The Russia-China-Iran Axis

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UNITED AGAINST NUCLEAR IRAN

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The Russia-China-Iran Axis

In 2018, the Trump administration withdrew from the Iran nuclear deal and initiated a "maximum pressure" campaign against the Iranian regime, re-imposing and expanding sanctions targeting Iran's energy, shipping, insurance, and banking sectors. Major European businesses responded by fleeing Iran. However, the Trump administration's efforts to isolate Iran still face a major hurdle as China and Russia move to fill the void and capitalize on the business opportunities emerging in the wake of European withdrawals.

The Political Context

The rationale for the Trump administration's renewed sanctions campaign was to compel Iran's leadership to return to the negotiating table for an expanded agreement that would fix shortcomings in the Joint Comprehensive Plan of Action (JCPOA) (sunset clauses and insufficient inspections regime), and also address malign Iranian conduct not related to its nuclear program (illicit ballistic missiles, support for terrorism, regional destabilization, and human rights abuses). Additionally, the renewed sanctions would materially deny Iran resources to further its nefarious regional political and military influence.

The re-imposition of sanctions, coupled with years of economic mismanagement, have compounded the economic stresses facing Iran's leadership. In late December 2018, President Hassan Rouhani unveiled his proposed $47.5 billion budget for the upcoming year, which, due to the impact of sanctions and the precipitous devaluation of Iran's currency, was less than half the previous year's budget. The failure of the JCPOA's promised benefits to materialize, coupled with widespread political alienation, provided the impetus for a revitalized protest movement that has amplified the pressure facing Iran's regime.

By Itself, Europe's INSTEX Won't Save Iran

While the Trump administration's efforts to squeeze Tehran are clearly having an effect, the lack of complete buy-in from the European Union, Russia, and China have shielded the regime from complete isolation. The EU has resisted the maximum pressure campaign, seeking instead to incentivize Iran to remain in the JCPOA by urging continued European trade and investment with Iran. Germany, the United Kingdom, and France have gone so far as to establish a Special Purpose Vehicle (SPV), known as INSTEX (Instrument in Support of Trade Exchanges), to allow European companies to facilitate ongoing non-dollar transactions with the regime through a third-party in circumvention of US sanctions.

The EU's efforts to establish a sanctions-workaround will in all likelihood be a fruitless endeavor, as dozens of major European companies weigh the benefits of economic engagement with Iran against the costs of losing access to the American market. Trump administration officials have downplayed the significance of INSTEX and made clear that the US intends to strictly enforce its sanctions against companies found engaging in illegal transactions.

Iranian officials have further expressed doubts about the efficacy of INSTEX, taking particular umbrage over concerns that Europe will link operationalizing INSTEX to Iranian compliance with the Financial Action Task Force's (FATF) anti-money laundering and countering financing of terrorism standards. Iran's foreign ministry explicitly stated that "Linking implementation of this mechanism... with the requirements of institutions such as the FATF is unacceptable." The fight over INSTEX has also come against a backdrop of fraying EU-Iran ties due to a resurgence of Iranian terrorist and assassination plots on European soil that culminated in the EU announcing sanctions targeting Iran's intelligence ministry in January 2019.

A Rising China in Iran

With INSTEX functionally stillborn, the primary obstacle to truly imposing "maximum pressure" on the Iranian regime will instead come from China and Russia. Both of these countries are unencumbered by concerns over Iran's illicit domestic and regional conduct and are happy to continue doing business with Tehran if they can get away with it. Russia and China view the collapse of European deals in Iran as win-win opportunities to bolster their own economies while frustrating America's objective of isolating Iran.

There is considerable historical precedent for China helping Tehran weather international storms dating back to the 1979 Islamic Revolution. China was one of the only countries willing to provide Iran with weapons and military equipment during the Iran-Iraq War, although it was also a large indirect supplier of military equipment to Iraq. China later emerged as a vital player in post-war reconstruction efforts and has remained engaged in the development of Iranian infrastructure, with a significant footprint in the construction of dams, factories, airports, roadways, and Tehran's subway system. Iran is currently a linchpin in Beijing's signature "One Belt, One Road" initiative, which aims to invest over $1 trillion in infrastructure, connecting over 60 countries in Europe, Asia, and Africa.

