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By Hayder al Khafaji



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By Hayder al Khafaji *

The embargo to be placed on the export of Iranian oil has elicited different reactions from countries that are hostile to Tehran and those which maintain relations with it; a matter that carries with it serious implications for trade in the Middle East and further afield, in Europe and America.

In response to these events, Hassan Rouhani, President of the Islamic Republic, told a news conference in Geneva that, “there is no justification for not exporting Iranian oil while oil from the region is still being exported.”¹

Heshmatollah Falahatpisheh, head of the National Security Committee of the National Security Council, announced that the United States is applying an incoherent or contradictory policy and its actions are a flagrant violation of international laws and norms.

Although Rouhani refrained from elucidating any further as to whether his statements imported threats or not, a day after his remarks were made, US crude rose by \$1.17 to reach \$75.11 per barrel, the highest since November 2014; whilst Brent crude added \$1.03 to reach \$78.33 per barrel.

In spite of the US Central Administration's statement that the US Navy and its regional allies are ready to guarantee freedom of navigation and uninterrupted

1. Mehr News Agency: Iran's president can close the Strait of Hormuz and Bab al Mandeb to oil tankers.

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passage through the Strait of Hormuz, creating a new crisis in the region will not benefit the world's consumers, especially given that 46 percent of world's oil exports pass through the strait, which is under Iranian control.

Estimates by the International Energy Agency

The International Energy Agency (IEA) reports that Asia is one of the largest destinations for crude shipments in the world, which after passing through the Strait of Hormuz, head for China, Japan, India, South Korea and Singapore. Other shipments go to Europe and America. Global energy demand rose by 2.1 percent in 2017, more than double the rate of the previous year, boosted by global economic growth.²

The International Energy Agency (IEA) estimated in 2013 that primary energy demands in South-East Asia will be more than double the global forecast rate until 2035, boosting strong and rapid economic growth. Overall energy demand in the region is forecast to increase by 83% between 2011 and 2035, accounting for more than 10% of projected energy consumptions worldwide.³

The US Energy Information Administration (EIA) estimates that a record high of 18.5 million barrels per day of oil was transported by sea in 2016, an increase of 9% on 2015, and which accounted for 30% of all seaborne crude oil passing through the Strait of Hormuz during the year (Figure 1.)

