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US Sanctions on Iran—The Price of Brinkmanship



Udayan Tandan is alumnus of Dr. Ram Manohar Lohiya National Law University, Lucknow. He was formerly a legal consultant at Directorate of Enforcement and currently practices law in New Delhi.

On May 8, 2018, the United States unilaterally withdrew from the Joint Comprehensive Plan of Action popularly known as “Iran Deal” or the “Iran Nuclear Deal.”¹ The agreement on the nuclear programme of Iran was signed in July 2015 between Iran, the P5+1 (the five permanent members of the United Nations Security Council—China, France, Russia, United Kingdom, United States—plus Germany) and the European Union. According to the deal, Iran will give up military atomic programme, reduce stockpile of uranium and allow inspection of its nuclear facilities in exchange for lifting of economic sanctions.

The US withdrawal from the treaty reinstates two sets of sanctions on Iran. The first set, which went live on August 7, places complete restrictions on Iran’s purchase of US currency; trade in gold and other precious metals; and the sale of auto parts, commercial passenger aircraft, and related parts and services to Iranian Companies. The second set of sanctions, which comes into force on November 4, restricts sales of oil and petrochemical products from Iran.

President Trump’s opposition to the Iran deal and scrapping it was one of his poll promises. At

Key Points

1. President Trump’s decision to pull the plug on the deal is proving to be an unpopular one both among allies and the world community at large.
2. Sanctions have become an important tool in geopolitics today, whose success depends on allies, a willingness to enforce them and incentives to bargain. Imposition of a second set of sanctions by the US in the absence of support from traditional US allies and majority of the world community, are unlikely to succeed in the long run, and will hurt US standing among the world community.
3. Major economies like China, EU, Japan and India are heavily reliant on energy imports and would like to keep in check oil prices, which are already high.
4. US imposition of unilateral sanctions on Iran will only spur Iran and its trading partners to set up alternative mechanisms of payments, which have no or little US influence on them.

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the time of withdrawal from the deal, Trump and his supporters could not adduce any evidence that Iran had not been adhering to the terms of the deal nor did Trump present any other alternative plan to replace the existing Iran Deal. Trump's disapproval of the deal, despite Iran agreeing to give up its nuclear bomb ambitions under the deal, stems from the fact that it did not put an end to Iran's ballistic missile development or its stated support for militias in the Middle East. Both these, however, were not part of the previous discussions and hence the agreement in 2015. The new issues being raised are quite apparently ways to put a further cap on Iran's nuclear weapon making and delivery capacities.

American pull-out has been welcomed by Iran's regional rivals and Trump's closest allies—Israel and Saudi Arabia. A few other nations—UAE, Bahrain, Yemen, and Egypt—have also welcomed the move. The high price of this American brinkmanship is being felt the world over in terms of rising oil prices with adverse effects on emerging economies threatening to derail the world economy and the global trading systems. The US withdrawal comes at a time when the Afghan conflict and Middle East situation are growing grimmer with each passing day.

Regional Power-play

Scrapping of the deal by Trump should be seen in light of the rising Iranian influence in the Middle East. Iran has emerged as a strategic player whose influence in Iraq, Lebanon, Syria and Yemen has steadily grown. The rise in Iranian influence and missile programme is also being seen as threatening Saudi and Israeli interests in the region. Pulling out of the deal and slapping of sanctions by the US may be construed as an attempt to contain Iranian power by choking it economically and helping its rivals and time-tested American allies in the region—Saudi Arabia and Israel.

The US withdrawal from the deal has evoked strong reactions from the other signatories and sent jolts among the International Community. The European Union's top diplomat Federica Mogherini said the EU was "determined to preserve the deal."² Russia cautioned that there will be inevitable harmful consequences to any actions towards breaking the deal.³

On June 4, 2018 Iran had begun preparations for increasing its uranium enrichment capacity, in case the 2015 nuclear agreement collapses⁴ but till date has been working within the framework of the deal. A confidential report dated August 30, 2018 published by International Atomic Energy Agency (IAEA) said Iran remained within limits of the level to which it can enrich uranium, its stock of enriched uranium and other items. This was the second quarterly report by the IAEA after the US withdrawal from the deal.⁵ The original aim behind the 2015 agreement clearly was to prevent Iran from acquiring nuclear weapons which would deal yet another blow to the NPT, and could start a regional arms race, further complicating the already volatile power equation in the Middle East.

