



INSTEX: EUROPE'S TOUGH MANEUVERING UNDER THE INFLUENCE OF U.S. SECONDARY SANCTIONS

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ABSTRACT

This analysis report aims to provide a nuanced analysis of the Joint Comprehensive Plan of Action (JCPOA), the consequences generated by its erosion, and those brought about by the reimposition of crippling US sanctions on the Islamic Republic of Iran. It makes the claim that the Instrument in Support of Trade Exchanges (INSTEK), designed to allow Europeans to bypass US sanctions and continue trade with Tehran, is not sufficient to guarantee the economic benefits anticipated by the nuclear deal reached in Vienna on the 14th of July 2015. While INSTEK cannot directly counteract the Trump administration's "maximum pressure" campaign -nor can it fully deliver on the JCPOA's economic promises, it can, however, help the Iranian population by reducing the inflationary impact of increases in the price of imported goods. This paper aims to expand on the prospects of this mechanism as well as the areas it fails to cover. By recounting the inception of the JCPOA, its evolution following withdrawal of the United States, and the damages caused by the reinstatement of American sanctions on Iran, this paper will make clear that this instrument alone is not enough to remedy the current situation. At the diplomatic level, Europe can and should provide Iran with guarantees as to its return to the international financial system. To do so, and in order for the European Union to remain credible towards Iran, the EU can begin by strengthening the scale and scope of INSTEK, stepping-up its recruitment of non-EU members to the Instrument, and addressing the overcompliance of European banks and businesses to American sanctions.

RÉSUMÉ

Cet article a pour ambition d'apporter une analyse nuancée de l'Accord sur le nucléaire iranien, le Plan d'action global commun (ou Joint Comprehensive Plan of Action – JCPOA), des conséquences générées par sa mise à mal et de celles provoquées par la réimposition de sanctions américaines contre la République islamique d'Iran. Il vise aussi à montrer que l'instrument de soutien aux échanges commerciaux (Instrument in Support of Trade Exchanges – INSTEK), conçu pour permettre aux Européens de contourner les sanctions américaines et poursuivre le commerce avec Téhéran, n'est pas suffisant pour garantir les avantages économiques attendus par l'accord nucléaire conclu à Vienne le 14 Juillet 2015. Si INSTEK ne peut pas contrecarrer directement la campagne de « pression maximale » de l'administration Trump, ni tenir pleinement les promesses économiques du JCPOA, il peut cependant aider le peuple iranien en réduisant l'effet inflationniste des augmentations du prix des marchandises importées. Cet article développe les perspectives de ce mécanisme ainsi que les domaines qu'il ne parvient pas à couvrir aujourd'hui. En relatant

la création du JCPOA, son évolution après le retrait des États-Unis et les ravages causés par le rétablissement des sanctions américaines contre l'Iran, cette analyse rappelle que cet instrument à lui seul ne suffit pas pour remédier à la situation actuelle. Au niveau diplomatique, les Européens pourraient et devraient fournir à l'Iran des garanties quant à son retour dans le système financier international. Pour ce faire, et pour que l'Union européenne reste crédible vis-à-vis de l'Iran, l'Union européenne peut commencer par renforcer l'échelle et la portée de l'INSTEX, intensifier son recrutement de membres non-UE et remédier à la trop grande conformité des banques et entreprises aux sanctions américaines. aide internationale et permette la reconstruction de l'économie du pays. Ces enjeux imposent à l'UE une impérieuse prise de position et de mesures face aux actes criminels de la coalition dont certains des États membres se rendent complice.

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EXECUTIVE SUMMARY

After the withdrawal, in May 2018, of the United States from the Joint Comprehensive Plan of Action (JCPOA), commonly known as the Iran nuclear deal, Europe was left dumbfounded. Even more appalling was the ruthlessness with which the Trump administration gratuitously reimposed crippling sanctions on Iran, who had hitherto adhered to the terms of the hard-earned deal. Less than a year after the US withdrew from the agreement, a special financial instrument, the Instrument in Support of Trade Exchanges (INSTEEX), was developed on the European scale. This financial compensation mechanism, established by France, the United Kingdom, and Germany, was designed to enable companies from these three countries to carry out commercial transactions with Iran in areas not sanctioned by the United States (humanitarian goods, foodstuff, medical commodities). As it does not require direct transfers of money between Iran and EU companies, INSTEEX creates a diplomatic shield that allows the EU to bypass punishing secondary sanctions from the US. In a report presented to the 74th session of the UN General Assembly in September 2019, the Special Rapporteur on the situation of human rights in the Islamic Republic of Iran, Mr. Javaid Rehman, stated that US sanctions unduly affected “food security and the availability and distribution of medicines, pharmaceutical equipment and supplies” in Iran.¹ However, INSTEEX has for a long time caused more frustration on the Iranian side than it has allowed for alleviation of the disastrous effects of the American withdrawal on the Iranian economy.

