Company) signed in 2005 remains unrealized. GAIL has been unable to find a way to construct the LNG liquefaction port in Iran as agreed to in the 2005 deal without running afoul of the CISADA and using American-made components and processes, which U.S. law restricts from being circulated in Iran.

Similarly, natural gas exploration and production projects of Indian companies have also been halted. In November 2009, the overseas arm of state-run Oil and Natural Gas Commission (ONGC), ONGC Videsh Limited (OVL), as well as Ashok Leyland Projects Services, a private company, signed agreements to take a 40 % stake in South Pars fieldphase 12 (SP-12), offered by the state-run National Iranian Oil Company (NIOC). OVL has also submitted a $5.5 billion plan to bring to production the Farzad-B gas find in Farsi gas fields in the Persian Gulf. Additionally, in December 2009, OVL agreed to take a 20 percent stake in the liquefied natural gas export facility that Iran LNG (a subsidiary of NIOC) is building on the southern Iranian coast. All these deals remain unimplemented due to sanctions.

IV. Crude Oil Dealings

The backbone of India-Iran energy ties is trade in crude oil, however. Here too, the heat of international sanctions are beginning to have their intended effect on Indian oil purchases. Indian refiners are already cautioning against major supply disruptions and have started shifting to alternative producers, although the near-term will see continued inflow of Iranian oil. India is nonetheless likely to see an 18% reduction in Iranian crude this year. In light of Japan’s 15-22% cut in oil purchases from Iran in the second half of 2011, New Delhi sees an 18% reduction as sufficient enough for the Obama Administration to exempt Indian companies from sanctions.

Iran’s oil sales to India have been fraught with payment problems since December 2010, at which time the Reserve Bank of India scrapped the Asian Clearing Union (ACU) payment mechanism following tougher U.S. sanctions on Iran’s financial sector. The international sanctions have curtailed India’s export of petroleum products to Iran as well. In June 2009, India’s largest private sector company Reliance Industries stopped exporting petroleum products to Iran in order to stave off possible restrictions on sales to the far bigger U.S. market. Reliance was exporting 2% of its total output, worth around $280 million. RIL exports petroleum products worth $14 billion annually, of which around 5% is to the US.

India’s crude oil imports from Iran have become even more problematic as of late. On December 31, 2011, President Obama signed the *National Defence Authorization Act (NDAA)* containing the first-ever sanctions against Iran’s central bank, Bank Markazi. Specifically, the bill requires the U.S. President to deny foreign banks or financial institutions that process payments through Iran’s central bank access to U.S. financial markets.

These new measures are aimed at reducing foreign demand for Iranian oil by punishing dealings with Bank Markazi, Iran’s clearinghouse for crude oil transactions. But, recognizing the need to avoid upending global financial health, the sanctions allow the Obama administration to make exemptions to countries that ‘significantly’ reduce their volume of purchases of Iranian crude oil, determined on a case-to-case basis. These sanctions are to come into full effect on July 1.

Since the RBI shut the ACU arrangement, Indian refiners have been directing oil payments through Turkey’s state-owned Halkbank. If this mechanism is halted, once the sanctions gets underway mid-year, India’s ability to import crude oil from Iran will be severely affected. In order to hedge against this possibility, India and Iran have worked out a payment agreement whereby New Delhi will be able to settle part of its oil bill using its own currency, the Indian Rupee. The lesser known state-owned Kolkata-based UCO Bank, which has little exposure to either the US or EU markets, has been selected to handle the payment.

This arrangement, however, only covers 45% of the oil bill as India maintains a substantial trade deficit with Iran. For example, in 2010-11, its exports to Iran stood at around $2.7 billion, whereas its imports totaled around $10.9 billion worth of goods (fig. 2). Even after accounting for a possible increase in exports to Iran due to the refusal of other countries to trade with it, India will still find it difficult to settle the remaining oil bill.

The Society for Worldwide Internet Financial Telecommunication (SWIFT), which handles global electronic fund transfers, which has India on board, dropped Iran out of its network recently. This creates further obstacles for India in repaying its dues. In addition, Indian refiners are also finding it difficult to secure shipping insurance for oil imports from the Persian Gulf state.