US sanctions on Iran have dealt a blow to the Iranian economy which was already in a tailspin as benefits of lifting of sanctions under the deal did not bear expected economic dividends. There have been massive protests by people on issues such as price rise, water shortages and civil rights.⁶ The Rial has halved in value since April. The prices of essential goods, including medicines, have shot up.⁷

US Defence Secretary Jim Mattis in July denied that regime change or collapse in Iran was US policy. He insisted that the goal of the sanctions is to curb what Washington sees as Iran's threatening behaviour in the Middle East.⁸ Rial crash has adversely affected the average Iranian. Unemployment has shot up as the economy is fluttering. According to a BBC report,⁹ prices of basic essential food items and medicines have gone up by almost 40%. The value of people's savings and properties has been reduced to one-third of their value compared to last year. Iran's problems are compounded as the country reels under the worst drought in 50 years. This has led to massive water shortages, which have fermented violent protests in the southern part of Iran. Power infrastructure has also been under severe duress due to lack of infrastructure investments after years of intermittent sanctions.

President Rouhani has been under massive pressure politically, his economy and labour ministers have been impeached over mismanagement and corruption

charges.¹⁰ On August 28, Iranian lawmakers grilled President Rouhani for the state of economic affairs and adverse impacts of sanctions on the average Iranian; the president acknowledged the issues but said it was not a crisis situation. He stressed the need for putting up a united front.¹¹ The Supreme leader of Iran, Ali Khamenei, blaming government mismanagement for economic woes, ruled out any negotiations or war with the US.¹²

In view of this, some analysts are of the opinion that the US wants to fan discontentment among the population at large by crippling Tehran and prompt regime change. The US appears to be aware that any external intervention in Iran will only give hardliners more space in Iranian polity and the current regime will use the opportunity to whip up nationalistic feelings and rally people around it. Further, any external intervention will open Pandora's Box throwing the entire region into chaos and has the potential of igniting the entire "Shia Crescent."

Pressures on the Oil Market

Geopolitical factors like Venezuela's economic meltdown, escalation of hostilities in Syria and Yemen have driven oil prices north. Disruption of supply of oil from Iran and strong demand from Asia will only drive up the oil prices. Oil prices which are already high are predicted to touch \$ 90 a barrel,¹³ despite assurances from Saudi Arabia that it will ramp up its production to contain disruption in oil supply caused by removal of Iranian oil from the market if US sanctions take effect.

With the US poised to be the world's second-largest oil producer,¹⁴ oil market fluctuations are unlikely to have any detrimental effects on its economy. US sanctions may rather prove a boon for US oil and gas sector, providing them with new markets to tap into. But the same cannot be said to be true for China, Europe and other countries who rely heavily on oil imports for their energy needs.

The Russians and the Chinese have rejected new US sanctions on Iran, pledging to maintain trade ties with Tehran. Chinese state energy firms CNPC and Sinopec have invested massively in Iran's giant Yadavaran and

North Azadegan oilfields, and are eyeing a larger piece of pie in the Iranian energy sector. CNPC has taken over Total's stake in the mega South Pars gas project after the French company decided to leave amid US sanctions.¹⁵

Russian President Vladimir Putin has said Russia is prepared to continue its oil investment in Iran at the level of \$50 billion in the face of US plans to reimpose sanctions on the Iranian energy sector.¹⁶ The Russian aviation industry has also seized the opportunity to fill the vacuum created by Airbus pulling out of Iran. Sukhoi recently signed memorandums of understanding for 40 Sukhoi SuperJet 100 passenger planes with two Iranian airlines.¹⁷ Iran and Russia have also emerged as strategic allies in the Middle East where both support the Syrian President against the anti-government rebels. There have been reports of China-Iran-Russia triangle emerging in Afghanistan.¹⁸

Allies and Others

Traditional US ally, the EU, has brought in force "blocking statute" which bans EU businesses from complying with those US sanctions, unless they get exceptional authorisation from the European Commission.¹⁹ EU is also creating a Special Purpose Vehicle with the aim of keeping trade with Iran flowing.²⁰ Trump's decision to withdraw from Paris Climate Agreement, ordering shift of the US Embassy from Tel Aviv to Jerusalem, his recent remarks about NATO and the trade war with EU over imposition of tariffs on steel and aluminium imports, have isolated America from its traditional allies and has damaged its credibility in the eyes of the world community and raised questions on its commitment to honour International treaties.