While the mechanism has been operational since June 2019, the first transfer carried out by INSTEEX did not take place until March 2020, a year and a half after its creation, and in view of the urgent need to allow Iran to obtain medical equipment in the midst of the COVID-19 crisis. In the first official reaction to the transaction, Iran’s foreign ministry spokesman Abbas Mousavi stated, “we see the launch of INSTEEX as a good omen,” but “what the Islamic Republic of Iran expects (from now on) is for the Europeans to fulfil the rest of their commitments in various fields (such as) banking, energy, insurance.”² In fact, the Iranian government has long considered that if its partners (France, the United Kingdom, Germany, China, and Russia) chose to remain in the JCPOA, this deal should ensure economic exchanges that involve the export of goods sanctioned by the United States—oil in particular. The Iran government has warned time and time again that if it could not export more than a million barrels per day (bpd), it would consider the nuclear deal to be of no further use. Prior to the US withdrawal from the JCPOA in May 2018, Iran was selling 2.5 million bpd.³ In July 2019, Iranian oil exports dropped to as low as 100,000 bpd.⁴ Today, Iranian oil exports remain below the million-barrel minimum indicated by Iranian government and the European Union appears to have no concrete plan to use INSTEEX to pick up those numbers.

This analysis report aims to provide a nuanced analysis of the Joint Comprehensive Plan of Action (JCPOA) and the consequences resulting from its sabotage. Further, it makes the claim that INSTEEX, the European response to the United States’ withdrawal from the JCPOA, even when operational, is not sufficient to guarantee the economic benefits anticipated by the nuclear deal reached in Vienna on the 14th of July 2015. While INSTEEX cannot directly counteract the Trump administration’s “maximum pressure” campaign nor can it fully deliver on the JCPOA’s economic promises, it can help the Iranian people by reducing the inflationary

1 UN General Assembly, ‘Situation of human rights in the Islamic Republic of Iran’, Report of the Special Rapporteur on the situation of human rights in the Islamic Republic of Iran, A/74/188, 18 July 2019.

2 “Iran Says INSTEEX ‘Good Omen’ But Insufficient”, Bourse & Bazaar, April 8, 2020.

3 Omid Shokri Kalehsar, “Iran oil exports face a tough future even after the coronavirus” The Atlantic Council, June 3, 2020.

4 Alex Lawler, “Hit by sanctions and rising tensions, Iran’s oil exports slide in July” Reuters, July 30, 2019.

impact of increases in the price of imported goods. This paper will aim to expand on the prospects of these mechanisms as well as the areas it fails to cover. By recounting the inception of the JCPOA, its evolution following the United States' pull out, and the damage caused by the reinstatement of American sanctions on Iran, this paper will make clear that this instrument alone is not enough to remedy the current situation. At the diplomatic level, Europe can and should provide Iran with guarantees as to its return to the international financial system. To do so, and in order for the European Union to remain credible towards Iran, it can begin by strengthening the scale and the scope of INSTEX, stepping-up its recruitment of non-EU members to the Instrument, and addressing the overcompliance of European banks and businesses to American sanctions.

One of the major geopolitical variables in a diplomatic solution to the deadlock in which the JCPOA stands today is, of course, President-elect Joseph Biden's smooth transition to power as President of the United States. Joe Biden has been an open critic of the US withdrawal from the nuclear deal by the Trump administration, which he considered to be an obvious betrayal to the country's European allies and a primary cause of escalating tensions with Iran. As such, it appears that Biden's victory in the 2020 US presidential election could have profound economic, diplomatic, and security repercussions on the Islamic Republic, notably by putting an end to the Trump administration's "maximum pressure" strategy. In an article Biden wrote for *Foreign Affairs* earlier this year, he pledged to rejoin the nuclear deal if Iran returned to its strict compliance. According to him:

"the historic Iran nuclear deal that the Obama-Biden administration negotiated blocked Iran from getting a nuclear weapon. Yet Trump rashly cast the deal aside, prompting Iran to restart its nuclear program and become more provocative, raising the risk of another disastrous war in the region. I'm under no illusions about the Iranian regime, which has engaged in destabilizing behavior across the Middle East, brutally cracked down on protesters at home, and unjustly detained Americans. But there is a smart way to counter the threat that Iran poses to our interests and a self-defeating way—and Trump has chosen the latter. [...] Tehran must return to strict compliance with the deal. If it does so, I would rejoin the agreement and use our renewed commitment to diplomacy to work with our allies to strengthen and extend it, while more effectively pushing back against Iran's other destabilizing activities."⁵

However, even with the political willingness to reduce sanctions, it may take a while before the Biden administration can succeed in reversing the current trend, making it all the more vital for the Europeans to expand INSTEX and ensure that it picks up speed.

In any case, the Trump administration's strategy has exposed the ineffectiveness of non-proliferation sanctions and has demonstrated that they are in fact more likely to hinder non-proliferation in Iran than to guarantee it. Regardless of exterior variables, INSTEX remains a show of European solidarity on the JCPOA and can participate in maintaining the agreement until diplomatic solutions are found. Although it has failed to remedy the disastrous effects brought about by American sanctions, it does have the potential to reduce the humanitarian harm caused by them and, at last, offer a glimmer of hope for an independent European foreign policy.

5 Biden, Joseph. "Why America Must Lead Again" *Foreign Affairs*, April 2020.

Part I – State of Play: The Iran Nuclear Deal's Rise and Fall

Part I recounts, from a historical perspective, the origins and the inception of the Iran nuclear deal, also known as the Joint Comprehensive Plan of Action (JCPOA). Further, Part I aims to provide a comprehensive understanding of the United States' "maximum pressure" strategy following the Trump administration's abandoning of the deal. This section also seeks to examine Iran's strategy as the country faces crippling sanctions from the US and struggles to convince its remaining JCPOA signatories to continue abiding by the terms of the deal, notably that of "strategic patience" and "maximal resistance." Last, Part I investigates the material consequences brought about in Iran as a result of US sanctions and of the European Union's failure to honor their JCPOA engagements via-à-vis the country.