China has provided a vital lifeline for Iran's energy sector as well, helping it to thwart the international sanctions regime that reached its zenith during the Bush and Obama administrations. With sanctions proscribing American and European investment in Iran's energy sector, China was more than willing to fill the vacuum, with its state-controlled energy giants, Sinopec and the China National Petroleum Company (CNPC) acquiring massive stakes in the development of Iranian oil and gas fields. Both sides benefited tremendously from their arrangement; energy-dependent China received a source for oil and was able to bolster a US adversary while Iran gained a patron that invested heavily in its energy sector, and at the same time, severely diminished the efficacy of the US sanctions regime.

For example, in July 2017, France's Total finalized an agreement to acquire a 50.1% stake in the $5 billion development of Phase 11 of the South Pars Gas field. Total decided to vacate the project in August 2018 after the first tranche of sanctions went back into effect despite having sunk $45.7 million into the project. In November 2018, Iran's oil minister announced that CNPC, which already had a 30% stake in the project, would be acquiring Total's stake. A month later, however, CNPC suspended its investment in the face of US pressure so as not to jeopardize ongoing Sino-U.S. trade negotiations. Nevertheless, CNPC plans to continue on investing in the North Azadegan and Masjid-i-Suleiman oilfields. Sinopec, meanwhile, is reportedly in talks with the state-owned National Iranian Oil Company (NIOC) to invest an additional $3 billion on top of its existing $2 billion investment in the Yadavaran oil field to boost capacity by 180,000 barrels per day.

Beyond the investment in Iran's energy sector, China serves as a crucial lifeline to Tehran by maintaining consistent oil imports even in the post-JCPOA withdrawal era. At the same time the Trump administration withdrew from the JCPOA, it granted waivers to eight countries, including China, capping Iran's legally sanctioned oil output at around 1 million barrels per day. This is a reduction from the 2.5 million barrels Iran was selling at the height of sanctions relief, but it is still a far cry from the Trump administration's expressed desire to eventually drive Iranian exports to zero.

In order to shield its Iranian oil trade from sanctions, China has shifted to exclusively using Iranian tankers owned by the National Iranian Tanker Co (NITC) to transport its $1.5 billion per month of crude imports. With European insurers discontinuing their coverage of Iranian shipments, it is now incumbent on Iran to provide insurance for its cargoes. According to an Atlantic Council report, "To further insulate the Iran-China oil trade from foreign entities, CNPC has its own bank, the Bank of Kunlun, which has limited exposure to the global financial system. The Central Bank of Iran has accounts at the Bank of Kunlun, where Chinese buyers of Iranian oil have deposited billions of dollars before, prior to the existence of the JCPOA." However, Reuters reported in December 2018 that Bank of Kunlun is seeking to cease Iranian transactions due to concerns over sanctions exposure. CNPC is exploring having smaller banks with less exposure to dollar-based transactions take over its Iran business.

The energy ties also burgeoned into military cooperation, with China selling ballistic missile components and conventional missiles to Iran and engaging in joint military drills. China has also played a role in the provision to Iran of sanctioned goods and services, as evidenced by the levying of fines against smartphone company ZTE and the arrest of Huawei's Chief Financial Officer for providing telecommunications equipment to Iran in violation of US embargoes which was used in government surveillance and repression.

Moscow in Tehran

Russia's relationship with Iran, meanwhile, took off in the late 1990s with the Kremlin assisting Iran with the development of port and rail infrastructure. As international concerns mounted over Tehran's illicit nuclear program and early sanctions came into effect, Russia became virtually the sole supplier of Iran's nuclear sector, taking the lead role in constructing the Bushehr nuclear reactor.

Russia appears less concerned than China overexposure to US sanctions in its dealings with Iran, as many major Russian entities are already subject to US sanctions. Following the United States' JCPOA withdrawal, a Russian business analyst noted to the state-funded news outlet Russia Today (RT), "Russian companies will continue doing business in Iran as if nothing happened at all – in oil, gas and nuclear energy. They have this advantage over the Europeans, who, like Total or Airbus, have major businesses in the US and are listed on American exchanges."

In July of 2018, Iranian official Ali Akbar Velayati, a key advisor to Supreme Leader Ali Khamenei, boasted that Russia stands "ready to invest $50bn in Iran's oil and gas sectors." An anonymous Russian official backed Velayati's assertion to the Financial Times. According to Velayati, Rosneft and Gazprom entered into negotiations with Tehran on contract talks expected to total approximately $10 billion.