There have been reports that the French, British and German governments are exploring activating accounts for the Iranian central bank with their national central banks.^{21, 22} Russia and Iran have launched an oil-for-goods exchange programme seeking to eliminate bilateral payments in US dollars.²³ Trade in Chinese Yuan-denominated crude oil futures at Shanghai International Energy Exchange (INE) has increased significantly since US withdrawal from the Iran deal.²⁴

These developments point towards lack of support for the sanction and attempts to establish alternative payment systems, with no or little US influence on them.

Yuan became a world reserve currency on November 30, 2015. China has been aggressively trying to internationalise the Yuan and gain more clout in the international payment systems, trying to dislodge the US Dollar from being the dominant global currency. Central Banks of European nations like France, England and Germany have started holding exchange reserves in Yuan.²⁵ These trends suggest that the US dollar is losing its monopolistic hold over the international payment systems. The current events are likely to further weaken the grip of the US dollar and help emergence of non-US dollar payment systems.

This should also be seen as laying of the foundation of an era where US dollar will not be the only dominant currency but will have to share space with currencies like Euro, and even to an extent with the Yuan, especially in parts of Asia, Africa and Latin America where China's economic influence has significantly risen over the past decade.

Imposition of second set of sanctions by the US will unquestionably make trading difficult with Iran in the short term as the US has overwhelming influence on the global payments system as it is the world's largest economy and EU entities are deeply dependent on it. That being said, US-imposed unilateral sanctions are unlikely to succeed in the long run due to absence of support from allies and a willingness to enforce them; furthermore, it will diminish American standing among allies and world community at large.

Legal Issues

Iran has taken United States to the International Court of Justice (ICJ) at The Hague, over validity of unilateral sanctions imposed over it. Iran has cited the 1955 US-Iranian Treaty of Amity²⁶ to invoke jurisdiction of the ICJ. Under Clause 2 of Article XXI of the treaty if a dispute between the parties is not resolved by diplomacy, then either party can approach the ICJ. The treaty was signed by the two countries in 1955, during the terms of US President Eisenhower and Iranian Prime Minister Hossein Ala. The treaty emphasises

friendly relations while encouraging mutual trade and investments and regulating consular relations.

The Treaty was signed at Tehran on August 15, 1955; ratified by the United States of America on September 14, 1956; ratified by Iran on April 30, 1957 entered into force June 16, 1957. The treaty was signed after the democratically elected Iranian government of Prime Minister Mohammed Mossadeq was overthrown in a coup orchestrated by the governments of the US and the UK under the name Operation Ajax in 1953.

The objective of the coup was to oust the government of Prime Minister Mohammed Mossadeq, and reinstal the Shah of Iran Mohammad Reza Pahlavi with almost dictatorial powers and policies favouring the Americans and the West.

Despite Iran withdrawing from the Bagdad Pact in February 1979 after the Islamic Revolution of 1979, and the US severing diplomatic ties and imposing sanctions on Iran in April 1980, the 1955 US-Iranian Treaty of Amity has continued to operate with neither Iran nor the USA withdrawing from it formally.

Both the counties have used the treaty to invoke the jurisdiction of ICJ. In the past, ICJ has assumed jurisdiction on the basis of this treaty. Once, during Diplomatic and Consular Staff crisis in Tehran²⁷ in 1979-80, the Court held that Iran had violated and was still violating obligations owed by it to the United States under conventions in force between the two countries and rules of general international law, that the violation of these obligations engaged its responsibility, and that the Iranian Government was bound to secure the immediate release of the hostages, to restore the Embassy premises, and to make reparation for the injury caused to the United States Government.

In May 1989, Iran sued the United States of America in the ICJ over the shooting down of Iran Air Flight 655 by US Naval Ship.²⁸ The USA raised preliminary objections to the jurisdiction of the Court, however as both the parties arrived at an out-of-court settlement, proceedings in the ICJ were discontinued.

Iran in 1992 again approached the ICJ in the Oil Platforms case²⁹ against the destruction of Iranian

oil platforms wherein the USA filed a preliminary objection to the Court's jurisdiction which was rejected by the Court. The Court in the case held that by attacking on two occasions and destroying three offshore oil production complexes, owned and operated for commercial purposes by the National Iranian Oil Company, the United States had violated freedom of commerce between the territories of the Parties as guaranteed by the 1955 Treaty.