The Outset of the Joint Comprehensive Plan of Action (JCPOA)

The history of US sanctions on Iran dates back to several decades ago. Since the 1979 Iran hostage crisis, in which Iranian students stormed the US Embassy in Tehran and took fifty-two American diplomats hostage, the United States has repeatedly imposed sanctions on the country. In fact, nearly all US administrations since Jimmy Carter (1977 – 1981) have imposed restrictions on activities with Iran and have used these sanctions as a tool to advance national and global security objectives. In 1996, for example, the US Congress passed the Iran-Libya Sanctions Act, which sought to penalize entities for investing in Iran's petroleum industry by fear that these investments would finance terrorism or allow Iran to develop or acquire weapons of mass destruction.⁶ As such, unilateral US sanctions have been repeatedly levied against Iran over the past decades despite numerous claims that these may in fact represent more of a threat than a guarantee to international peace and security.⁷

The Joint Comprehensive Plan of Action (JCPOA), reached on July 14, 2015 in Vienna between Iran on one hand, and the United States, France, Great Britain, Germany, China, and Russia on the other, concluded years of rocky negotiations. Initiated in October 2003 by France, Germany, and the United Kingdom (UK), with Russia, China, and the United States joining in later on, these negotiations, first driven by the European states, have had their fair share of ups and downs. Between 2010 and 2013, the European Union imposed increasingly tight sanctions on Iran, including an oil embargo over its nuclear program. Talks between Iran and the EU3 + 3—UK, China, France, Germany, Russia and the United States (also known as the P5 + 1)—failed to produce an agreement on the nuclear issue. Starting in 2013, President Barack Obama, bent on finalizing a deal with Iran before the end of his second mandate, entrusted this file to his new secretary of state, John Kerry, with the intention of concluding it. On the Iranian side, the spring of 2013 saw the election of a moderate president, Hassan Rouhani, eager to rid himself of the punishing US, UN, and EU sanctions imposed on his country. This alignment of possibilities made for a decisive occasion, which was eventually seized by both sides.

In July 2015, Iran and the P5 + 1 met in Geneva and, in a unique show of multilateral diplomacy, signed the JCPOA. The aim of the agreement was straightforward: Iran was to dismantle much of its nuclear program and give international inspectors extensive access to its facilities in exchange for relief from economic sanc-

⁶ Kumar Sen, Ashish. "A Brief History of Sanctions on Iran" The Atlantic Council, May 8, 2018.

⁷ Pierre Ramond and Leopold Werner. Iran, le jour d'après. Pour une nouvelle politique iranienne de l'Union européenne. Groupe d'études géopolitiques, Asie intermédiaire, April 2, 2020.

tions. However, the deal suffered a considerable weakness from the get-go. To avoid having to submit it to Congress, where it would surely face a Republican majority hostile to Iran, the Americans did not want the deal to take the form of a treaty bound by international law. As such, the deal took the form of an administrative arrangement, a simple plan of action, as its title indicates: a “Joint Comprehensive Plan of Action”. Finally, once submitted to the UN Security Council, the JCPOA was at last approved and the Council called for its immediate application (all this, without rendering its respect mandatory under the UN Charter). On the 16th of January 2016, the Iran nuclear deal was finally implemented.

After a brief period of enforcement by the Obama administration, the JCPOA was called into question in October 2017, less than two years after its implementation, by the new American president, Donald Trump. Trump, who regularly denounced the JCPOA as being “the worst deal ever negotiated”, reproached the deal for simply delaying Iran’s nuclear capacity rather than decisively obliterating it. In addition, he also criticized the fact that the JCPOA did not cover other controversial subjects — according to him, the nuclear deal did nothing to address Iran’s hegemonic ambitions in its surrounding environment as well as its continuing development of ballistic missiles.⁸ In May 2018, the United States notoriously abandoned the deal, leaving the international community in shock while inflaming the already tense transatlantic relationship.⁹

American sanctions and European inaction: From “Strategic Patience” to “Maximal Resistance”

The effects of the US withdrawal from the JCPOA were immediate: American sanctions were stringently reimposed on Iran, as well as on all of its commercial partners. These sanctions have prohibited Iran from buying American dollars, trading in gold, aluminum, or steel and have targeted the country’s oil industry, shipping, insurance, as well as Iran’s central bank. Additionally, non-US companies that continue to do business with Iran are at risk of having their access to the US market and financial sector completely denied. This threat has proved extremely effective given the dependency of non-US companies on the US financial system.¹⁰ For most, the benefits of trading with Iran are not worth risking US secondary sanctions and, as a result, Iran has been left completely isolated from the international financial system.

Trump, by exerting this maximum pressure strategy, expected Iran to fall to its knees, return to the negotiation table, and comply with his conditions, which implied addressing Iran’s ballistic missiles development “as well as its alleged support for terrorist or extremist groups in Lebanon, Yemen and elsewhere.”¹¹ Instead, Iran and its five remaining partners decided to maintain the accord. Meanwhile, the Iranian government meticulously ensured that it remain consistently faultless when investigated by the International Atomic Energy Agency (IAEA) with regards to the country’s obligations towards the JCPOA.¹² During this period, Hassan Rouhani asked the Europeans to intervene to counter US sanctions (notably by providing guarantees on bank-

8 Office of the President. *Ceasing U.S. Participation in the JCPOA and Taking Additional Action to Counter Iran’s Malign Influence and Deny Iran All Paths to a Nuclear Weapon* (Issued May 8, 2018).

