U.S. Sanctions and the Nuclear Endgame in Iran

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In April 2012, Iran resumed negotiations with six world powers in an attempt to resolve outstanding international concerns over the purposes of Iran's nuclear program, namely that Tehran could use its nuclear facilities to illicitly pursue nuclear weapons. During the 15 months that elapsed between the breakdown of negotiations and their resumption, the United States and many of its allies implemented additional sanctions[1] designed to further isolate the Iranian regime and pressure it to return to the negotiating table. The gradual increase in economic pressure applied by the sanctions regime is one-half of the "dual track" approach that the six powers, China, France, Germany, Russia, the United Kingdom and the United States (also referred to as the P5+1) are using to address Iran's nuclear program. The second track is diplomatic engagement with the regime in comprehensive negotiations[2] to resolve the outstanding international concerns regarding Iran's nuclear program.

Sanctions against Iran, however, are hardly a new element of U.S. policy. Since the 1980's the U.S. has placed a number of restrictive measures on Iran for a variety of reasons, including for sponsoring terrorist groups and violating human rights. Increasingly, however, both U.S. and international sanctions against Iran are designed to prevent Iran from obtaining the necessary materials to develop nuclear weapons, should Tehran decide to do so, and encourage a greater measure of transparency over what Tehran maintains is a peaceful nuclear program allowed under the terms of the Nuclear Nonproliferation Treaty (NPT).

In general, U.S. sanctions against Iran have attempted to target investment in the oil and gas sector, and, increasingly, isolation of the country's economic sector from the global financial system. [3] Unlike other sanctions efforts, however- such as the more comprehensive sanctions imposed against Iraq in the 1990s that caused a great deal of humanitarian suffering-[4] the restrictive measures imposed on Iran are targeted and specific measures designed to pressure the government to alter its nuclear policies and prevent it from obtaining the necessary materials and technology to continue developing its nuclear program. While the regime in Tehran at times employs religiously-inspired rhetoric as a justification for action, it is, at its core, a rational actor that employs a cost-benefit analysis when making decisions on national security issues.

U.S. sanctions seek to raise the cost of Iran's continued defiance of its international obligations in the nuclear realm. Targeted sanctions imposed against Iran have three purposes, or three mechanisms through which the 'cost' of continued action is raised.[5] First, the sanctions aim to disrupt Iran's programs in areas like ballistic missile development and nuclear advances by denying them access to necessary technical materials and expertise.[6] This is done in part by using sanctions and export controls to prevent the regime from obtaining the necessary materials to continue illicit work. Second, sanctions are intended to dissuade other parties from assisting Iran in developing these programs, both by preventing access, and increasing the general costs of continuing to do business with Iranian entities the U.S. designates as supporting these illicit activities. The costs to companies that continue to engage in these transactions include restricted access to accounts in the U.S. and measures such as a prohibition on receiving government contracts. Third, the sanctions are intended to influence Iranian leaders' cost-benefit calculus regarding their nuclear program by increasing the general costs to the regime of moving forward with these programs, such as preventing oil and gas sector development and isolating Tehran's financial sector from the international economy.

Brief History of U.S. Sanctions Against Iran[7]

The most recent sanctions imposed on Iran cannot be viewed in isolation of the larger U.S. history of imposing restrictive measures on Tehran. Current sanctions are built on legislation and executive orders dating back to the 1980s. The United States also complies with the international sanctions imposed by the U.N. Security Council in several resolutions dating back to 2006, which are legally binding on all member states. It was around this time that the use of sanctions as a mechanism to influence the Iranian governments' behavior became more widely accepted in the international community, as opposed to the more unilateral U.S.-led effort that existed prior to the U.N. Security Council's decision to call on Iran to suspend its nuclear program.[8]

U.S. sanctions against Iran were first imposed during the Carter Administration after Iranian revolutionary students stormed the U.S. embassy in 1979, and took its employees hostage for 444 days. These measures, however- which included a ban on Iranian oil imports and freezing Iran's assets – were lifted by the Reagan administration after the hostages were released in 1981.

The Reagan Administration later reinstated the sanctions after it discovered Iran's role in the 1983 bombing of U.S. Marine peacekeepers in Beirut, Lebanon. As the Iran-Iraq war progressed, increasingly restrictive measures on the export of dual-use goods that could be utilized for military purposes were put into effect, and another ban on importing Iranian oil was passed in 1987.[9]

Under President Clinton, U.S. sanctions against Iran were broadened to include prohibitive measures designed to prevent U.S. investment in the development of Iran's oil and gas sector. These sanctions, first put into place in March 1995, were expanded two months later when President Clinton issued Executive Order 12959, which banned U.S. firms from trading with or investing in Iran. There were several exceptions made to the general prohibition on trade, however, which were designed to prevent the kind of widespread humanitarian suffering that was caused by the blanket sanctions imposed on Iraq between 1990 and 2003. These exemptions included such things as food, medical products, and travel. For example, Iran has continued, at times, to import large quantities of U.S. wheat.

