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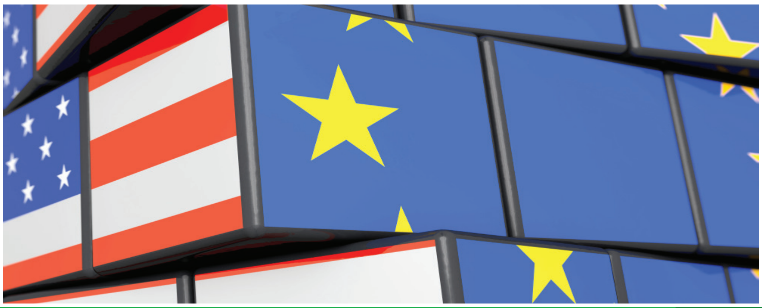
Sanctions and the End of Trans-Atlanticism

Iran, Russia and the Unintended Division of the West



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Abstract

Sanctions have become the dominant tool of statecraft of the United States and other Western states, especially the European Union, since the end of the Cold War. But the systematic use of this instrument may produce unintended and somewhat paradoxical geopolitical consequences. The sanctions imposed on the Islamic Republic of Iran and the Russian Federation in the field of energy are particularly illustrative of this phenomenon.

Firstly, Iran and Russia demonstrated their resilience and a real ability to adapt, thus transforming the perspective to European companies. One of Tehran's responses to sanctions was to establish the so-called "resistance economy" in order to make Iran resistant to all kinds of economic shocks and reducing the reliance on a single commodity. For its part, Russia has adapted and offered new perspective to European and Asian businesses by creating a precedent with the case of Total. Some European companies are now ready to operate according to these rules—at least in the gas sector, as the oil is too risky relative to U.S. policy and law.

Secondly, differences in the approach of the United States and Europe over the type and intensity of economic statecraft against both Iran and Russia have increasingly undermined trans-Atlanticism. The so-called secondary sanctions imposed on both Iran and Russia have become the primary vehicle for signaling and even implementing a decoupling of U.S. and European political objectives. On the one hand, the costs of complying with U.S. secondary sanctions is perceived as too high for European companies. On the other, Europeans are not ready to bear the consequences of internal U.S. divisions.

All of this might even have reinvigorated the European project, by triggering a debate on the need for European countries to protect their economic sovereignty. The European Green Deal might become the emerging unifying theme that might relaunch the European project and make Europe a fully-fledged geopolitical actor.

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Introduction

Sanctions have become the dominant tool of statecraft of the United States and other Western states during the post-Cold War era. Sanctions are useful when diplomacy is not sufficient but force is too costly.[1] Despite decades of scholarship that explains the nuances of sanctions, it is still all too common to hear misguided inquiries into whether sanctions "work," as though such a tool might be chosen only to change behavior that is resistant to outside influence or without regard to the relevant policy options. The capacity of states under sanctions to adapt is, furthermore, too often forgotten. Sanctions imposed on the Islamic Republic of Iran and the Russian Federation are two telling examples.[2]

In this paper we explore the unintended and somewhat paradoxical geopolitical consequences of Western sanctions on Iran and Russia. Although Iran and Russia may have actively sought from time to time to undermine trans-Atlanticism, those efforts have, for the most part, failed. Tensions about Russia and Iran have, however, succeeded where those two countries themselves failed.

The American over-use of unilateral economic sanctions as a tool of statecraft, especially in the energy sector, has significantly undermined trans-Atlanticism. The so-called secondary sanctions, better known as extraterritorial sanctions, imposed on both Iran and Russia are at the core of these tensions. In May 2016, Washington announced its withdrawal from the Join Comprehensive Plan of Action (JCPOA) and introduced a "maximum pressure" campaign against Iran,[3] thereby causing a public rebuke by European political and business elites, as well souring public opinion. Then the U.S. president signed in August 2017 the Countering America's Adversaries Through Sanctions Act (CAATSA), which imposes sanctions on Iran, North Korea, and Russia. Since then, there are persistent tensions inside the United States over imposing new sanctions on Russia. The overall situation has generated frustration and outrage throughout

1. J. Kirshner, "The Microfoundations of Economic Sanctions", *Security Studies 6*, No.3, December 2007, p.32-64.

2. It should be remembered that both sanction regimes are different in nature and purpose: Iran sanctions are backed by UN resolutions, whereas Russian sanctions were adopted in March 2014 by the EU and the USA in reaction to the annexation of the Crimea and destabilizing activities of Russia in Eastern Ukraine.

3. U.S. Department of State, April 22, 2019, available at: www.state.gov.

European business communities, especially since the signature of sanctions against companies involved in constructing Nord Stream 2 by the President Donald Trump.

We argue that differences in the approach of the United States and Europe over the type and intensity of economic statecraft against both Iran and Russia that emerged approximately five years ago have increasingly undermined trans-Atlanticism. The fissures began before the election of Donald Trump to the presidency of the United States. Fears of an impending failure of the trans-Atlantic relationship, set in the context of increasing U.S. unilateralism and harsh U.S. criticism of the European Union,[4] has put a damper on the U.S.-European cooperation. In addition, this division was heightened by Iranian and Russian adaptation to sanctions, adaptation that has transformed the perspective to European companies. All of this might even have reinvigorated the European project, by triggering a debate on the need for European countries to protect their economic sovereignty. The use of economic coercion by the Trump administration against European countries has revealed their vulnerability to any form of weaponization of economic interdependence by the United States.

4. "*Europe treats us worse than China. […] European nations were set up in order to take advantage of the United States*", Donald Trump on Fox News, June 26, 2019.

US secondary sanctions as instrument of decoupling

At first glance, a consensus among the United States and the European Union

The main goal of U.S. and EU energy-related sanctions, which constitute the bulk of economic and trade sanctions in the Iranian and Russian cases, is to make the renewal and export of oil and gas resources more difficult, thereby depriving Iran and Russia of income. This can be achieved through a total or partial disconnection of these targeted countries from international financial, energy, and insurance markets.