9 Lander, Mark. “Trump Abandons Iran Nuclear Deal He Long Scorned.” *New York Times*, May 8, 2018.

10 Samantha Sultoon and Justine Walker, “Secondary Sanctions’ Implications and the Transatlantic Relationship”, *The Atlantic Council*, September 2019.

11 Anne Gearan and Abby Phillip. “Trump sets new conditions for U.S. to stay in Iran nuclear deal, tossing issue to Congress.” *The Washington Post*, October 13, 2017.

12 Bertrand Badie and Dominique Vidal, *Le Moyen-Orient et le Monde*, (Paris: Editions La Découverte, 2020), 253.

ing channels and oil sales) as well as ensure that the agreement was respected on their side.¹³ This posture of “strategic patience” nonetheless failed to generate even a modicum of the rewards Iran had hoped from its remaining partners.¹⁴ Banks and businesses chose to pass as well, fearing that their position on the global market would be compromised if they began doing business with Iran. Iran did not rule out the idea of negotiations but asked that the United States return to the terms established by the JCPOA. This demand, inconceivable in the eyes of the President of the United States, was met instead with more resistance. Indeed, in April 2019, Trump decided to toughen his sanctions and began by cancelling nearly all exemptions in terms of oil exports that had been originally established. Faced with this, the Iranian government changed their strategy and decided to rebuff the United States’ “maximal pressure” using “maximal resistance”.¹⁵

This new posture has been apparent on two fronts. On the regional front, Iran sent signals to its adversaries in the Arabian Peninsula and to the Americans themselves. Between May and June 2019, oil tankers were mysteriously hit in the Strait of Hormuz, and, in September 2019, drones and missiles destroyed some Saudi oil installations. These attacks were not openly admitted by Iran but were, nonetheless, easily deciphered by its opponents. Between the two episodes, in June 2019, an American prying drone was shot down as well, making clear to Washington that the Islamic Republic had no intentions of letting the deployment of American forces in the Persian Gulf intimidate the country.

The second front is that of Iran’s nuclear activities. There, the message is primarily addressed to Europe. As long as the European states do not take the necessary measures to alleviate the disastrous effects of US sanctions and as long as they are unable to provide the necessary compensations for having controlled its nuclear activities by respecting the terms of the JCPOA, Iran will, every two months, rid itself a little more of its obligations outlined by the deal. This explains how Iran gradually came to surpass the limitations set for its enriched uranium stocks, halted the restrictions placed on its nuclear research, and no longer respected its imposed maximum number of active centrifuges. In fact, until August 2019, UN and International Atomic Energy Agency reports stated that Iran *was* complying with its nuclear obligations under the JCPOA. Since mid-2019, Iran has decreased its compliance with the nuclear restrictions of the JCPOA on the grounds that

Sanctions imposed on Iran following the US withdrawal from the JCPOA:

- *the purchase or acquisition of US-dollar bank notes by Iran*
- *Iran’s trade in gold and precious metals*
- *transactions using the Iranian rial*
- *transactions with Iran in graphite, aluminum, steel, coal, and industrial software*
- *transactions related to the issuance of Iranian sovereign debt*
- *sale to Iran of cars and car parts*
- *imports to the US of Iranian luxury goods such as carpets and caviar*
- *sale to Iran of commercial passenger aircrafts*
- *Iran’s oil exports and energy sector*
- *financial institutions conducting transactions with the Central Bank of Iran*
- *port operators, shipping and ship-building sectors*
- *provision of insurance and financial messaging services to Iran.*

¹³ “Iran president asks Europe for guarantees on banking channels and oil sales” Reuters, 27 August 2018.

¹⁴ Coville, Thierry. Interview with Thierry Coville. *Accord sur le nucléaire iranien: la riposte de Téhéran*. Institut des relations internationales et stratégiques, Paris. July 10, 2019.

¹⁵ Ibid.

the United States has reimposed secondary sanctions on Iran. All of these transgressions are done, however, in complete transparency, as the Islamic Republic continues to welcome the International Atomic Energy Agency (IAEA) on a regular basis.¹⁶

Here too, this behavior failed to yield the expected results. In December 2019, an American contractor was killed on an American base in Iraq by a rocket most likely fired from a local militia close to Iran. Less than a week later, on the 3rd of January 2020, a drone strike at the Baghdad airport killed the Iranian General Qasem Soleimani, as well as the principal coordinator of Iraqi militias, Abou Mehdi al-Mohandes.¹⁷ In Iran, the death of Soleimani brought about an enormous outcry of emotion. The Islamic Republic responded with a ballistic missile strike on two American bases in Iraq, causing many injuries, but no loss of life. To add to the havoc, on the 8th of January 2020, Ukraine International Airlines Flight 752 was accidentally shot down shortly after takeoff from by the Iranian Islamic Revolutionary Guards Corps causing the deaths of 176 civilians.¹⁸