2. Global energy demand grew by 2.1% in 2017.

3. IEA: Southeast Asia Energy Outlook - WEO Special Report.

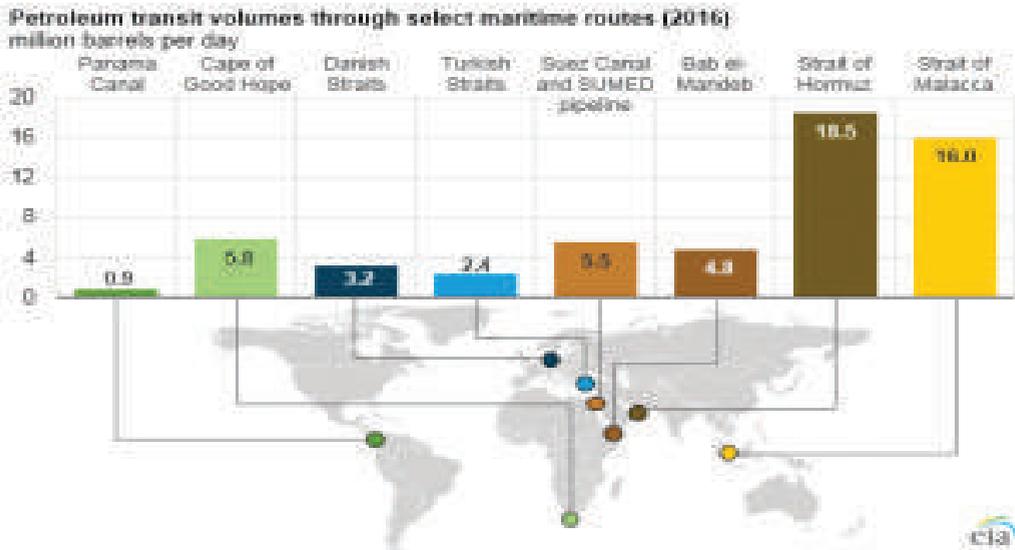


Figure 1. Volume of oil shipments through major maritime routes in 2016

Vortexa – a company specialized in oil market analysis – has estimated that raw and condensate oil shipments through the Strait of Hormuz amounted to 17.2 million bpd for 2017 and about 17.4 million bpd in the first half of 2018.⁴ Shipping through the Strait of Hormuz takes two directions, the first path lead to East Asia through the Indian Ocean and the Strait of Malacca, near Singapore, which accounts for shipping 15.2 million bpd, while the second path lead to Europe and the United States through the Strait of Bab al Mandab, south of the Red Sea.⁵

The Gulf States export their oil in oil tankers that pass through the Strait of Hormuz; while their imports are carried by shipping vessels that also pass through the same strait, especially those coming from China, Japan, South Korea, Singapore and Taiwan.

4. FACTBOX–Strait of Hormuz: the worlds most important oil artery.

5. Strait Talk – The Strait of Malacca.

The economic importance of the Strait of Hormuz

The Strait of Hormuz is located at the entrance of the Arabian Gulf between Oman and Iran, linking the Arabian Gulf with the Gulf of Oman and the Arabian Sea. In the eyes of international law, it is part of the high seas. All ships have the right and freedom to pass through it as long as their passage does not harm the safety of the coastal countries or their security. Thus, all shipping through the Strait are subject to international transit passage laws.

The Strait of Hormuz is considered as the world's most important oil corridor. About 30 oil tankers pass through the strait daily, accounting for 46 percent of the world's oil trade. Most of the crude oil exported from Iran, Saudi Arabia, the United Arab Emirates, Kuwait and Iraq passes through it. The UAE and Saudi Arabia have tried to find alternative routes to the Strait, but statistics indicate that the Gulf states export about 90% of their oil through the Strait of Hormuz.

The Strait is also an important route for the export of liquefied natural gas (LNG). In this regard, the British Petroleum Company (BP) says that the largest exporter of LNG is Qatar, which shipped 30% of the world's gas supplies in 2016 through the Straits of Hormuz; thus, one third of the world's oil and liquefied gas supplies pass through here.

Oil market got the jitters following threats of closure

The war of words between Iran and the United States over the past days, especially after Trump withdrawal from the nuclear deal with Iran, which Trump considers to be deeply flawed.⁶

There is little doubt that the United States attempts to target Iran's economy, and more precisely its oil revenues. Although oil sales will decline significantly,

6. The Economist: Out of the deal.

Iran will still be able to take a share of the global oil market under the numerous bilateral and multilateral treaties. The question here is what will this share amount to, and to what extent can the US sanctions hurt global markets and what damage can they inflict on the interactions between international companies and banks on one hand and Iran on the other hand?

What are the implications of closing the strait?

The mere threat of closing the strait led – as usual – to a rise in oil prices. Should the threat ever materialise, it will undoubtedly lead to a huge rise in oil prices. When the global oil markets detected that Iran's threat to close the Strait of Hormuz may in fact become a reality, prices shot up to \$70 per barrel.⁷

The UAE's 240-mile (400 km) pipeline, operational for the past three years, which connects the UAE's largest oil fields with Oman, has eased concerns about the closure of the strait. Nevertheless, the strait remains a key artery for the worldwide shipment of oil.⁸

Since the Strait of Hormuz is the vital artery that supplies the world with its energy from all the countries bordering it, the consequences of its closure will undoubtedly be catastrophic for all concerned. The countries that will bear the biggest brunt of the closure of the Strait of Hormuz are: China, Japan, South Korea and Singapore. It is noteworthy that these countries are the primary and major global trading partners of the Gulf countries.

