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GEOPOLITICS

US Threads Needle on Iran-China Oil Trade

- *New congressional sanctions targeting the Iran-China oil trade reflect frustration on Capitol Hill over surging Iranian crude exports.*
- *But the White House is balancing an array of bilateral and global policy priorities with China, and countering Russia's war effort is taking precedence over any crackdown on Iran's oil trade.*
- *Tighter enforcement of Iran sanctions runs counter to the Joe Biden administration's focus on keeping the market supplied, but those calculations could change in the medium to long term.*

The Issue

Washington is ratcheting up economic pressure on China on multiple fronts, from threatening tariffs to address "overcapacity" in the renewables trade to introducing and threatening sanctions over China's trade supporting Russia's war effort in Ukraine and Iranian oil purchases. How hard the US will ultimately push on each issue will be weighed against broader attempts to stabilize ties with Beijing and competing policy priorities — and the risk of blowback, including for Mideast tensions. So far, signs point to Iran oil sanctions pressure taking a back seat in the White House's calculations. The measures also don't take effect until 180 days after being signed into law, or just ahead of the November election.

Iranian Oil in Crosshairs

As US Secretary of State Antony Blinken arrived in China last week to warn Beijing over its support for Russia's defense industry, back in Washington, Congress was aiming to blunt Iran's bustling oil trade with China.

The $95 billion aid package for Ukraine, Israel and the Indo-Pacific passed by Congress and signed into law by Biden had already incensed Beijing over new funding for Taiwan and targeting the social media app TikTok. But tucked into the law is a raft of Iran-related sanctions that directly and indirectly touch on Tehran's oil trade with China, setting the stage for a potential showdown.

One bill, the Stop Harboring Iranian Petroleum (Ship) Act, extends primary and secondary sanctions to foreign ports, shippers and refineries that "knowingly" process, purchase, conduct ship-to-ship transfers or transport petroleum or petroleum products exported from Iran. Another bill, the Iran-China Energy Sanctions Act, aims to counter Chinese purchases of Iranian oil by expanding secondary sanctions to Chinese financial institutions that facilitate the purchase of Iranian petroleum products.

Enforcement Question

With critics accusing the Biden administration of looking the other way to avoid disrupting energy flows, reporting requirements to Congress will effectively name-and-shame violators and put them in the crosshairs of sanctions. The laws don't require immediate sanctions, but they will increase pressure and make it harder for the executive branch not to impose sanctions on entities determined to be in violation, said Amir Fadavi of advisory firm K2 Integrity. A senior State Department official told Energy Intelligence that Congress had provided "additional tools" and now the focus is on "practically how we enforce that."

But Gregory Brew, an analyst with Eurasia Group, said he is doubtful the US will aggressively enforce the measures, even though the administration does have scope to do so. "The question that is raised by these new measures is: Will this lead to tougher US enforcement of sanctions on Iranian oil to China in the medium and long-term?" he said.

Oil markets and Chinese buyers shrugged off the threat, with teapot refiners viewing it as just one more addition to the many existing sanctions acts on Iran, said Muyu Xu, a senior oil analyst at Kpler. The muted response also reflects a 180-day winddown period, meaning the scope of implementation and enforcement will effectively fall to the next US president.

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Even then, "effective enforcement of the act will require China's cooperation," Xu said.

Meanwhile, "thanks to the tightened sanctions on Venezuela and Russia, which have pressured their oil prices downward, Iranian oil is now being offered at lower levels (about $1 per barrel cheaper) in Shandong compared to a month ago," Xu added. "That will attract stronger buying interests from teapots" who will soon need to replenish their stockpiles on coming out maintenance.

Further out, if implemented and enforced, the Ship Act could add up to $8.40/bbl of upside risk to crude, according to ClearView Energy Partners. "The Ship Act could discourage ships, ports and refiners that are not fully disconnected from the US financial system from receiving, conveying or processing Iranian crude," it said. The key will be how Chinese players assess the risk. Most of Iran's exports are sold via a "shadow fleet" to China's independent teapot refiners and smaller ports that typically have limited ties to the US financial system.

Calibrating Policy Priorities

From countering Russia to trade and economic policy with China, the US has other priorities that could potentially win out over cutting off the flow of Iranian oil, said Brew. That point was echoed by Fadavi, who argued that if the US wants to push China not selling dual-use items to Russia, it probably has to give up some pressure on them buying energy from Iran. In response to US warnings, China has refrained from directly supplying Russia with weapons. But Chinese firms are providing dual-use goods that have enabled Russia's defense industrial base to prosecute the war in Ukraine — and the US is re-upping threats to target Chinese banks facilitating this burgeoning trade. Such threats can have a wider chilling effect, although Chinese buyers of discounted Russian crude have largely found payment workarounds.

Washington is seen as refraining from sanctioning major Chinese banks, however, given the wider economic fallout and the risk of Chinese economic retaliation. Additionally, the US is asking China to exert influence over Iran to de-escalate tensions in the Middle East and would likewise need Beijing's help to address any potential dash by Iran for a nuclear weapon.

"This is absolutely a question of competing or parallel priorities. The United States can't do it all," said Brew. "That's particularly the case when cutting off the flow of Iran's oil to China comes with a lot of potential negative externalities, including increasing the price of oil, provoking the Iranians to retaliate and escalate in the Middle East crisis, and worsening relations with China."

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