The Material Consequences of US Sanctions and European Paralysis

With both sides unwilling to cooperate, the JCPOA seems entirely frozen. Europe's paralysis has indisputably exacerbated the material consequences brought about by US sanctions. Iran's economy has hit record lows, living costs in the country have risen dramatically, the rial has halved in value, and oil exports have plummeted. Iran has been going through a severe economic crisis since 2019 with, according to the IMF, a 7.6% drop in GDP and inflation reaching 33.5% (Appendix 1). Iran's economy, with 80% of state revenues coming from oil and gas sales, is essentially rentier. In 2018 for example, Iran exported 2.2 million barrels of oil per day on average. Today, due to US sanctions, Iran's oil exports have plummeted and more than halved (Appendix 3 & 4). With this massive drop in government revenue, the Islamic Republic's investments in the public sector have largely diminished, especially in the health and education sectors, directly impacting the Iranian population's wellbeing.¹⁹

The crisis has continued this year and COVID-19 has worsened its effects. The sharp depreciation of the Iranian currency *rial*, paired with rising unemployment is causing devastating social consequences on a labor market that was already struggling in 2019 (Appendix 2).²⁰ Human Rights Watch reports that this situation is severely limiting Iranian companies and hospitals from purchasing essential medicines and medical equipment from outside of Iran that residents depend upon for critical medical care. Moreover, "renewed US sanctions have directly impacted families' purchasing power, contributing to inflation rates of around 30 percent in the past year. Iran's nearly universal health care coverage currently absorbs a significant portion of health care costs - but the failure of this system, which is already under serious financial stress, will likely have devastating effects on millions of patients."²¹ Excessive caution or "overcompliance" by banks and phar-

16 Bertrand Badie and Dominique Vidal, *Le Moyen-Orient et le Monde*, (Paris: Editions La Découverte, 2020), 253.

17 Doucet, Lyse. "Qasem Soleimani: US kills top Iranian general in Baghdad airstrike" BBC. January 3, 2020.

18 McKernan, Berthan. "Iran admits unintentionally shooting down Ukrainian airliner." The Guardian. January 11, 2020.

19 Interview with Azadeh Kian, Iran : la république Islamique en pérille. IRIS France, October 1, 2020.

20 Coville, Thierry. Interview with Thierry Coville. *L'Iran sous le feu des sanctions américaines*. Institut des relations internationales et stratégiques, Paris. September 25, 2020.

21 Tara Sepehri Far, Arvind Ganesan, Andrea Prasow, et al. Maximum Pressure: *US Economic Sanctions Harm Iranians' Right to Health*. New York: Human Rights Watch, October 29, 2019.

maceutical companies wary of falling afoul of US sanctions is a significant factor in limiting Iran's access to funds for imports of medicines and medical equipment. As stated by former French ambassador to Washington, Gérard Araud, "the fact is that banks are so terrified by the sanctions that they don't want anything to do with Iran."²²

Part II – EU/EUMS Policy on the ground: The Unexploited Potential of INSTEX

Part II breaks down INSTEX's purpose and potential as an instrument designed to counter secondary sanctions and explores the reasons for INSTEX's inability to bring about the kind of comprehensive economic normalization that was expected under the JCPOA.

A European special-purpose vehicle (SPV)²³, INSTEX was established in January 2019 in a bid to maintain commercial transactions with Iran and persuade Tehran to stick by the terms of the 2015 nuclear deal despite American sanctions.²⁴ Efforts to establish this financial compensation mechanism from the E3 (France, the UK, and Germany) in partnership with the European External Action Service, are aimed at enabling companies from these three countries to carry out commercial transactions with Iran in areas not sanctioned by the United States—humanitarian goods, food, health products, etc. In order to avoid financial flows between Europe and Iran, INSTEX is designed to offset European exports to Iran against the value of Iranian sales to Europe without direct transfer of money between the commercial banks of the two parties. One key challenge is that the value of European exports to Iran exceeds the value of Iranian exports to Europe.²⁵ This is problematic because of INSTEX's netting system—more specifically, the instrument creates a virtual ledger that offsets any balances in relation to import and export payments, so that payments are only exchanged between European businesses importing and exporting to Iran, and no direct payments to or from Iran are required.

According to Federica Mogherini (Italy), previous High Representative of the EU for Foreign Affairs and Security policy, the purpose of INSTEX is to facilitate "legitimate trade" with Iran for any EU member.²⁶ More recently, in February 2020, the European signatories of the JCPOA have delegated to the Spanish HR/VP, Josep Borell, the responsibility to represent them in the framework of the Dispute Settlement Mechanism of the nuclear deal.²⁷ This mechanism, outlined in paragraph 36 of the JCPOA, has a constraining but modifiable timetable, and has been activated by the Europeans in order to negotiate with Iran a solution to the impasse in which the JCPOA stands today.²⁸

²² Ibid.

²³ A special purpose vehicle, also called a special purpose entity (SPE), is a subsidiary created by a parent company to isolate financial risk. Its legal status as a separate company makes its obligations secure even if the parent company goes bankrupt.

²⁴ Norman, Laurence. "EU Ramps Up Trade System with Iran Despite U.S. Threats" *The Wall Street Journal*, March 31, 2020.

²⁵ Erästo, Tytti. "After UN Showdown, INSTEX Can Help Sustain Iran Nuclear Deal" *Bourse & Bazaar*, August 27, 2020.

²⁶ Federica Mogherini, Response to Questions by the European Parliament on the effectiveness of INSTEX. April 2, 2020. https://www.europarl.europa.eu/doceo/document/E-9-2020-002028_EN.html

²⁷ Pierre Ramond and Leopold Werner. *Iran, le jour d'après. Pour une nouvelle politique iranienne de l'Union européenne*. Groupe d'études géopolitiques, Asie intermédiaire, April 2, 2020.