Before the introduction of Western sanctions, both Iran and Russia were highly dependent on (i) access to energy markets, (ii) the price of oil and natural gas, (iii) Western technologies and investments, (iv) and cheap Western credit.[5] Oil and gas revenues compose a large part of the national budgets of these nations and play a significant role in economic development. Generous state energy subsidies ensured social stability and sometimes financed military forces, including Islamic Revolutionary Guard Corps (IRGC). Energy-related sanctions thus undermine the integrity of a targeted government by depriving it of revenues and weakening domestic energy firms, which are often the most profitable and politically meaningful. These effects also make structural reforms to diversify and modernize the economy more difficult to achieve.

Energy-related sanctions allow significant room for maneuver to the United States and the European Union. The Iranian case shows that restrictive sanctions can have an almost immediate effect on the energy sector (as the 2012 EU oil embargo) and consequently on the economy. More comprehensive sanctions have long-term effects, as in the Russian case. On the U.S. and European side, in 2014, the logic was the following: not affecting current Russian oil exports, which could disrupt supplies and potentially drive up global prices, but undermining Russian oil production over the long run. The entire Russian economy is not sanctioned, and that is

5. A. Bros, "Low Oil Prices, Sanctions and Structural Problems: the Tribulations of Russia's Oil and Gas Sector", Fondation pour la Recherche Stratégique (FRS), No.05/2017, July 2017, available at: www.frstrategie.org.

why the U.S. sectoral sanctions identifications (SSI list) was created in 2014. It forbids certain kinds of financial transactions, while most of the others are allowed. The "classical" Specially Designated Nationals and Blocked Persons List (SDN list) does target specific individuals, vessels, and entities, such as Rosneft and Gazpromneft. Last but not least, no sanctions have been imposed on the insurance sector. This means that companies (whatever the nationality) can still hedge when they buy Russian oil.

Sanctions also tarnish Russia's and Iran's diplomatic reputation—almost impossible to quantify in monetary terms. The reputation risk is, nevertheless, a compelling psychological element of the sanctions regime. Western sanctions carry much more than simple pecuniary costs. They can significantly hinder Russia's and Iran's ability to establish closer ties with other nations, companies, and entities. Financial services firms, for example, become more wary of engaging with sanctioned countries for fear of violating U.S. law.

U.S. secondary sanctions: the bone of contention between the United States and Europe

Although the United States and Europe largely agree on the "substance" of sanctions, they disagree on their implementation. The crux of the matter is U.S. secondary sanctions, also known as extraterritorial sanctions. These secondary sanctions have become the primary vehicle for signaling and even implementing a decoupling of U.S. and European political objectives.

It is necessary to distinguish between U.S. primary sanctions and secondary sanctions. Primary sanctions restrict U.S. companies, entities, and citizens from doing business with a sanctioned country or entities under sanctions. They also apply to U.S. transactions and U.S–origin goods on U.S. territory. To some extent, European restrictive measures follow the same logic. European individuals, business people, and entities (under the scope of the European jurisdiction) are limited in their "interactions" with a country or entities under sanctions.

U.S. Secondary sanctions forbid any transaction in U.S. dollars and prevent any U.S. nexus from doing business with a country, persons, or organization under the U.S. sanction regime.[6] To put it simply, these

6. In this study, we use the definition given by the Cornell Law School which defines a U.S. nexus as: "any United States citizen, permanent resident, alien, entity organized under the laws of the U.S. or any jurisdiction within the United Sates (including foreign branches), or any person in the United States". See Legal Information Institute, Cornell University, available at: www.law.cornell.edu.

sanctions also target foreigners, hence the name of extraterritorial sanctions. A U.S. nexus operating in a foreign jurisdiction cannot be involved in negotiating, approving or otherwise facilitating any portion of a prohibited transaction. Individuals and businesses thus are obliged to clarify in advance whether their proposed activities comply with U.S. laws. The result is an astonishingly comprehensive set of restrictions that preclude business conducted in dollars or that touches in essentially any way a U.S. firm or individual. Financial institutions, insurance companies, and energy companies cannot operate within Iranian and Russian jurisdictions.

Secondary sanctions have always divided the United States and Europe because they represent U.S. interference in European affairs and interests. The more secondary sanctions are employed, the more they are perceived in Europe as infringements of both national and Union sovereignty—as an unacceptable intervention in Europe's autonomous decision making. For example, the 1996 "Iran and Libya Sanctions Act", issued by the Clinton administration, which imposed secondary sanctions on the Islamic Republic became a bone of contention between Europe and the United States. Although Europe did not call into question the fight against terrorism, it objected to the way Washington was attempted to eradicate it,[7] while complaining about the fact that the United States was conducting its own agenda. At that time European countries had strong economic connections with Iranian business, and the re-imposition of secondary sanctions on Iran after the U.S. withdrawal from the JCPOA has become the primary tool by which the United States deters European firms from implementing an agreement to which their national governments remain committed. The same situation occurred in 2014 and 2017, when the United States imposed U.S. secondary sanctions on Russia and increased the list of secondary sanctions (see part 4). Even worse, the ongoing conflict between the executive and legislative branches of the U.S. government tends toward an escalation of sanctions against Russia and prevents the emergence of a trans-Atlantic consensus.

The costs of complying with U.S. secondary sanctions is perceived as too high for European companies, which have been forced to leave Iran and thereby lose many long-term investments and either to or downscale investments or change their investment model to continue to operate in Russia (see part 5). Moreover, European energy companies, banks, and insurance companies face the threat of a fine or even disconnection from the U.S. clearing system. In July 2014, for example, two French banks, BNP

7. M. McCurdy, "Unilateral Sanctions With a Twist: The Iran and Libya Sanctions Act of 1996", *American University International Law Review*, Vol.13, No.2, 1997, available at: digitalcommons.wcl.american.edu.