ICJ on August 30 concluded hearings on indication of provisional measures.³⁰ During the proceedings³¹ the Iranian side argued that the sanctions violated the 1955 Treaty of Amity, Economic Relations, and Consular Rights between Iran and the US, which grants the ICJ jurisdiction over disputes and prayed for suspending US sanctions as an interim measure.

The Iranians further submitted that the USA has no cogent reasons to reimpose sanctions, as IAEA has repeatedly confirmed that Iran has been complying with the terms of the nuclear deal. US sanctions are besieging Iran economically, with all the dramatic consequences that a siege implies for the besieged population. The Americans submitted before the Court that it lacks jurisdiction in the dispute, and that Iran's assertions fall outside the bounds of the treaty.

The ICJ is the principal judicial organ of the United Nations; its judgements are binding, though it lacks power to enforce them. Article 94 of the UN Charter lays down that it shall be the duty of all UN members to comply with decisions of the Court involving them. If parties do not comply, the issue may be taken before the Security Council for enforcement action.

It may be worthy to recall in the case of Nicaragua vs. United States of America³² where the ICJ held that the US had violated international law by supporting the Contras in their rebellion against the Nicaraguan government and by mining Nicaragua's harbours. The United States refused to participate in the proceedings after the Court rejected its argument that the ICJ lacked jurisdiction to hear the case. The US also blocked enforcement of the judgment by the United Nations Security Council and thereby prevented Nicaragua from obtaining any compensation.

If the ICJ rules in favour of Iran and the US declines compliance of the interim order, the world community and Iran will get a moral boost to circumvent the unilateral US-imposed sanctions, thereby giving the faltering Iranian economy and regime some respite, consequently, aiding in the emergence of new economic blocs and systems.

India's Dilemma

"Few people have been more closely related in origin and throughout history than the people of India and the people of Iran."

—Jawaharlal Nehru, *Discovery of India*

The peoples of India and Iran have enjoyed close historical links through the ages. The cultural and trade bonds between the two nations are ancient and engrained in the minds of its people. In the present era, trade between India and Iran has been largely defined around one commodity—Oil. In June 2018, the US dispatched US envoy to the UN, Nikki Haley, to India with a message "rethink its relationship with Iran"³³ and scale back its oil imports from Tehran. India has been striving to maintain a balance between its ties with Iran and the USA. It is stepping up cooperation with the USA to counter aggressive Chinese posturing in the region, and is the second largest buyer of Iranian Oil.

India depends on crude imports to meet over 80% of its oil demand. It might be able to cut out Iran by buying more Saudi or Iraqi oil, but these options would be more expensive. Indian refineries such as Mangalore Refinery and Petrochemicals Limited, which are designed to process Iranian crude, can be upgraded at a cost. However, preferential terms—discounts, extended payment timelines offered by Iran to India may not be offered by other oil producers.

Iran has been offering lucrative terms to India to incentivise it to keep buying oil from it. Iranian Heavy, one of the country's main grades of crude, is priced 90 cents lower per barrel than Arabian Medium, a similar Saudi crude, for September shipments. The price difference between the two grades has tripled over the past year.³⁴ Tehran has also offered an arrangement where Iran would be organising tankers

and insurance.³⁵ New Delhi earlier this year committed itself to increasing its oil offtake by 25% when Iranian president was in New Delhi.³⁶

It would be difficult for India to comply with US-imposed sanctions on Iran. The Modi government cannot afford to allow domestic energy prices to rise further as elections are due next year and rising oil prices may prove costly to the government politically.

Moreover, a further rise in oil prices will put higher pressures on India's rising import bill and the Current Account Deficit (CAD), which have already been affected by the strengthening of the dollar and rise in US interest rate. Given the current global oil market, an alternative to the deal offered by Iran would be expensive, undermining India's energy security.

Furthermore, India has vital strategic investment in Iran – the Chabahar port in which it has invested large amounts to open up an alternative route to Afghanistan, Central Asia and Russia, bypassing Pakistan. Additionally, Chabahar port is of extreme strategic value in view of Pakistan and China expanding their military ties. Any disengagement with Iran is bound to have an effect on Chabahar port; further it will also translate into pushing Tehran further towards China and embracing China's Belt and Road Initiative, which would prove detrimental to India's policy of maintaining a balance in the Gulf region.

