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INSIGHT

Iran's Expanding Economic Relations with Asia

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Overview

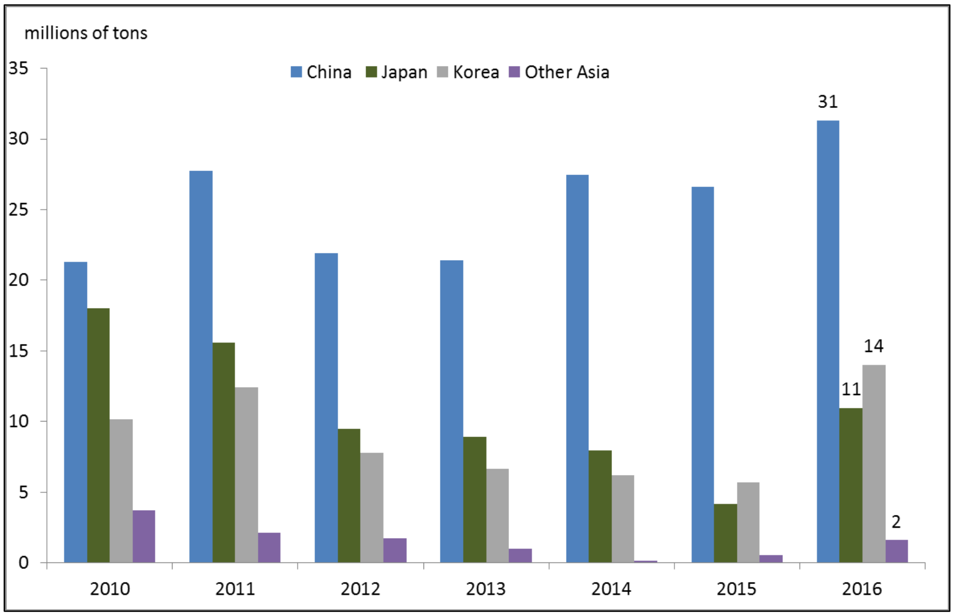
Since multilateral sanctions on Iran were lifted in January 2016 under the Iran nuclear agreement (Joint Comprehensive Plan of Action, JCPOA), foreign firms have begun to resume business with Iran. Iranian leaders seem to be counting on expanded economic ties with the major East Asian economies to help Iran emerge from the years of international sanctions, diversify its economy away from reliance on hydrocarbon products, and become a regional trading hub. Expanding ties with Asia is politically easy for Iran because the major Asian countries remained engaged in Iran's economy even during the 2010-2016 multilateral sanctions regime (see CRS Report RS20871, *Iran Sanctions*).

East Asian Economic Engagement with Iran

As top Iranian oil customers, China, Japan and South Korea played a key role in escalating energy sanctions against Iran. Their reductions of Iranian oil purchases (to earn a U.S. sanctions exemption for "significantly reducing" purchases of oil), combined with the EU's oil embargo, led to a significant contraction of Iranian exports after 2011. From 2011-2012, Chinese imports of Iranian crude fell by nearly a quarter; Japanese and South Korean imports fell about 40% and further by 2015. Japan and South Korea also banned energy-invested projects in Iran and restricted trade financing.

Iran has worked to regain market share in Asia since sanctions were eased. China and South Korea's oil imports have reached or surpassed pre-sanction levels; purchases by Japan and other Asian countries have been slower to rebound (**Figure 1**). Iran also regained access to some $115 billion in hard currency held abroad, whose repatriation was restricted by foreign banks, particularly those in Japan and South Korea, to comply with U.S. sanctions (see CRS Report RS20871, *Iran Sanctions*).

Figure 1. Major Asian Crude Oil Importers from Iran



Source: International Trade Centre.

Notes: Crude oil based on HS product code 2709. "Other Asia" includes Malaysia, Singapore, and Taiwan.