Paribas and Crédit Agricole S.A., were ordered to pay respectively almost 9 billion USD and 329.5 million USD as a result of violations of various U.S. sanctions programs (by concealing billions of USD in transactions) against Sudan, Iran, Cuba, and Burma between 2003 and 2008.[8] In 2015, the German financial institution Deutsche Bank was fined 258 million USD for violating U.S. sanctions.[9] Recently, the Italian bank Unicredit had to pay 1.3 billion USD for the same reason: violation of U.S. sanctions.[10] It is not always clear whether the violation of U.S. law was a conscious decision or the result of an inability to trade hydrocarbons without using the U.S. financial system. This chilling effect is leading to an increasing self-censorship, also called "de-risking" and "over-compliance," which is fueling increasing frustration inside Europe because European companies must give preeminence to a foreign national law into their decision making process while conducting business. Furthermore, U.S. withdrawal from the JCPOA shows that the list of sanctions can grow anytime, and that the reconnection with international energy markets after decades of sanctions is largely subject to the goodwill of sanctioning states, as well as European investment in targeted countries.

8. Settlement Agreement made by and between the U.S. Department of the Treasury's Office of Foreign Assets Control and BNP Paribas SA, 2013.
9. "Deutsche Bank muss 235 Millionen Euro zahlen", *Die Zeit*, November 4, 2015, available at: www.zeit.de.
10. "Italy's UniCredit to Pay $1.3 Billions to Settle U.S. Sanctions Probe", *Reuters*, April 15, 2019, available at: fr.reuters.com.

Adaptation efforts by Iran and Russia on energy sanctions

The case of Iran

Sanctions against Iran can be divided into three distinct categories:

- U.S. unilateral sanctions, which date back to the 1979 Iran hostage crisis and are numerous.[11] Washington also imposed manifold unilateral sanctions on Iran's energy sector from 2006 until 2013, which approximately corresponds to Mahmoud Ahmadinejad's presidency;
- The election of Mahmoud Ahmadinejad in 2005 and Tehran's efforts to acquire the capability to build nuclear weapons, coupled with the development of a ballistic missile program, were a game changer in Europe. The EU decided to impose manifold unilateral sanctions on Iran's energy sector from 2007 onwards;
- International sanctions were voted for between 2006 and 2010. Unlike U.S. and EU sanctions, the scope of sanctions passed by the UNSC is somewhat limited. They target Tehran's nuclear and ballistic missile programs but do not affect the energy sector due to Chinese and Russian opposition.[12]

The consequences of U.S. and EU sanctions were many (the list below is non-exhaustive) and the impact of sanctions was magnified by structural problems.[13] Such a situation led to the elimination of Iran from regional and global gas markets despite its huge reserves with these results:

- the reduction of oil and condensate production and exports due to the embargo on oil,

11. G. Samore (ed.), "Sanctions against Iran: A Guide to Targets, Terms, and Timetables. Addendum to Decoding the Iran Nuclear Deal (April 2015)", Belfer Center for science and international affairs, Harvard Kennedy School, Cambridge, 2015, available at: www.belfercenter.org.
12. D. R. Jalilvand, "Iran's Gas Exports: Can Past Failure Become Future Success?", The Oxford Institute for Energy Studies, June 2013.
13. For more details, see A. Bros, "Iran's Energy Sector's Ups and Downs: How Do Sanctions and Structural Problems Hamper Efforts to Become a Global Player?", European Union Centre for Energy and Resource Security at King's College, newsletter, No.82, February 2019, available at: gallery.mailchimp.com.

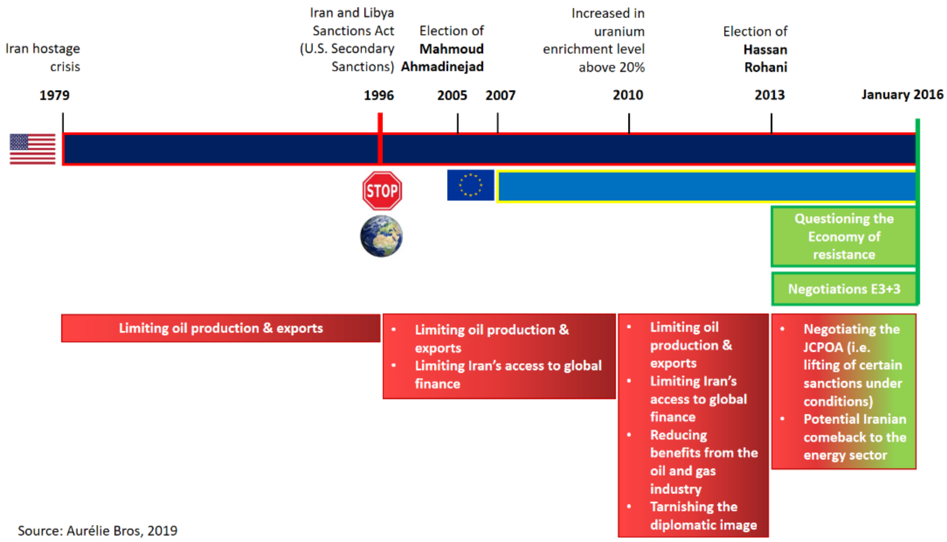
- the impossibility of developing the liquefied natural gas sector partly due to the restriction to services to Iran's shipping/shipbuilding industry, and the lack of technology,
- the cancellation of projects led by Western foreign companies,
- decreasing refining capacity,
- isolation of Iran's Central Bank and no access of the largest Iranian banks to the U.S. financial system,
- disconnection from the SWIFT system.

One of Tehran's responses to sanctions was to establish the so-called resistance economy—a concept memorialized in policy doctrine in September 2010 by Iran's Supreme Leader Ayatollah Ali Khamenei. This economic model was supposed to make Iran resistant to all kinds of economic shocks and reducing the reliance on a single commodity. The Iranian resistance economy is polymorphic and includes, among others, the expansion of domestic capabilities, the reduction of dependence on oil exports, and the setting up of efforts for self-reliance via substitution. It includes the development of the large non-oil industrial sector, the continuation of trade relations with neighboring countries even if they have difficult relations with the United States, and the cultivation of a certain expertise in smuggling.