Bloomberg reported that in March 2018, state-owned Zarubezhneft agreed to terms on a joint project to boost production at two brownfield sites valued at $4 billion. However, in November 2018, Reuters reported, "Russian state-owned oil producer Zarubezhneft has pulled out of projects in Iran because of looming U.S. sanctions…" Russia has also pledged to purchase at least 100,000 barrels a day of Iranian crude, which it plans to pay for by bartering machinery and food.

Russia is also exploring ways to assist Iran in the civil aviation sector. After Boeing and Airbus scrapped plans to provide Iran with aircraft, Iran turned to Russian manufacturer Sukhoi seeking to purchase $2 billion worth of Sukhoi Superjet 100s. However, these plans appear to be in jeopardy as 10-15% of Sukhoi components are U.S.-manufactured and thus subject to embargo.

Lastly, Russia has invested in Iran's missile defense systems. For instance, it delivered the SA-20c SAM to Iran in 2016, which, according to the Director of the US Defense Intelligence Agency Lieutenant General Robert Ashley, provided Iran with "the flexibility of a highly mobile, long-range, strategic surface-to-air missile."

Russia, China Stand as Primary Impediments to Isolating Iranian Regime

China and Russia capitalized on Iran's pre-JCPOA isolation to establish entrenched commercial interests inside Iran and are positioned as a result to benefit from the West's renewed drive to isolate and pressure Iran. Both countries are seeking to enhance their clout and carve out spheres of influence in the Middle East, further opening the door for expanded ties with Iran. Iran sought in the post-JCPOA period to attract Western investment from players like Royal Dutch Shell and Total, but with the exit of such players in the face of crippling sanctions, Russian and Chinese energy companies are now positioned to take over planned projects free of competition.

Adding a further wrinkle, China and Russia have stepped up their own economic and political cooperation and are presenting a united front stemming from dissatisfaction with US sanctions on Russia for its meddling in Ukraine and the 2016 US presidential election and the Trump administration's trade war with China. Russian and Chinese leaders have criticized America's "protectionist" and "unilateral" measures as an effort to gain an advantage in the U.S.-built global trading system. The sanctions push against Iran is yet another irritant that has driven China and Russia to work collaboratively to withstand American pressure. Such cooperation has manifested itself at the United Nations as well, leading China and Russia to use their permanent positions on the UN Security Council to block punitive sanctions.

In the immediate aftermath of the US withdrawal from the JCPOA, Iranian Foreign Minister Javad Zarif embarked on a diplomatic tour to mitigate against the impact of the coming re-imposition of sanctions. His first two stops were Beijing and Moscow. In the months that followed, China and Russia have sought to expand their trade and investment with Iran and assess the feasibility of taking over outright European deals that had collapsed. While the re-imposition of sanctions has created an opportunity for both countries, it has complicated matters as well. Ultimately, the extent to which China and Russia can benefit from the current state of play comes down to their ability to limit sanctions exposure and create workarounds such as mechanisms to conduct transactions in local, non-dollar currencies. In September 2018, Foreign Minister Zarif outlined Iran's plan to avoid using the US dollar: "You can use your own currency. Sell stuff in your own currency, buy stuff in the other country's currency, and at the end of a specific period, balance it out in a non-dollar currency. It's quite possible and may even be profitable." As a result of these complications, some deals announced to great fanfare have been temporarily put on ice.

Conclusions

Iran's hoped-for economic rapprochement with Europe is currently in shambles, increasing Iran's reluctant reliance on the two leading nations that helped it weather previous isolation campaigns. In spite of all the obstacles posed by the Trump administration's maximum pressure campaign, China and Russia remain committed to seeing through their business dealings with Iran. The halting progress in execution indicates that the sanctions are working as intended. In Beijing's and Moscow's view, however, the economic and geopolitical benefits outweigh the potential risks of sanctions exposure and they continue to seek ways to move forward and find alternative approaches that would undermine America and the dollar's centrality to the global economic system.

