McLARTY INDIA UPDATE: Speedbumps Ahead: US Sanctions and India

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KEY POINTS:

1. Both the US' CAATSA sanctions and withdrawal from the JCPOA have resulted in India potentially getting caught in the crosshairs.
2. India will need a waiver from President Trump to avoid sanctions on its recent purchase of the S-400 missile defense system from Russia.
3. While India has reduced its purchases of Iranian oil, it will be hard-pressed to reach the Trump administration's demand of zero oil imports from Iran.
4. If the Trump administration decides to sanction India for one or both of these measures, it will represent a significant setback in the growing US-India partnership.
5. The recent collapse of discussions on a trade package between the US and India raises the possibility that the Trump administration may be less sympathetic to India's concerns.

Two separate US sanctions regimes, neither directed at India, nonetheless have the potential to fix India in the crosshairs. While the Government of India does not recognize sanctions outside the UN umbrella—they view the US use of this tool as a unilateral measure—the prospect of potential application to India has focused attention in New Delhi.

Should the US decide to impose sanctions on India under either of these programs, it will mark a significant setback to the strengthening US-India partnership. **We do not believe the Trump administration seeks to sanction India, but do believe that it sees compliance with these programs as necessary, and will focus its diplomacy with India accordingly. However, the collapse of the USTR-led trade talks raises the possibility that the White House could choose a more punitive approach, possibly on the Iran sanctions.**

Countering America's Adversaries Through Sanctions Act (CAATSA)

The US Congress passed CAATSA in 2017 to expand the sanctions tools available to respond to Iran, Russia, and North Korea. Section 231 of this law requires imposition of sanctions on a person who:

> "engages in a significant transaction with a person that is part of, or operates for or on behalf of, the defense or intelligence sectors of the Government of the Russian Federation, including the Main Intelligence Agency of the General Staff of the Armed Forces of the Russian Federation or the Federal Security Service of the Russian Federation."

The US president has the authority to waive imposition of these sanctions should he find that the waiver would be in US national security interests, that the country waived is reducing its reliance on Russia, and that it is cooperating with the US

Defense procurement is the arena in which India finds itself potentially caught in this sanctions regime. Since 2016, India has been negotiating with the Russian Federation to procure the S-400 surface to air missile defense system. **During Russian President Vladimir Putin's visit to India October 4-5, the two finally concluded a purchase agreement. The dollar value of the deal is generally assessed at $5 billion, making it a "significant transaction" by any metric.**

It is not clear whether the agreement, or a financial transfer, or delivery of the system would serve as the trigger for these sanctions. It is also unclear how the sanctions would be applied—to individuals? To components of the Indian military? Given the close and deepening US-India military relationship, this is a complicated consideration.

India has a long tradition of defense procurement from Russia—in fact, Russia was India's major defense provider for decades during the Cold War. While Indian procurement from US companies has flourished over the past decade, **Russia remains one of several key providers in India's diversified defense trade basket. US government officials are aware of this, and have taken care to note that the CAATSA legislation is designed to target Russia, not India.**

But the question of whether the president himself will decide to use his waiver authority for India remains one that only the president can answer. President Trump, in response to a recent question on this matter from the press, replied, "India will soon find out."

Iran Sanctions

The Trump administration's withdrawal from the Joint Comprehensive Plan of Action (JCPOA)—the agreement crafted between the United States, China, France, Germany, Russia, the United Kingdom, the EU, and Iran to halt Iran's nuclear weapons development—meant that the United States would revert to the Iran sanctions regime that had been in place with the 2012 Iran sanctions legislation. In addition to reimposing sanctions on Iranian entities, this legislation reaches broadly to sanction third-country companies doing business with Iran, including in the petroleum sector. The United States has mounted a global pressure campaign to convince companies and countries around the world to reduce their oil procurement from Iran to zero by November 4, the date at which sanctions for this sector will be reimposed.

India is the second largest market for Iranian oil, after China, and the Indian petroleum sector includes both state-owned entities as well as large private companies. Reliance Industries, which operates the world's largest refinery, has already announced that it has ended imports from Iran as it does not want to risk sanctions given its large exposure to US financial markets. **According to press reports, Indian procurements overall are down by nearly half what they were earlier this year—but they are not at zero.**

The Iran sanctions **allow for a waiver if a country has made "significant reductions."** During the earlier phase of these sanctions from 2012 to 2015, India received an exemption under this guidance for each of the six-month periods of review. The Trump administration is not the Obama administration, however, and **it is not clear how they will evaluate countries' efforts to reduce in the months ahead or how generously they will measure what a "significant reduction" entails.**

It **will be hard for India to get to zero imports from Iran.** This is because some Indian refineries are set up to process Iranian crude, and will require technical adjustments to change; and to complicate matters, alternative sources of crude such as Saudi Arabia, Iraq, the United States, or Venezuela, are more expensive. It is also the case that as the volume of imports shrinks due to reductions, it gets harder and harder to keep making significant cuts. Press reports from India indicate that India and Iran have been in discussion over a rupee payment mechanism to transact business outside the US-dollar financial system entirely.

In addition to the high-level visit of Secretary Pompeo and Secretary Mattis to India in early September, Special Representative for Iran Brian Hook and Assistant Secretary for Energy Resources Fannon visited recently to discuss this specifically with the External Affairs and Petroleum Ministries. **We assess that India is likely to receive a waiver during the November round, but see future waivers as likely more difficult to receive given the Trump administration's strong line on Iran.**

India has one more issue at stake with the Iran sanctions: its port development in **Chabahar**. India has worked closely with the Iranians to build a deep water port that links to a road leading up into Afghanistan, since Pakistan does not allow India overland access through its territory. India is the fifth-largest bilateral assistance provider to Afghanistan, so overland access is important.

The Iran sanctions legislation provides an "exception for Afghan reconstruction" that was included due to the Indian government's lobbying, given their economic assistance to Afghanistan. This exception still requires a presidential determination that the exception would be in US national interests. The Trump administration has placed great importance on India's role as an economic assistance and development partner to Afghanistan in its overall South Asia Strategy. **We assess that India is likely to be exempted from sanctions on Chabahar, but then the larger question will be to what extent other countries are willing to use this port as overland access to Afghanistan to make it financially viable.**