In August 2013, Hassan Rohani, representing the relatively moderate and reformist faction, won the presidential election and started working to reintegrate Iran into the international community and reconnect its energy sector with international markets. President Rouhani and his allies sought to move beyond the resistance economy. Seen from Rouhani's perspective, the more Asian and European companies invest in Iran, the less the United States might be able to increase its sanctions regime, while the reconnection to energy markets is possible. Between the first day of the implementation the JCPOA and the U.S. decision to withdraw from this agreement, Tehran started to re-connect its energy sector with international markets and to reap the fruits of the ongoing normalisation of relations with the international community. Its five principal objectives were to (i) develop oil and gas production, (ii) export oil, (iii) expand natural gas output to meet growing domestic demand and to avoid becoming a net gas importer, (iv) attract investments and facilitate technology transfer, and (v) diversify its international energy portfolio. In most instances, Tehran tried to strike a balance between Europe and Asia, between private Western international oil companies and Russian/Chinese international oil companies with close links to their respective governments, and between national and private Iranian oil companies.

This Iranian policy of openness resulted in the sixth Five-Year Development Plan (approved in March 2017), which was drafted by the Expediency Discernment Council in order to modernize the Iranian economy. The plan was supposed to deliver: (i) economic growth, (ii) an improvement of the position of the country at regional and international levels, and (iii) an enhancement of the business environment and competitiveness.

Sanctions against Iran until January 2016



Source: Aurélie Bros, 2019

In May 2018, Washington declared its withdrawal from the JCPOA. Two weeks later, the main requirements for a new agreement with Tehran were explained. Washington, among others, demanded that Tehran withdrew forces from Syria, ended its support to Hamas and Hezbollah, and put an end to nuclear enrichment and development of nuclear-capable missiles.[14] At the same time, the U.S. administration has not clearly stated the necessary conditions for the removal of sanctions, which fact has created many misunderstandings. It suggests two possible scenarios: a regime change in Iran or the "capitulation" of the current Iranian government, both of which are more wishful thinking than effective foreign policy doctrine.

14. US Department of State, "After the Deal: A New Iran Strategy", May 21, 2018, available at: www.state.gov/secretary.

Multiple recent U.S. attempts to bring Iran's hydrocarbon production to zero and totally disconnect the country from world energy[15] and financial markets will not necessarily lead to the signature of a more comprehensive agreement that the JCPOA.[16] So far, Teheran remains away from the negotiation table. Furthermore, U.S. policy is certainly not about to result in regime collapse. Rather, such a situation fuels tensions between conservatives and moderates inside Iran. So far, the U.S. decision has contributed to the consolidation of the IRGC's hold on the Iranian energy sector (initially, U.S. and EU sanctions were introduced to have the opposite effect). Furthermore, Iran is reducing its commitment to the nuclear deal for several months.[17] Furthermore, the cultivation of the resistance economy has been renewed. This situation is throwing a whole bunch of uncertainties in the 2021 Iranian presidential election. Moreover, it is quite clear that the country might not be able to face the U.S. army in times of armed conflict (if that were to happen). But despite a disastrous economic situation[18] and a broken financial sector, the Islamic Republic is still capable of imposing significant harm to the world economy by generating enough insecurity in the Middle East to make navigating the Strait of Hormuz unattractive[19] at a time when President Trump has promised to end "America's endless wars" overseas.[20]

The case of Russia

Contextualization

U.S. and EU sanctions are structured around:

- capital market restrictions;
- prohibition of transactions dealing with new long-term debts (indirectly it deprives Russian companies of cheap Western loans);
- limitations on technical assistance and access to specific technologies, which undermine the development of oil greenfields (especially shale

15. At the same time, Washington unilaterally decided to issue waivers to some countries such as China authorizing them to trade oil with Iran during a short time period (until May 2, 2019 for China).
16. On November 1, 2019, Brian Hook, US Special Representative for Iran said in an interview with Al Arabiya: "We're going to keep imposing sanctions on Iran until we are able to get a new and better deal to replace the Iran nuclear deal that we left". Available at: https://english.alarabiya.net.
17. "The Iranian Leader Meets the IRGC Commanders: We Continue Reducing the Commitments", BBC, October 2, 2019, available at : www.bbc.com.
18. According to International Monetary Fund, Iran's economy is expected to contract by 9.5% in 2019. See *Reuters*, October 15, 2019, available at: www.reuters.com.
19. Approximately 20 percent of the world's oil supply traverses the Strait daily.
20. Donald Trump, Annual State of the Union, February 2019.

plays), Arctic shelf, the Caspian Sea aquatorium, and deep offshore exploration (more than 152 meters). Exploration and production of greenfields that will replace cheap-to-produce brownfields might be troublesome.[21]

From March 2014 until January 2017, the EU and the United States worked together to prevent inconsistencies, mainly trying to avoid putting the America's European allies in an awkward position by sanctioning the gas sector and gas transport infrastructure. This would have jeopardized the European security of supply. It is of note that in 2014, Russian natural gas represented approximately 40 percent of total European gas imports. This is mainly the result of the growing relationship between the EU and Russia over the course of the 2000s and early 2010s, as well as the low Russian gas price. However, the production of natural gas falls within the sanctions regime if the explored field, located on the Russian territory, is an associated gas field which will lead to the production of oil.

Since the middle of 2014, the Russian state and energy companies have above all suffered more from low oil prices than from U.S. sanctions. The Russian state has found itself in a precarious position. Due to falling oil prices, its hydrocarbon rents started significantly to decline and led, in part, to a two-year recession. During this period, the share of oil and gas within the state budget slightly decreased to approximately 43 percent in 2015 and 37.4 percent in the first quarter of 2016[22] – a direct consequence of the deterioration of the oil market. As a result, Russia's federal budget progressively shifted from a surplus to a budget deficit, that is to say from +0.7 percent of GDP in 2011 to -0.4 percent, -2.4 percent and -3.5 percent of GDP respectively in 2014, 2015, and 2016.