If the maximum pressure campaign is to bear fruit and bring Iran back to the negotiating table in good faith, the Trump administration must take the following steps:

Prioritize curtailing Iran's Chinese and Russian lifelines. The Russian-Iranian-Chinese troika have a vested interest in standing up to the American pressure campaign, setting up a battle with critical implications for the survivability of the Iranian regime, China's and Russia's role in the Middle East, and the continued efficacy of the U.S.-led economic order. The Trump administration should seek to ensure that Chinese and Russian business dealings with Iran are as cumbersome as possible and that Beijing and Moscow are unable to carry out such trade through legitimate channels and in dollars or euros. Chinese or Russian entities that attempt to skirt sanctions by, for instance, relying on small local banks to facilitate sanctioned transactions, should still face punitive measures and loss of access to the US market. As with European companies who may engage in sanctionable activity with INSTEX, Chinese or Russian entities seeking workarounds to deal with Iran should face the full weight of US sanctions enforcement.

Reduce Iranian oil exports to zero. The US State Department warned the remaining eight purchasers of Iranian oil, including China, that the US would not be granting another round of waivers in May 2019. Following through with this directive is a vital measure to choke off Iran's oil revenues, the regime's primary source of funding. The US should work with other global oil producers to ensure adequate supply in order to avoid price spikes. Iran is likely to offer its oil at a significant discount to China and to engage in subterfuge, such as oil tanker lightering (the transfer of cargoes from one vessel to another) to disguise the origin and destination of its exports in order to entice China into continued purchases. The US should be vigilant against such schemes and link progress in ongoing trade negotiations with China to verifiably ceasing Iranian oil imports.

Update 1: (April 30, 2020)

On May 2, 2019, the waivers allowing the sale of limited quantities of Iranian crude oil expired and were not renewed over China's objections. As predicted in this resource, the end of the waivers did not completely choke off Chinese imports of Iranian crude oil, as both sides sought workarounds to continue the illicit trade.

On July 22, 2019, the Trump administration sanctioned Chinese company Zhuhai Zhenrong and one of its executives, Youmin Li, for knowingly violating the sanctions banning the import of Iranian crude oil. On September 25, the administration announced further sanctions on a number of Chinese firms, including China Concord Petroleum Co., Limited, Kunlun Shipping Company Limited, Pegasus 88 Limited, and COSCO Shipping Tanker (Dalian) Seaman & Ship Management Co, Ltd. for knowingly importing proscribed Iranian crude, as well as Kunlun Holding Company Ltd. and COSCO Shipping Tanker (Dalian) Co., Ltd, which had ownership or controlling stakes in the sanctioned companies. Notably, the sanctions did not extend to the parent companies of the entities involved, one of which was the state-owned shipping giant COSCO Shipping Corp, in what was seen as an effort to defray the diplomatic fallout from the designations.

Even after the sanctions designations, tanker traffic monitoring showed that Iran continued crude oil exports to China using the National Iranian Tanker Company (NITC) vessels. Chinese customs data showed that in 2019, China imported 295,400 barrels per day of Iranian crude oil, about half the imports of 2018, but still an impediment to the Trump administration's efforts to completely cut off Iranian oil exports. In January 2020, the administration lifted sanctions on one of the COSCO Shipping Corp subsidiaries designated in September 2019 in the context of ongoing trade talks with China.

In January and again in March 2020, the US announced new rounds of sanctions on petrochemical and petroleum companies, several of which were Chinese, for facilitating continued crude oil, petrochemical, and refined product exports from Iran. The Trump administration asserted that state-owned Chinese companies have ceased oil purchasers from Iran and that independent refiners are responsible for the continued illicit transactions. Even if this is the case, it highlights that China is largely responsible for providing an ongoing lifeline to Tehran's crude oil and petrochemical sectors, and as some illicit Chinese networks are shut down, others will continue to spring up in their place.

Update 2 (August 5, 2020)

In recent months, Russia and China have taken steps toward deepening their trade, energy, diplomatic, and military ties with Iran. Their primary aim is to throw a wrench in one of the Trump administration's signature Middle Eastern initiatives, the maximum pressure campaign designed to ratchet up economic pressure and isolate Iran in order to compel Tehran to return to the negotiating table for talks on its nuclear program and potentially other outstanding issues, including its ballistic missile program and support for terrorist proxies. Russia and China seek to draw closer to Iran to resist the U.S.-led international order and to carve out a countervailing sphere of Middle East influence to challenge US regional dominance.

