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The Return of U.S. Sanctions on Iran: Challenges and Prospects for Korea

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The economic relationship between Korea and Iran encountered a huge obstacle in 2018, which both parties are still trying to overcome. On July 14, 2015, Iran and the P5+1 (the United States, the United Kingdom, France, Russia, China, and Germany) agreed on a Joint Comprehensive Plan of Action (JCPOA) regarding Iran's nuclear program. The JCPOA was implemented on January 16, 2016, but lasted less than three years before President Trump of the United States withdrew on May 8, 2018, with Iran and the other participants still staying in the deal.

In August 2018, the U.S. sanctions which were lifted as part of the agreement clamped down again on Iran, such as sanctions on trading U.S. dollars, gold, aluminum, and steel, and the Iranian auto industry. On November 5, as the wind-down period ended, the U.S. fully reimposed its sanctions on the shipping, shipbuilding, finance, and energy sectors of Iran, the most important industries for the country. Korea and seven other major oil importers from Iran obtained temporary waivers to continue imports of Iranian oil, albeit with "significant reductions" in the amount of oil they imported. The waivers will be regularly reviewed every 180 days. The waivers also include an understanding about the Korean

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won-based settlement system, which allows payment for Korean exports of permitted goods and services to Iran from an escrow account with the money from Iranian oil sales.

The Iranian economy has been severely affected by the U.S. reimposing its sanctions. According to the IMF, the real GDP growth of Iran was -1.5% (est.) in 2018 and is expected to fall to -3.6% in 2019. The inflation rate has skyrocketed: the annual inflation rate was 29.6% (est.) in 2018 and is expected to record 34.1% in 2019, which is similar to the level of inflation in 2013 when Iran and JCPOA partners started negotiations on the Iranian nuclear program. Several economic-issues-driven protests have continued and escalated from late 2017 in Iran. The Iranian government, however, finds itself with few policy options to overcome the high unemployment, inflation, and, exchange rate volatility under the sanctions.

Korea has been a major economic partner of Iran. In 2017, Korea was the top-3 export destination of Iran while Iran was the third largest importer of Korean products in the Middle East. The main export products of Korea to Iran are automobiles and their parts, chemicals, steels, electronics, and machinery. The value of Korean construction contracts in 2017 was about five million U.S. dollars, though many contracts have been canceled due to the recent pullback.

The outlook on the economic relationship between Korea and Iran remains unclear. The six-month cycle of waiver renewal hinders the re-engagement of Korean firms in the Iranian economy, especially in energy sectors. In addition, the United States is expected to increase its monitoring of the Iranian sanctions. Recently the CFO of China's Huawei was arrested in Canada upon the U.S.'s request, for alleged violations of U.S. sanctions on Iran. Although exemptions from the sanctions were announced in November 2018, the Korean government has been negotiated details with the U.S. government until recently. It will take a significant time for the sanction waiver to fully come into effect. In this regard, Korean banks are still deliberating over ways to continue financial transactions with Iran.

The two countries still have a chance to continue and expand their economic relationship. Most of the products traded between the two countries are on the U.S.'s sanction waiver list. Small and medium-sized enterprises in both countries have a particular demand for each other's products and services. Some Korean energy companies are preparing to resume their oil imports from Iran. As the Korean won-based settlement system relaunches, trade between the two countries will recover soon. It is worth noting that bilateral trade between Iran and Korea peaked in 2011, just after a United Nations Security Council Resolution was passed in 2010 to place an embargo on Iran.

To ensure a sustainable economic relationship between the two countries, the Korean government may reevaluate the relationship based on the three following points. First of all, it is true that full-scale operations in the Iranian economy will be impossible in the short term, and mid- and long-term strategies to continue the relationship will be needed. Iran is the largest country in the Middle East in terms of population, and one of the few economies in the region with an established industrial base. Nonetheless, the lifting of sanctions on Iran, in accordance with the JCPOA, increased trade volume between Iran and Korea but did not expand the diversity of bilateral trade between the two nations. Trade diversification could be enhanced by expanding the trade of non-sanction products, and by reorganizing the current bilateral relationship centered on large firms to one that is more inclusive of small and medium-sized firms. The Iranian government is also striving to diversify its oil-centered economy and trade relationships. Thus, both governments can work together toward the goal of enhancing economic diversification.

Second, sanctions could have the effect of securing the Iranian market from international competition. Actually, the current sanctions on Iran are hardly new development in the relationship between the two countries. U.S. sanctions on Iran have been in place since the 1980s. Those were Korean exports and construction companies that substituted European products and firms withdrawing from the market in the late 2000s as international sanctions on Iran were tightened. Despite an increase in the U.S.'s monitoring of Chinese firms operating in Iran, China rose as the top economic partner of Iran as the most severe international sanctions were imposed. Large European firms which had reentered the Iranian market after the implementation of the JCPOA are leaving Iran again. This time could be an opportunity for others. Since business relationships will face many obstacles in the short term, now could be an opportune time to expand private partnerships in the meanwhile, promoting the exchange of entrepreneurs, students, and technicians between the two countries.

Third, Korean firms and the government should closely monitor short-term situations in the Iranian economy in addition to the status of sanctions by the U.S. Sanctioned lists are limited. The Iranian economy seems vulnerable to external conditions such as exchange rates and import limitations mainly caused by the recent sanctions and changes in the U.S. position on Iran. Some Korean firms newly entering the Iranian market after the JCPOA are suffering from fluctuations in exchange rates and the shutdown of the Korean won-based settlement system. These firms had been encouraged by the Korean government to enter the Iranian market after the implementation of the JCPOA and the Korea-Iran Summit in 2016. The Korean government could provide financial support temporarily to allow these firms to continue their operations in Iran until the Korean won-based settlement system works again. KIEP