Oil production has not been adversely affected by sanctions, but sanctions have (i) impeded the development of the oil greenfields which are intended to replace brownfields; and (ii) significantly undermined the development of the Arctic shelf, the Caspian Sea aquatorium, and shale plays. This next generation of oil sources will require technologies and equipment currently not available in Russia. The situation is even more critical given that Russian oil companies need foreign investors to support the costly development of the new projects. Western sanctions have had no direct effect in the short run as those projects were intended to come on line later (in about 5 or 10 years), but they have dissuaded foreign firms from investing significantly in the development of these oil resources.

21. In 2014, cheap-to-produce brownfields are no longer as cheap as depleted but are still relatively cheaper that the Norway-North Sea productions.

22. "Россия не слезла с нефтяной иглы" ["Russia Cannot Get Off its Oil Addiction"], gazeta.ru, October 8, 2015, available at: www.gazeta.ru.

Overall, European sanctions against Russia have not, unlike U.S. sanctions, significantly increased since 2017. Under the CAATSA, both SSI and SDN lists have increased in order to increase as much as possible Russia's room for maneuver and capability to adapt. For example, new sanctions make the development of shale oil difficult for Russian companies like Rosneft, not only in Russia but also outside of Russia if one were to interpret U.S. sanctions very strictly.

Recently, in December 2019, President Donald Trump signed the National Defense Authorization Act for Fiscal Year 2020[23], which includes sanctions on companies involved in the construction of Nord Stream 2 gas pipeline. Unsurprisingly, the U.S. law has generated frustration and outrage throughout European business communities. German is now calling for a European cooperation in order to put EU companies out of reach of U.S. sanctions, since the U.S. law has been interpreted as a way to for the USA to export more LNG to Europe. So far, U.S. sanctions will certainly delay the construction rather than prevent it. Even if the Swiss-Dutch company Allseas has suspended work to avoid sanctions, Gazprom has a pie-laying vessel in the Far East that can be used for these purposes. It is just a question of additional months to bring it to the Baltic Sea.

From confusion to "de-Americanization"

No one could have realistically imagined that the regime of President Putin would return the Crimean peninsula to Ukraine because of sanctions, no matter how thorough or painful. Even a moment's thought suggests that the opposite would had to have been more likely—since the regime in Moscow could not be seen to have bowed to foreign pressure. Even if Moscow wanted desperately to relinquish its claims to the peninsula, the sanctions regime has made the choice nearly impossible. At the time neither the United States alone, nor any major European power, nor the North Atlantic Treaty Organization (NATO) was prepared to countenance armed conflict with Russia to preserve the territorial integrity of Ukraine. Force was, in other words too much. Yet all the Western support for regime change in Ukraine meant that after the unfolding of the Euromaidan, the annexation, and the conflict in Eastern Ukraine, diplomacy by itself would have been insufficient. Rather, sanctions were chosen to signal displeasure, to punish, to create inconvenient internal divisions inside Russia and among supporters of the Putin regime, and weaken Russia's hydrocarbons-exporting economy.

23. National Defense Authorization Act for Fiscal Year 2020, 116th Congress (2019-2020), available at: www.congress.gov.

In this context, Russia has started to adapt. Like Iran, Russia has structural problems that made the situation worse, but in order to decrease the influence of Washington's decisions, Moscow has found a way to mitigate some negative consequences of U.S. sanctions and protect key sectors or projects likely to be under primary and secondary sanctions if the list of sanctions increase.

This started with the Yamal LNG project on the Yamal peninsula, a French-Russian project (before mid-2014, Total and Novatek were the majority shareholders). Although U.S. sanctions do not affect the gas sector, the development of Yamal LNG was seriously jeopardized because Gennady N. Timchenko, a businessperson allegedly close to Vladimir V. Putin, was subject to U.S. sanctions, and, as a consequence, had difficulties functioning under U.S. capital market restrictions.[24] Furthermore, it was not clear if condensates were under sanctions or not. In 2015, sources of funding quickly decreased, making the financing of a multi-billion dollar investment chain difficult. At the same time—in early 2016—the risk of external financing became the primary problem. After an initial period of confusion, during which the shareholders' aim was to avoid the worst, Novatek implemented corrective measures related to trying circumstances, with the support of the Russian state and Russian banks. These actions turned the ailing financing strategy around. The company raised capital through equity financing and did not incur debt in USD, but in RUB, EUR, and Renminbi (RMB; Chinese currency). New institutions like the Export Bank of China and the China Development Bank provided some of these credit lines. China also provided technology, which has led to a progressive "Sinicization" of the project. Russian efforts bore fruit. The project was finished one year ahead of schedule, and a vessel carrying gas from Yamal reached the United States in January 2018.[25] Russia, in a way, has been able to look to previous mistakes made by Iran's partners in order to avoid making the same ones and increase the chilling effect.

By saving a project deemed strategic by both the Russian government and Novatek, Russia has found a way to partially decrease U.S. monetary power, reduce the influence of coercive diplomacy on the Russian state, and protect its LNG sector from hypothetical additional sanctions. The process of delinking Russian projects from the U.S.-centric financial system has continued. Rosneft announced that its export contracts would be henceforth

24. A. Bros and T. Mitrova, "Yamal LNG: an Economic Project under Political Pressure", Fondation pour la Recherche Stratégique, August 2016, available at: www.frstrategie.org.

25. "Первая партия газа с 'ЯмалСПГ' прдет в США" ["The First Delivery of Gas From Yamal LNG Will Be Delivered in the USA"], *Interfax*, January 9, 2018.

denominated in euro.[26] Novatek also confirmed that most of its contracts are denominated in euro.[27] Russia's adaptation has led the euro to become an increasingly important currency for energy commerce.