²⁸ European Parliament, *Joint Comprehensive Plan of Action*. Vienna, July 14, 2015, paragraph 36.

Over a year after its creation, and in the midst of the COVID-19 pandemic, INSTEK conducted its first transaction in March 2020 which entailed trade of approximately 500,000 Euros of medical aid by a private Germany company to its Iranian counterpart. The names of the parties were not revealed, nor how the financial transaction was completed.²⁹ Despite this small victory, the “overcompliance” of banks and large companies on the European side, motivated by deterrent examples of past US sanctions (BNP Paribas in particular) makes it difficult to use INSTEK effectively.³⁰ For example, as stated by Grégoire Mallard, an associate professor in the Department of Anthropology and Sociology of Development at the Graduate Institute of International and Development Studies in Geneva:

“Global banks’ culture of ‘overcompliance’ with sanctions is in large part the outcome of their entanglement with US financial authorities and the lack of clarity of US rules governing sanctions exemptions. Even though the US government insists that it observes a broad humanitarian exemption, all payments in the field of medicine or food that would go to an entity even remotely controlled by a designated entity (for instance, the Iranian Revolutionary Guards) would constitute a violation of US sanctions law. Confronted with the risk that due diligence procedures would fail to detect a connection to a US designated entity, global banks have preferred to massively ‘de-risk’ rather than apply uncertain Know Your Customer (KYC), Know Your Customer’s Customers (KYCC), and Know Your Transaction (KYT) procedures mandated in the transnational governance of sanctions.³¹ Instead, they have dropped customers from Iran and other sanctioned jurisdictions *en masse*, or not facilitated transactions with correspondent banks of banks located in Iran, even in the humanitarian field.”³²

INSTEK has, as a result, appeared to cause more frustration on the Iranian side than it has made it possible alleviation of the disastrous economic effects of the American. Mr. Mohammad Javad Zarif, Iran’s foreign minister, described INSTEK as “not sufficient”. In fact, speaking in New York last year, Mr. Zarif told reporters at the Iranian mission to the UN that INSTEK “may not resolve our problem” because it could not facilitate oil exports. According to him, “unless oil goes into INSTEK, cannot be substantial...without oil, there is no substantial trade.” It is also worth noting, however, that the establishment of an authority capable of organizing local compensation between importers and exporters has been particularly slow in Iran and blocked by domestic policy issues. As such, it is clear that INSTEK, while having the merit of being a useful tool to transfer much needed humanitarian aid to Iran, is simply not enough to remedy the disastrous effects brought about by American sanctions. According to Dr. Tytti Erasto, Senior Researcher in the SIPRI Nuclear Disarmament, Arms Control and Non-proliferation Programme, “the instrument’s humanitarian mission should be viewed as a matter of ethical necessity, rather than a nuclear-related concession.”³³ In this lens, INSTEK would remain important on an ethical standpoint even without the JCPOA.

29 “INSTEK: Europe’s fragile muscle flexing” *Tehran Times*, July 29 2020.

30 Bertrand Badie and Dominique Vidal, *Le Moyen-Orient et le Monde*, 253.

31 In recent years, authorities in the US and abroad have increased their focus on modernizing and enforcing anti-money laundering and terrorism financing (AML) regulations. As part of these efforts, the US’s Financial Crimes Enforcement Network (FinCEN) proposed Know Your Customer (KYC) requirements in 2014. FinCEN’s KYC requirements were proposed as part of a broader regulation setting out the core elements of a customer due diligence program. Taken together, these elements are intended to help financial institutions avoid illicit transactions by improving their view of their clients’ identities and business relationships. (Dan Ryan, PricewaterhouseCoopers LLC, February 2016)

32 Grégoire Mallard, Farzan Sabet, and Jin Sun. “The Humanitarian Gap in the Global Sanctions Regime” *Global Governance: A Review of Multilateralism and International Organizations*, April 9, 2020.

33 Erästö, Tytti. *European Non-Proliferation Diplomacy in the Shadow of Secondary Sanctions*. Stockholm International peace Research Institute.

Part III - Policy Recommendations

In order to uphold its ethical principles and remain credible towards Iran, the European Union must move past its meek posture of passivity. To do so, it can begin by strengthening the scale and the scope of INSTEX, notably by moving towards oil trade; stepping-up its recruitment of INSTEX non-EU members—as an expanded ownership further contributes to risk and cost sharing; and thirdly by addressing the overcompliance of European banks and businesses to American sanctions.

Expand INSTEX's Scope and scale

Michael Bock, the current INSTEX president, confirmed that the instrument could cover areas beyond strictly humanitarian trade once this one runs smoothly.³⁴ From a legal standpoint, the instrument could include oil trade, but going against US sanctions would imply the withdrawal of European bank cooperation, a problem in and of itself. According to Dr. Tytti Erasto, “while INSTEX cannot dismantle on its own the de facto primacy of US law, it could be extended to non-humanitarian trade that is not targeted by the USA but is impeded by fear of US secondary sanctions, such as tourism and trade on various consumer goods”.³⁵ Now that INSTEX's first humanitarian transaction last March has gone smoothly, the EU needs to seriously consider opening up INSTEX's scope—first by including consumer goods that are not directly sanctioned by the US and then moving towards oil once policy makers have found effective ways to legitimize trade via this device.