The Trump administration's most pressing concern regarding Iran is extending the arms embargo under UN Security Council Resolution 2231, which is set to expire on October 18, 2020. If the arms embargo lapses, Tehran will have a free hand to acquire conventional armaments from willing benefactors, most notably Russia and China, without the approval of the UN Security Council.

Iran has signaled its intention to go on a buying spree when the embargo lifts, but it will be hamstrung by the devastating financial effects of the maximum pressure campaign. Accordingly, Iran has sought in recent weeks to cement long-term military and trade partnerships with Russia and China, offering discount oil in exchange for energy investment and access to weaponry. In addition to profiting from lucrative arms and energy deals, China and Russia seek to let the Iranian arms embargo expire as part of a short-sighted strategy to partner with Tehran to form a united bloc against American influence in the Middle East.

Both Russia and China resent the imposition of US sanctions against them for malign activities such as meddling in Ukraine and 2016 election interference in the case of Russia, and for human rights abuses against the Uighur minority and in Hong Kong in China's case. They are therefore willing and motivated to help Iran, which has attempted to portray itself as unjustly victimized by US sanctions, withstand U.S.-led isolation efforts.

In July 2020, the New York Times reported that it had obtained an 18-page draft agreement for a proposed economic, energy, and military partnership between China and Iran. According to sources familiar with the details of the agreement, China would invest roughly $400 billion in projects within Iran's energy, banking, telecommunications, and transportation sectors in exchange for access to heavily discounted Iranian oil over a 25-year period. The deal also calls for enhanced security cooperation over the same period.

The proposed deal would give Iran a much needed economic lifeline but has raised concerns among some Iranian politicians that the regime is effectively mortgaging Iran's independence and future out of desperation. Other developing nations that have accepted Chinese largesse as part of its "Belt and Road Initiative" have wound up indebted and beholden to Beijing. For Iran, non-alignment with great powers – neither East nor West – is one of the core principles of the regime's revolutionary ideology. Allowing China to establish strategic economic and military interests – including access to major port facilities – within Iran would be a seeming betrayal of this principle. Another crucial component of the regime's ideology is advocacy on behalf of oppressed Muslim populations. Because of its burgeoning economic reliance on China, the government has stayed silent on China's suppression of the Uighurs, prompting some politicians to call out the regime's hypocrisy.

Iran has also been in talks with Russia to extend a 20 year agreement with Russia originally inked in 2001 that covered oil, arms sales, and nuclear cooperation. In July, Iranian foreign minister Javad Zarif made his third visit to Moscow this year to continue talks on an extension of the agreement.

Iran's pursuit of these bilateral deals with Russia and China, as well as increased strategic cooperation between Russia and China in energy, commerce, and security, shows that all three sides are open to formalizing a tripartite alliance. Notably, Russia, China, and Iran held a joint four-day naval exercise in the Indian Ocean in December 2019, a clear indicator of burgeoning security cooperation.

While these developments have sparked consternation in Washington, they do not yet mark the death knell of the maximum pressure campaign's effort to isolate Tehran. Iran has been making a lot of noise about its proposed deal with China, but Beijing has yet to publicly comment on the progress toward a deal. Iran has a history of announcing business deals and MOUs to great fanfare that never come to fruition.

The $400 billion investment figure cited by the New York Times is almost certainly a massive exaggeration. While China has been willing to defy the US to an extent, the maintenance of US secondary sanctions has severely curtailed trade and oil imports between Iran and China. China's Bank of Kunlun, a bank designed to have limited exposure to the global banking system to facilitate sanctionable energy transactions, is reportedly refusing to carry out business with Iran due to the Financial Action Task Force (FATF) decision earlier this year to reinstitute countermeasures against Tehran for failure to comply with anti-money laundering/counter-financing of terrorism (AML/CFT) controls. The same report noted that Russian banks are also refusing to do business with Iran.

While Iran, Russia, and China have a shared interest in standing up to Washington, the US still has leverage to ensure Iran's continued isolation. The maintenance of unilateral sanctions is itself a strong tool that can dissuade against significant trade, energy, or arms deals with Iran. The US should additionally urge its Middle Eastern allies to impose costs on Russia and China if they take steps to draw closer to Tehran. Saudi Arabia and the UAE, in particular, have forged strategic partnerships with China based on oil exports in exchange for Chinese arms. China should not expect to be able to invest heavily in these countries' primary geopolitical foe without suffering consequences.