Such a situation has also laid the foundations of a Russian commercial strategy that accords with the country's foreign policy: reducing U.S. influence worldwide, while maintaining connections with Asia and Europe (like Rouhani's supporters), and strengthening state control over Russian energy sector.

Russia's adaptation hinges primarily on four main axes, as shown below:

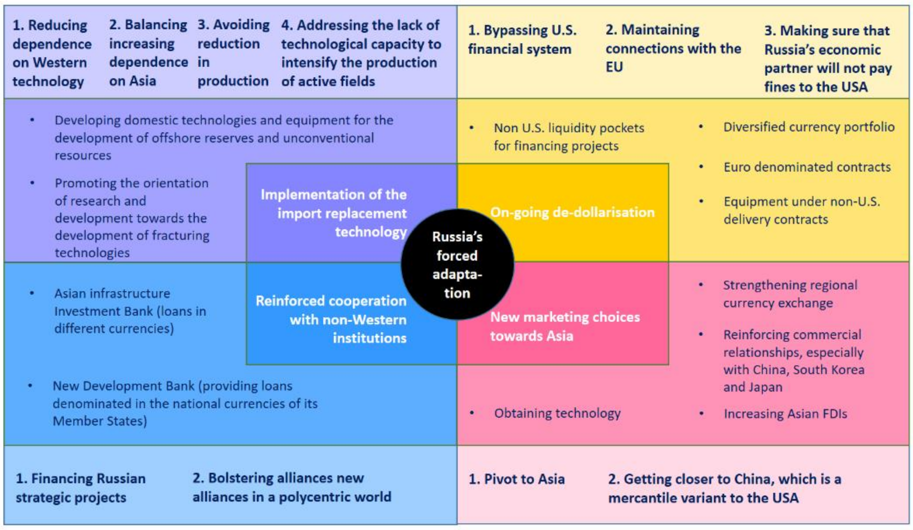
- Launching new marketing choices towards Asia, specifically China, Japan and South Korea;
- Increasing cooperation with non-Western institutions;
- Implementing import replacement measures aimed at tackling the limited access to foreign technologies that are necessary for the development of unconventional and offshore oil reserves, deep water exploration, etc.;
- Organizing the 'de-dollarization' of strategic projects in order to circumvent secondary sanctions while increasing the role of the European currency in the energy sector by (i) pushing companies to sell goods under non-USD contracts or equipment under non-US delivery contracts, and (ii) by raising debt in non-USD currency.

Put another way, this process is neither more nor less than a forced diversification of Russia's financial and energy portfolios in the context of rising tensions with the Washington. In a way, the United States has forced Russia to reconsider its comfortable, but quite archaic *modus operandi*.

26. "Роснефть перевела экспортные контракты в евро" ["Rosneft Converted Export Contracts to Euros"], *Neftegaz.ru*, October 25, 2019, available at: neftegaz.ru.

27. "'Новатэк' перевел почти все расчеты экспортных контрактов в евро" ["Novatek Has Converted Almost All Its Export Contracts in Euros"], *Vedomosti.ru*, October 24, 2019, available at: www.vedomosti.ru.

A schematic of Russia's emerging model



Source: Aurélie Bros, 2019

This on-going process has to be fine-tuned if Russia wants to maintain its leading position in the oil and gas sector.

The trickling down of Iranian and Russian decisions on business and politics

Russia's adaptation offers new perspective to European and Asian businesses

In 2018, Novatek mainly invested in the development of (i) Salmanovskoye field – a resource base for Arctic LNG 2, (ii) front-end engineering design for Arctic LNG 2 project, and (iii) gravity based platforms. This led to a significant increase in its CAPEX, but the company is now about to launch the new multi-billion dollar project Arctic LNG 2 on the Gydan peninsula (expected to become operational by 2022-2023). The final investment decision was announced in September 5, 2019. This is in line with the tendency observed in the Yamal LNG project, Novatek's success story (which also came true due to tax holidays). Along with Yamal LNG, the two plants will produce around 36 million tons of LNG annually. This production confirms (i) Russia's long-term goal of becoming a major LNG producer and of catching up with other LNG producers, (ii) the necessity to internationalize gas exports, and (iii) French involvement, because Total has acquired a direct working interest of 10 percent in the project.

Novatek has benefited from what might be called the "Total effect," defined as the sanctioned country's ability to attract international partners despite those sanctions and the inability to access U.S. debt and equity markets for long-term financing. This effect is demonstrated when an IOC from a country imposing sanctions is still able to successfully invest in a sanctioned country. Henceforth, this will be a major psychological factor that should not be underestimated.

So far, Total has a direct 10% interest in Arctic LNG 2 alongside Novatek (60%), the Chinese CNOOC (10%), the Chinese CNPC (10%) and the Japanse Mitsui-Jogmec consortium, Japan Arctic LNG (10%). Officially, Russian law do not allow a foreign company to acquire more than 25 percent ownership of a project. Since Total also owns an 11.6% indirect participation in the project through its 19.4% stake in Novatek, thus an aggregated economic interest of

21.6% in the project if Novatek retains 60 percent of Arctic LNG 2.[28] The Arctic LNG 2 demonstrates that, from an economic perspective, the most important preoccupation of a sanctioned country is a diversification of the portfolio of economic partners. Some European companies are now ready to operate within these new rules—at least in the gas sector, as the oil is too risky relative to U.S. policy and law.

It is much easier to de-dollarize gas projects than oil projects. Even if LNG trade has rapidly expanded and connected hitherto disparate and isolated markets (resulting in more flexibility and liquidity), gas is not a global commodity, unlike oil. Natural gas is still dominated by regional and local forces (e.g. TTF in EUR, NBP British pounds (GBP), Henry Hub in USD, Japan Korea Marker in USD for LNG in Asia, etc.). Consequently, gas prices still vary between and within regions, whereas oil prices tend to change globally. Furthermore, in the gas area it is possible to issue invoices denominated in USD, but also in EUR, RMB and GBP.