India is in negotiations for buying a stake in the Farzad-B gas fields. Further, India has also committed itself to investing \$500 million to build berths at Chabahar's Shahid Beheshti Port, and \$2 billion to build a rail line through the Zahedan province to Afghanistan.³⁷ Even if India succeeds in substituting Iranian Oil, the strategic advantage offered by Chabahar port and other investments qua trade and security can never be substituted as the same is vital for long-term Indian interests in the region. In view of this, India is likely to maintain its strategic autonomy and pursue an independent Iran policy.

In the inaugural Indo-US 2+2 dialogue joint statement³⁸ and press conference, no references to the Iran sanctions were made. It is unlikely that the Iran situation would not have been discussed between the participants.

Absence of any reference to Iran sanctions points towards lack of common ground on the issue between the two countries and India's unwillingness to bring a cut in its energy ties with Iran.

On September 27, 2018 Alice Wells, the Principal Deputy Assistant Secretary for South and Central Asia, told IANS in an interview that, "When it comes to Chabahar, we are in the process of reviewing the imposition of sanctions. So that process (of review) is underway and we take India's concerns and interest in being able to expand exports to Afghanistan and to increase Afghanistan exports to India, very seriously."³⁹ This points to the fact that the US appears to be well aware of the importance of Chabahar port and the adverse effects that American sanctions might have on the project, if India complies with them. However, considering the Trump Administration's past capricious actions, not much hope can be pinned that waivers may be provided.

This should also be seen in the back-drop of the US tightening sanctions on Russia – another major partner of India, especially in the defence-industrial sector. The Indian domestic reactions to US sanctions on Russia are likely to put pressure on India's improving relations with the US as well.

In the present circumstances, none of India's alternative choices look very attractive and without cost. Hence, India is unlikely to comply with US-imposed sanctions due to the reasons enumerated above.

The Modi government has to look at various options and strategies to deal with US-imposed unilateral sanctions without jeopardising the nation's energy security. India has maintained that it only complies and recognises sanctions imposed by the UN and not any unilateral sanctions. Indo-Iran trade is likely face bottlenecks on the payments front due to sanctions imposed by the US, as Americans have a dominating hold over the global payments system.

That being said, this is not the first time when challenge of payments has threatened Indo-Iran trade. India is trying to revive Rupee-Rial payment system⁴⁰ like it did in 2012 when all payment avenues were blocked due to US-EU sanctions. Wherein half of what it owed

Tehran for oil imports would be held in a UCO Bank account and made available to Iranian companies to use for any imports from India. India in July this year approved a proposal from Iranian private lender Bank Pasargad to open a branch in Mumbai to facilitate bilateral trade.⁴¹ This development should be seen in tandem with the imposition of US sanctions. Iranian Bank channels can be used to ensure flow of funds between the countries.

Otherwise, payment for oil in a non-USD currency route can also be explored. Alternatively, it can also consider using a special purpose vehicle as proposed by the EU and which is open to be used by “partners” to circumvent the US sanctions on Iran, and is expected to be finalised and in place before November.⁴²

Conclusion

President Trump’s decision to pull the plug on the deal is proving to be an unpopular one both among allies and the world community at large. Reasons attributed to abrupt US pull-out are not cogent and appear to be based on narrow regional considerations. The Iran deal was a result of long and arduous diplomatic negotiations and the American pull-out has raised questions on its commitment to honour international agreements. US brinkmanship can lead to derailing

of emerging economies and further complicate the Middle East conflict.

Sanctions have become an important tool in geopolitics today; however, they remain a very risky proposition whose success depends on allies, a willingness to enforce them and incentives to bargain.⁴³ Imposition of a second set of sanctions by the US in the absence of support from traditional US allies and majority of the world community, are unlikely to succeed in the long run and will hurt US standing among the world community.

The US is poised to be the world’s second-largest oil producer,⁴⁴ and oil market fluctuations are unlikely to have any detrimental effects on its economy. But other major economies like China, EU, Japan and India are heavily reliant on energy imports and would like to keep in check oil prices, which are already high.

US imposition of unilateral sanctions on Iran will only spur Iran and its trading partners to set up alternative mechanisms of payments, which have no or little US influence. In the long run, the isolationist policies being pursued by Trump will likely lead to a dawn of an era where the US dollar will not be the only dominant currency but multiple currencies will coexist on a more equal footing in the international markets.

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CENTRE FOR LAND WARFARE STUDIES (CLAWS)

RPSO Complex, Parade Road, Delhi Cantt, New Delhi 110010

Tel.: +91-11-25691308, Fax: +91-11-25692347, Email: landwarfare@gmail.com

Website: www.claws.in

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