Having processed only one pilot transaction so far, it is crucial that INSTEX rapidly increases the frequency of its transactions as well as their scale. One of the major challenges faced by INSTEX is that the value of European exports to Iran surpasses the value of Iranian exports to Europe.³⁶ Because of INSTEX's netting system, no direct payments to or from Iran can be made. One potential solution to this problem would be to pay European exporters using Iran's revenues currently frozen in foreign banks or offering Iran a loan to buy humanitarian goods.³⁷ Of course, the US is seeking to prevent these arrangements. Another option would be that INSTEX charge a commission fee for the use of its services, hence creating reserves and generating cash flow that could be used to balance trade within a given payment period.³⁸

Expand INSTEX's Membership

In addition to the E3, six other European states have joined INSTEX. As of September 2020, INSTEX has nine sovereign owners:³⁹

- Republic of France
- Federal Republic of Germany

34 Erästö, Tytti. *European Non-Proliferation Diplomacy in the Shadow of Secondary Sanctions*. Stockholm International peace Research Institute.

35 Erästö, Tytti. *European Non-Proliferation Diplomacy in the Shadow of Secondary Sanctions*. Stockholm International peace Research Institute.

36 Erästö, Tytti. “After UN Showdown, INSTEX Can Help Sustain Iran Nuclear Deal” *Bourse & Bazaar*, August 27, 2020.

37 Ibid.

38 Geranmayeh, Ellie. “Trading with Iran via the special purpose vehicle: How it can work” *European Council on Foreign Relations*. February 7, 2019.

39 <https://instex-europe.com/about-us>

- United Kingdom of Great Britain and Northern Ireland
- Kingdom of Belgium
- Kingdom of Denmark
- Kingdom of the Netherlands
- Kingdom of Norway
- Republic of Finland
- Kingdom of Sweden

In order to increase the timely delivery of international aid to Iran, to reduce the damages caused by US sanctions, and to honor their JCPOA commitment, it would be useful for Europe to continue expanding INSTEX's membership. According to Ellie Geranmayeh, Senior Policy Fellow and Deputy Head of the MENA Programme at the European Council on Foreign Relations, expanded ownership further contributes to risk and cost sharing and enforces the 'sovereign shield' around the mechanism.⁴⁰ While this diplomatic shield does not write out the risk of US pressure on INSTEX, it does "substantially raise the stakes" for the US should Washington attempt to directly sanction or otherwise coerce a sovereign European entity or its senior management board.⁴¹

Non-European countries could also join the INSTEX. In fact, Russia and China have expressed interest in joining the mechanism, as have Turkey and India, which count among Iran's major trading partners.⁴² Indeed, over a year ago, in July 2019, Russia signaled its willingness to join INSTEX and called on Brussels to expand the new mechanism to oil exports.⁴³ According to two EU officials, Brussels was initially interested in allowing Russia into INSTEX, but said that the mechanism would have to be up and running with humanitarian trade first.⁴⁴ Now that its first transaction has succeeded, European policy makers need to find ways to strengthen INSTEX and ensure that it rapidly picks up speed. This remains, for the most part, a question of political will.

Address Overcompliance of European Banks and Businesses

Since the US pulled out of the JCPOA, the European Union has adopted different strategies. Its approach has shifted from seeking to counter secondary sanctions to addressing the obvious problem of sanction overcompliance. The EU's reluctance to engage in open confrontation with the US and the constraints that a dollar-dominated world economy imposes on European autonomy helps shed light on this moderation of goals.⁴⁵ Based on Ellie Geranmayeh and Manuel Lafont Rapnouil's research, one potential solution to sanc-

40 Geranmayeh, Ellie. "Trading with Iran via the special purpose vehicle: How it can work" European Council on Foreign Relations. February 7, 2019.

41 Ibid.

42 Esfandyar Batmanghelidj and Sahil Shah. Protecting Europe-Iran Trade to Prevent War: A provisional Assessment of INSTEX. Bourse & Bazaar. June 2019.

43 Henry Foy and Demetri Sevastopulo. *Kremlin throws weight behind EU effort to boost Iran trade*. The Financial Times. July 18, 2019.

44 Ibid.

45 Erästö, Tytti. *European Non-Proliferation Diplomacy in the Shadow of Secondary Sanctions*. Stockholm International peace Research Institute.

tion overcompliance would be for EU member states to develop a 'pan-European enforcement authority'.⁴⁶ This authority could provide EU companies with advice on due-diligence and on potential reparations from damage caused by secondary sanctions imposed by the US.⁴⁷ The EU could also create a fund in order to make reparations for such damage. On the longer term, strengthening the role of the Euro as a global currency seems unavoidable to preserve Europe's independence more generally. In any case, and as stated by Dr. Erastro, INSTEX can already be seen as a test case for a more independent European foreign policy.⁴⁸

46 Ellie Geranmayeh and Manuel Lafont Tapnouil, *Meeting the challenge of secondary sanctions*. European Council on Foreign Relations. June 25, 2019.

47 Erästö, Tytti. *European Non-Proliferation Diplomacy in the Shadow of Secondary Sanctions*. Stockholm International peace Research Institute.