In this emerging environment, U.S. companies' adaptability is decreasing. ExxonMobil is a prime example. In 2012, ExxonMobil and OAO Rosneft entered into a 3.2 billion USD join-venture agreement. Both agreed on developing the Black Sea (deep-water drilling) and the Arctic's Kara Sea, and onshore assets in Siberia. This was part of the Russian strategy having to develop greenfields, especially shale oil. Seen from the U.S. perspective, this deal was part of potential future growth, even if the Russian market was not the largest part of Exxon's oil and gas production, and the exploration and production in the Arctic was challenging. Like many Western energy companies investing in Russia (e.g., French Total), ExxonMobil criticized sanctions. Some projects were frozen after the introduction of sanctions. In July 2015, the company asked the U.S. Office of Foreign Assets Control (OFAC) to make a few exceptions. It was denied. In 2017, Exxon applied for a waiver from U.S. sanctions on Russia, which was also refused. In 2018, Exxon left Russia.

Exxon had limited room for maneuver. It is a U.S. company. Its main market is the U.S. market. The company benefits from the U.S. financial system. If the company had stayed in Russia, it would have had to have done what European companies are doing: changing the currency, working with Chinese companies, signing credit lines with Russian and Chinese financial institutions, and getting a political support from the Russian government. There is also a significant risk of a fine for violating sanctions. (This happened in 2017, although the fine was very small). Against this background, the company could not continue its activities in Russia.

28. "Russia: Launch of the Giant Arctic LNG 2 Development", Total, September 05, 2019, available at: www.total.com.

European intervention after U.S. withdrawal from the JCPOA

Brussels made it immediately clear after U.S. withdrawal from the JCPOA that Europe will seek to protect its companies investing in Iran, while salvaging the nuclear deal, at a time when the United States and Europe are drifting apart. On August 7, 2018, the EU updated the so-called "blocking statute" (Council Regulation No. 2271/96, OJ. L 309/1, voted in 1996) in support of the Iran nuclear deal.[29] As long as Tehran complies with the JCPOA, Brussels wanted to encourage European companies to keep trading with Iran, by banning EU businesses from "*complying with US sanctions*". In other words, the EU gave its companies a mandate not to change their behaviour. To do so, it amended some laws listed in the Annex of the aforementioned Regulation. The main objectives were to: (i) remove obstacles for the European Investment Bank to finance activities in Iran, (ii) strengthen sectoral cooperation (including financial assistance), and (iii) develop relations with the Iranian Central Bank in order to make one-off bank transfers possible (the only way to ensure payments to Iran). The list goes on. However, the blocking statute is no silver bullet. One of the weaknesses was that the enforcement of the regulation is left to member states.

In addition to the blocking statute, the EU, led by Berlin, London, and Paris, tried to work on the implementation of the 'Special Purpose Vehicle' (SPV), which came into effect on November 4, 2018. From a European perspective, it was the last chance to keep Iran inside the JCPOA agreement. Theoretically, the SPV should facilitate payments related to Iran's exports, including oil, and imports. It would work as a barter system in order to avoid U.S. financial system. At that time, Brussels was trying to embrace a kind of de-dollarization process.

U.S. maximal pressure on Iran forced Asian and European companies to withdraw from both gas projects in the country – a sign that the USA still is a hegemon in the energy sector. For example, both Total and Siemens scaled back their business operations before leaving. European firms are now suffering from what had once been the immense usefulness of the dollar-based system. The disappointments of the SPV as a means to maintain the agreement with Iran reveal a gap between Europe's capabilities and its geopolitical ambitions.

29. "Updated Blocking Statute in support of Iran nuclear deal enters into force", Press Release, European Commission, August 6, 2018.

Does the undermining of trans-Atlanticism relaunch the European project?

The unilateralist, isolationist trends in American foreign policy that had been building for more than a decade have been made manifest in the Trump presidency. President Trump did not create these trends, and in that sense his approach represents not an aberration but a culmination. The appetite for withdrawal from the complexities of world politics has, moreover, a long tradition in the United States, including the years before First World War when the country sought to insulate itself from instability in Europe. In this sense, the years after the Second World War are far more unusual than the current trajectory.[30]

U.S. trade conflicts around the world, including with Europe, have undermined the global trading system. The over-use of U.S. financial sanctions has not only alarmed companies, but also many governments and European institutions into actions to limit their economies exposure to the U.S.-based clearing system that creates such tremendous vulnerability for literally every country in the world that is not the United States.

Increasingly EU leaders recognize that European security depends on political stability in the Middle East and believe that American policies directly undermine that agenda by destabilizing tactics in the region, especially maximum pressure strategy towards Iran. The refugee crisis has created deep divisions within the EU. An unstable Iran, made more likely by American belligerence, is contrary to European interests.

Seen from Europe, U.S. internal divisions have also become difficult to understand. The U.S. president may, for example, impose sanctions by signing an executive order. The latter is at the initiative of the executive power, contrary to a law passed by both houses of the U.S. Congress and then signed by the President. In August 2, 2017, President Trump signed a law that includes Russian-related sanctions, CAATSA. It includes as Title II the *Countering Russian Influence in Europe and Eurasia Act* (CRIEEA)[31] – an

30. R. Abdelal and U. Krotz, "Disjoining Partners: Europe and the American Imperium", *in* L. W. Pauly, B. W. Jentleson (ed.), *Power in a Complex Global System*, London, Routledge, 2014.
31. U.S. Department of Treasury, available at: www.treasury.gov.

act voted by the U.S. Congress on 15 June 2017. By turning an act into a law, the legislative power wants among other things to make the removal of sanctions more complicated and reduce Donald Trump's capacity to revoke, modify, and/or make exceptions from Russia-related executive orders. Such a situation reflects the current tug of war that is taking place inside the United States between opposing camps, such as Republicans and Democrats, but also pro-Trump and anti-Trump. To sum up, the more U.S. politicians feel that U.S. executive power is ready to take decisions on a whim, the more sanctions against Russia tend to become difficult to abolish and/or modify, while fostering the introduction of sanctions on is initiative. The Trump administration easily reintroduced sanctions against Iran with an executive order against the will of numerous politicians. Europe is not ready to bear the consequences of internal U.S. divisions, which consequences might threaten both European business and security over the longer run.