The vagaries of crude oil purchases from Iran due to international sanctions are driving the Indian processors to seek alternative supplies, supported tacitly by the government. Reports say that notwithstanding the Indian government’s stated position that it is not under any obligation to abide by unilateral US sanctions, it has advised its refineries to cut Iran imports by at least 15 %. Delhi's strategy appears to be to find the right balance between cutting enough to satisfy Washington without completely choking off Iran's supply.

India is not alone in pursuing this strategy. Other Asian buyers such as China, South Korea and Japan have also cut their oil imports from Iran in the first quarter of this year in compliance with U.S. sanctions on Iran's central bank. Even as, China, Iran's top trade partner and crude buyer, has made it clear that it rejects the unilateral U.S. sanctions, February saw a decline of 40 % from the previous year in the amount of Iranian oil China purchased. India has not yet disclosed its February purchases of Iranian crude. Although it rose by 19% in January from the previous year, this is a reflection of crude orders made prior to the imposition of sanctions under the NDAA.

The pressure on India to reduce imports of Iranian oil has intensified with U.S. Secretary of State Hillary Clinton's announcement that Japan and ten European countries had qualified for exemptions from U.S. penalties on institutions that deal with Iran's central bank. India's imports reductions have not yet been demonstrable because refiners' annual crude term deals with Iran typically run from April to March. The planned reductions are most likely to start when new annual contracts begin in April 2012.

Iran's biggest Indian oil client, Mangalore Refinery and Petrochemicals Ltd (MRPL), plans to cut its annual imports from Tehran by 44 % to 80,000 barrels per day (bpd) in 2012-2013, as western sanctions make trade more difficult. The cuts in oil imports by MRPL would imply a reduction of more than 20% in India's total purchases of Iranian oil in the next fiscal year that began this month.

Much like other Indian refiners trying to make up for the loss of Iranian crude, MRPL has been seeking additional supplies from Arab Gulf nations including Saudi Arabia, Kuwait and the United Arab Emirates. Bharat Petroleum Corporation Limited (BPCL), India's second-biggest state refiner, is seeking to increase its oil imports from Saudi Arabia by 27% in FY2012 over the previous year to compensate for the reduction in imports from Iran. BPCL has approached the world's top oil exporter to lift the size of its term deal for the next fiscal year beginning this month to 152,000 bpd versus 120,000 bpd this fiscal year. The refiner plans to reduce its Iranian deal size by about 50% to 10,000 bpd in 2012-13.

The Mumbai-based refiner, Hindustan Petroleum Corporation Limited (HPCL), has said it will cut Iranian imports by about 15 % to 60,000 bpd in its annual contract. It plans to buy 40,000 bpd from Iran on a firm basis and keep 20,000 bpd as optional volumes. However, the private refiner Essar Oil intends to keep imports unchanged at 100,000 bpd.

V. Non-Economic Factors

There are other reasons behind India's balancing act between Iran and the United States. At the political level, India does not endorse the military component of Iran's nuclear programme and is on the same side as the West, including the United States, on this issue. Since its September 2005 decision to vote with the U.S. against Iran at the International Atomic Energy Agency (IAEA), India has maintained that position. It is worth noting that India also does not look favorably on Iran's threats to close down the Strait of Hormuz.

On the other hand, India's continued denouncements of American sanctions are also a reflection of domestic political realities. It is unpopular with domestic audiences for Indian politicians to be seen as towing the American line on Iran, given domestic constituents tendency to view India's Iran policy a litmus test of its autonomy in decision-making on international issues.

Additionally, India's important strategic interests are also linked with Iran. Iran provides India with land access to Afghanistan and Central Asia, something that Pakistan has not been willing to do. India is also cooperating with Iran to build a trade route from the Iranian Chabahar port in the South to the Caspian Sea in the North. When completed this will reduce the length of the cargo transport distance from the Indian Ocean region to Northern and Eastern Europe by two-thirds, relative to the route through the Suez Canal and the Mediterranean. The two countries are also cooperating to secure Persian Gulf sea lanes.

India also has a strong interest in the Persian Gulf's political stability. As a country that has six million nationals working in the Gulf region and an economy that is highly dependent on foreign energy, India is naturally concerned at the prospect of a regional conflict in the Gulf. Therefore, it is advocating for a peaceful diplomatic resolution to the dispute with Iran. As India tries to strike a balance between its relations with Iran and the United States, contradictions between New Delhi's stated position and actual action will be increasingly seen.

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