Tightened sanctions increased Iran's reliance on Chinese trade; China's share of Iran's global trade expanded from 20% in 2010 to 31% in 2016. Due to missing data reported for Iran, the trade shares are based only on the data of Iran's trading partners. Although China cut oil imports it did not fully ban energy trade, allowing China to surpass the EU in 2011 as the top buyer of Iranian oil. While energy remains China's largest import from Iran, plastics, ores, and organic chemicals account for a growing share, some 30% in 2016. This in part reflects Iran's attempt to diversify toward non-oil sectors.

Blocked from accessing foreign exchange at the height of U.S. sanctions, Iran settled its trade balance with its oil customers, particularly China, in goods rather than hard currency. Chinese exports to Iran doubled from 2010 to 2014. China supplies about one-third of Iran's overall imports, and accounts for as much as 50% to 100% of Iran's imports of such products as textiles, rail locomotives, ships, and iron and steel. South Korea accounts for less than 10% of Iran's imports but remains a key source of certain inputs, such as auto parts. China and South Korea have become Iran's top auto parts suppliers, accounting for 29% and 22% of Iranian imports, respectively. Iran has prioritized its auto industry, the largest industry after energy, after production fell 55% from 2011 to 2013. Iran moved to limit auto imports to incentivize foreign direct investment (FDI) in domestic production.

FDI in Iran has increased since sanctions were eased. In 2016, total announced investment projects in Iran were valued at $12.2 billion, compared to $2.5 billion in 2015. East Asian countries have taken steps to facilitate new investment. In February 2016, Japan and Iran signed an investment agreement, and in May 2016, South Korea and Iran signed memorandums of understanding for 30 joint projects in energy and infrastructure. Among new Asian investments in Iran are:

- **Oil.** Chinese firms CNPC and Sinopec are in talks for phase two development of Yadavaran and Azadegan oil fields. Japanese firm Inpex, which divested its 10% stake in Azadegan in 2010, is reportedly also considering re-joining that project.
- **Oil and gas refineries.** Hyundai, Daelim, Daewoo and SK E&C signed several agreements. In July 2017, Korean and Japanese firms signed a $3 billion agreement for development of Siraf refineries. Sinopec has contracted to renovate the Abadan refinery.
- **Natural gas.** CNPC joined French company Total in a contract to develop the South Pars gas field. In May 2016, KOGAS signed an MOU to explore development of Balal gas field.
- **Shipbuilding.** In December 2016, Hyundai Heavy Industries announced a $700 million deal to build 10 ships for Iran's state-owned shipping company. Daewoo and DSME announced a joint venture for shipyard construction.
- **Autos.** In March 2017, Hyundai signed a joint venture production agreement with Kerman Motor, and Kia Motors resumed selling production kits to Saipa.

China views Iran as an important player in its "Belt and Road" initiative (BRI), which aims to boost economic connectivity across continents, including through financing massive infrastructure and energy projects. BRI is also viewed as an outlet to deal with China's industrial overcapacity in steel, cement, and other commodities. Chinese state-owned enterprises and private businesses are involved in several projects, backed by state financing, to modernize Iran's transportation infrastructure, including the Tehran subway. Chinese automaker, Chery, is the largest foreign automaker in Iran and operates an auto industrial park. In December 2014, Iran, Kazakhstan, and Turkmenistan inaugurated a railway connecting China to Tehran, and in February 2016 the first rail cargo arrived in Iran. BRI may facilitate increased bilateral trade with China, but could also expand Iran's role as a hub linking Central Asia to Europe.

Implications

Iran's expanding economic ties with the countries in East Asia, especially China, are likely to give Tehran additional allies in its efforts to counter pressure by the Trump Administration and Congress to renegotiate the JCPOA or to impose additional sanctions on Iran through legislation. In particular, China, which appears to see Iran as a lynchpin of its regional economic strategy, holds a seat on the U.N. Security Council, and is positioned to slow U.S. efforts to isolate Iran. Yet, the relative lack of East Asian political or military involvement in the region ensures that U.S. and European leverage on Iran remains significant.