Once upon a time, European policy-makers and executives worried that Russia was a necessary, but often unreliable and unpredictable partner. Today, however, it is the United States that seems to be the more unreliable. Even European banks, firms, and governments that seek to comply with the U.S. sanctions regime find that OFAC responds to requests for clarification too slowly and sometimes not at all. The answers are vaguely worded and thereby create the possibility for uncertain post-hoc interpretation.[32]

As the trans-Atlantic alliance has frayed, European citizens have increasingly demanded a more coherent and effective EU foreign policy. According to a study published in September 2019, European voters believe "that there is a growing case for a more coherent and effective EU foreign policy in a dangerous, competitive world", while "they want to see the European Union come of age as a geopolitical actor and chart its own course".[33] Trust in the United States has been broken. EU citizens expect one specific thing from Brussels: the EU must demonstrate that it controls it foreign policy despite economic interdependence with the United States. This does not mean that the European population supports the easing of EU sanctions on Russia. According to the same study, the majority of European voters (more than 50 percent) view "the EU's policy on Russia as either balanced or not tough enough". Furthermore, the Nord Stream 2 project remains a cause of disagreement inside Europe. There is little chance of seeing EU Member States unite with Germany to defend the pipeline under U.S. sanctions. But the majority perceives the United States as a country

32. Interviews conducted in the EU and in Russia in 2018 and 2019 by the authors of the study.

33. European Council on Foreign Affairs, "Give the People What They Want: Popular Demand for a Strong European Foreign Policy", September 2019, available at: www.ecfr.eu.

controlling EU foreign policy through the EU-U.S. economic interdependence. Europe is in an embarrassing position due to the asymmetric interdependence with the U.S. economy, the size of U.S. markets, and the global role of the U.S. dollar.

All of this might even have reinvigorated the European project around the energy sector. History has shown that European states can more easily work together on energy issues, despite challenges. The European Green Deal might become the emerging unifying theme that might relaunch the European project and make Europe a fully-fledged geopolitical actor. It certainly is a unique opportunity since the Green Deal might:

- Increase European soft power worldwide, and eventually bring the energy transition around the world,[34]
- Let a legal framework emerge that protects European companies outside of European borders,
- Let emerge a commodities trading platform in the Eurozone territory (especially in the electricity sector)
- Encourage the euro-isation of energy contracts, promote financial energy storage contracts in euros,[35]
- Massively invest in research and development (making Europe competitive, innovative, and less dependent on foreign technology),
- Create a new system able to decrease inequalities among EU member states and within each EU member state.

There is a huge potential, but challenges are numerous. EU institutions have understood that a solid currency needs a solid banking system (which the Eurozone does not yet have). Currently, the Eurozone must face one of the greatest challenges, that is to say the poor state of the banking systems in a number of European markets (e.g., Italy). Such a situation could leave the Euro exposed to an eventual downturn, which could lead to even more negative interest rates and a sharp fall in the Euro. Therefore, this could lead to a rise on the nominal price of the Euro-priced commodities or a hit to commodity sellers.

34. A. Bros and T. Bros, "Energy: Europe's Energy Needs Pragmatism not Dogmatism", *Natural Gas World*, October 23, 2019, available at: www.naturalgasworld.com.
35. A. Bros and T. Bros, "'Make Euro the Green Currency of the 21st Century!', Open Letter to Mrs Christine Lagarde, President of the European Central Bank", *World Natural Gas*, November 25, 2019, available at: www.naturalgasworld.com.

Conclusion

The United States and Europe are divorcing because of their own internal contradictions, and Tehran and Moscow have become metaphors for this acrimony. Iran and Russia are the text rather than the sub-text of this rupture.

Since the election of Donald Trump as president of the United States, sanctions are not only seen as the expression of Washington's preferences and whims, but as an instrument of the U.S. economic war, which attract the ire of historic allies of the USA, like the EU. One of the main challenges revolved around the question of economic interdependence and energy security in particular. U.S.-Russia and U.S.-Iran trades were and remain relatively unimportant, and certainly the United States relies little on its economic relationship with Russia and Iran. Furthermore, this is happening at a time when the EU is "pressurized" by multiplying problems. The economic situation is fragile and the future of the EU currency is still unsettled. Further economic degradation would work in favor of extremist and Eurosceptic parties. And the list goes on. Consequently, interferences in European economic activities and European energy security are not always well perceived, and tend to increase tensions inside the Union.

So aggressive, thorough U.S. sanctions cost the American economy almost nothing. But an over use of them might have a significant cost over the long run. The greatest threat is the progressive isolation of the USA and a decreased influence in a multipolar world with different financials and economic powers. In other words, will secondary sanctions continue to work in the future? Both Teheran and Moscow adaptation are game changer. This will certainly help numerous countries to use sanctions as a geopolitical tool.[36]

If the EU wants to build up its "resilience" against secondary sanctions, it requires a coordination between different sectors, i.e., energy, business, finance, diplomacy and defense. This is a significant challenge for the EU, which has not yet worked on this scale. The autonomization of Europe could increase its room for maneuver, but as long as member states do not act in unison, this resilience will never materialize.

36. E.-A. Martin, "The Sanctions Policy of the European Union. Multilateral Ambitions Versus Power Politics", *Études de l'Ifri*, Ifri, October 2016, available at: www.ifri.org.

Europe is on the verge of redefining its energy policy around one common goal: climate protection—with no realistic expectation of cooperation with the United States. The success of the European Green Deal depends on the decisions that will be taken in the coming months/years by the European Commission, the European Central Bank and European head of Sates and Governments. So far, the EU has overpromised and under-delivered. This is a make or break moment if it wants to show the opposite.

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