There is a sort of unofficial business sharing protocol between the various Southeast Asian countries, where Korean companies are active in infrastructure projects (refining, energy, desalination, highways, airports, bridges and nuclear power plants in the UAE and Saudi Arabia). Data from the International

7. AA Energy: Rouhani slams US calls to halt Iranian oil exports.

8. The Telegraph: In the shadow of Iran – a new UAE oil port is transforming the energy sector.

Contractors Association of Korea (ICAK) shows that the Gulf region – Saudi Arabia in particular– is considered as one of the most important global regions for Korean businesses in this field. The GCC countries have concluded more than a third of all infrastructure contracts with Korean companies, starting from the mid-1960s till now. At the beginning of 2016, the total worth of the contracts for the entire Middle East region was \$725 billion, of which \$140 billion belonged to Saudi Arabia; \$77 billion to the UAE, and \$49 billion to Kuwait.⁹

According to a recent study conducted by the Middle East Research Centre – (MRP) Partners – the total value of projects commissioned by the Gulf countries amounted to about \$2.6 trillion, or more than 160% of the total GDP of the GCC countries combined.¹⁰ Together, the UAE and Saudi Arabia account for about 70% of the value of projects currently under way. The Gulf region, despite the decline in world oil prices and government expenditure, is still full of investment opportunities, especially after the mega projects envisioned by “Saudi Vision 2030” and by the UAE in Expo Dubai 2021.¹¹

Iran’s trade volume with China reached \$80 billion between March 2017 and February 2018.¹² Iran is OPEC’s third-largest oil producer and accounts for 20% of the Gulf region’s oil. Iran’s exports to Asia and Europe in March 2018 averaged 2.45 million barrels per day and gas condensates 300,000 barrels per day.¹³

From amongst the European countries, Spain, Italy and Greece will be the hardest hit by the closure of the Strait of Hormuz because they import Iranian oil on credit. Russia’s suspension of oil exports to Greece followed the freezing of the bilateral military agreement. One third of Iran’s oil exports, or more than 800,000

9. International Contractors Association of Korea.

10. Study: GCC construction market records 30% growth in 2017.

11. Ibid.

12. Iran’s trade volume reached 80 billion dollars in 10 months.

13. Iran: Monthly exports of oil and condensates exceeded 2.75 million barrels per day.

barrels per day, go to European companies.¹⁴

Is there another alternative for shipping oil out of the region?

There are only two countries in the region capable of pumping crude oil and natural gas through pipelines out of the region – namely, Saudi Arabia and the United Arab Emirates – however, their pipeline network can pump only a fraction of the huge quantities currently passing through the Strait of Hormuz.

According to the International Energy Agency (IEA), by the end of 2016, Saudi Arabia had the capacity to pump 6.6 million barrels per day through the King Fahd (Yanbu) terminal on the Red Sea, from which it exports the remaining oil in the network, however, it only pumped 2.8 million barrels of the capacity available at that time.

What is the likelihood that Iran will actually close the strait?

It is difficult to predict, as the Islamic Republic of Iran has never closed the entire strait. Following the end of the Iran–Iraq war, which lasted 8 years, there were some disagreements between the Iranian and American sides in the Strait of Hormuz. Iran's last threats to close the Strait of Hormuz occurred in 2011 and 2012 when US President Barack Obama led a campaign to impose global sanctions on Iran because of its research into the development of nuclear energy, however, the closure of the strait never went ahead because the Obama administration engaged into negotiations which resulted in the 5 + 1 nuclear agreement of 2015.

Iran's oil exports are the linchpin or backbone of the Iranian economy; however, Iran's oil production stands at only one fifth of its real potential. The US government's capacity to put pressure on Iran through sanctions should not be overstated, because in the past it used more than 36 kinds of sanctions against Iran.

14. Iran: Monthly exports of oil and condensates exceeded 2.75 million barrels per day.

Conclusion

The turbulent security situation in the Gulf region does not bode well for the energy-consuming Asian countries and, to some degree, for the Gulf states as well, a situation which could propel the strategy for the diversification of energy sources to the top of the global agenda. In other words, the current Gulf crisis may hasten the signing by Asian companies of new energy deals with US and Russian companies, and even with African countries, in order to side-step a war in the Gulf region.

Iran's foreign policy has been always been characterised by foresight and a clear understanding of regional affairs, as well as a constructive outlook on many of the region's political issues. Iran possesses all the necessary ingredients to play a vital security role in the region, and to become an influential international power in global issues.

As such, Iran's leadership is perfectly aware of the fact that it cannot resort to excessive force in the region, nor resolve the current crisis through war.

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