48 Ibid.

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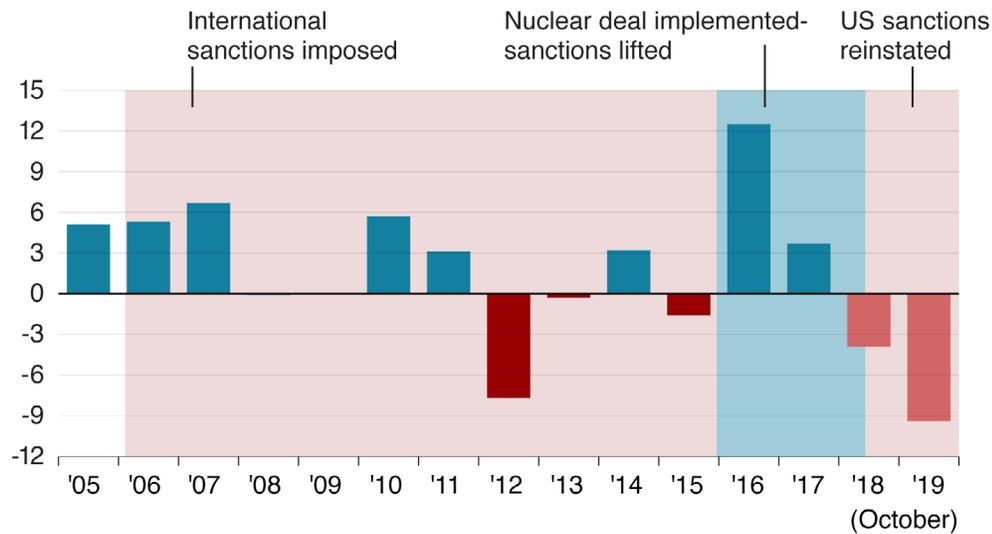
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Appendix

Appendix 1

Economic growth in Iran

GDP growth rate %



Source: Central Bank of Iran, IMF



Appendix 2

Iran's currency has hit record lows recently

Number of Iranian rials to one US dollar at unofficial market rate



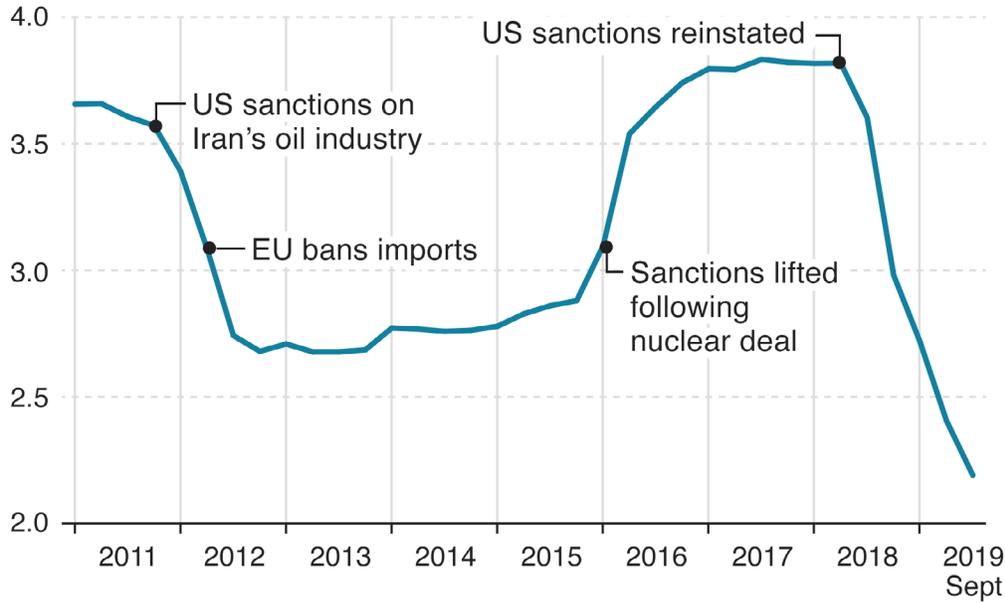
Source: Bonbast.com



Appendix 3

Iran's oil output

Production in millions of barrels per day



Data to September 2019

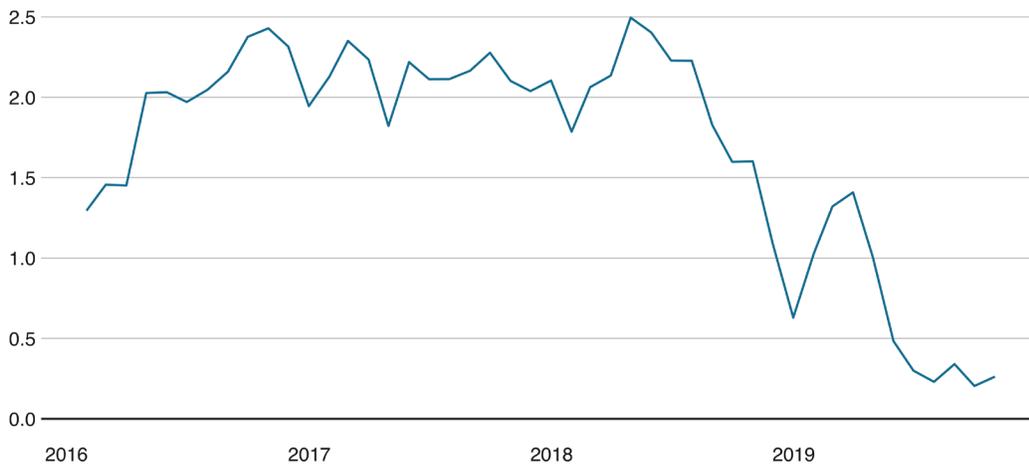
Source: OPEC



Appendix 4

Iran brent crude exports

Exports in millions of barrels per day



Source: Bloomberg