The following year, in 1996, Congress passed another bill, the Iran and Libya Sanctions Act, which later became know as the Iran Sanctions Act (ISA). When first passed, this legislation caused significant controversy abroad because it authorized "extra-territorial" sanctions. Under these measures, the United States imposed penalties against foreign firms, many of which were incorporated in allied states, for conducting certain business transactions with Iran, such as such as annual investments worth over $20 million. These penalties ranged from denying the firms U.S. military contracts and bank loans totaling over $10 million annually, to banning financial institutions from dealings in U.S. treasury bonds. Presidential waivers could, however, exempt firms from these punitive actions. Despite the imposition of these sweeping sanctions, their actual impact continued to be minimal due to weak enforcement.

This began to change in 2005 when President George W. Bush issued the first in what became a series of executive orders that granted the Treasury Department the authority to freeze the assets of individuals and firms-both Iranian and foreign-it deemed facilitating Iran's sponsorship of terrorism or supporting its alleged nuclear weapons program. In 2006, Congress gave the executive branch greater authority in these areas when it adopted the Iran, North Korea, and Syria Nonproliferation Act.

Under the Obama administration, Washington has taken a number of measures to further tighten the sanctions against Iran. For example, in 2010, Congress passed and the President signed the Comprehensive Iran Sanctions, Accountability, and Divestment Act, which strengthened parts of the 1995 ISA legislation. The following year, Congress also added provisions to the FY 2012 National Defense Authorization Act (NDAA) that require the President to sanction any companies conducting transactions with Iran's Central Bank, the main mechanism through which Iran processes payments for its oil sales. These measures originated in an August 2011 letter 92 Senators sent to the administration urging it to adopt a "comprehensive strategy" to pressure Iran's financial systems by imposing sanctions on the Central Bank of Iran and expanding the extra-territorial sanctions against foreign banks that continue to conduct business with Iran's Central Bank. President Obama signed the NDAA into law on December 31, 2011.

According to the relevant provisions of the NDAA, the administration can deny foreign banks access to U.S. financial markets if they continue to process transactions with the Central Bank of Iran. While this measure initially applied for all transactions except oil, as of June 28, 2012 it includes oil sales as well. The legislation did, however, authorize the administration to grant six-month waivers to states that made a "significant reduction"[10] in the amount of oil they imported from Iran prior to the June deadline. While these waivers can be renewed every six months, the administration must first certify that the states continued to further reduce their imports of Iranian crude.

Impact of the Central Bank Sanctions

As mentioned above, the main purpose of the targeted sanctions is to change Iranian leaders' cost-benefit analysis regarding the continuation of their nuclear program. To achieve this, the U.S. must impose sanctions against companies doing business with Iran's Central Bank without losing the international consensus it has gained in continuing to pressure Iran. As these measures have the potential to dramatically increase the price of oil, the Obama administration faces the difficult task of determining how far they can isolate Iran's oil sector without causing a oil market shortage and the resulting spike in oil prices. A spike in oil prices would not only undermine this international consensus for sanctions but also would lessen the impact the sanctions have on Tehran by allowing it to sell whatever oil it could at higher prices. Indeed, it is telling that, as the EU and U.S. sanctions were set to take effect, Iran began appealing to OPEC to reduce its oil production quota.

In order to avoid a dramatic rise in the price of oil, before the legislation could be implemented, it required the Obama administration to certify that increasing the capacities of other exporters, such as Saudi Arabia, could make up for the loss of Iran's crude in the international energy market. The administration issued this certification in February 2012.

The United States also sought to prevent oil spikes and economic hardship for ally states by issuing waivers allowed by the legislation. Sanctions are only valuable if they are enforced, and continued economic pressure from U.S. extra-territorial measures is affected by international support and compliance. Waivers facilitate continued international cooperation by allowing states to reduce their oil dependency on Iran more gradually. In March 2012, the United States issued waivers to 10 European Union states and Japan.[11] In June 2012, only weeks before the sanctions entered into force, the U.S. Department of State also announced that seven additional economies had reduced their imports enough to warrant waivers, including India, South Korea and Turkey, three of the top ten importers of Iranian oil. On June 28th, the day that the sanctions went into effect, U.S. Secretary of State Hillary Clinton announced that last minute waivers for China and Singapore, citing "significant reductions" in their oil imports.[12] In total the Obama administration has issued waivers to 20 different states, giving them a temporarily license to continue purchasing Iranian oil over the next six months. The Chinese waiver is particularly significant because China is the largest importer of Iranian oil.

According to Clinton's June 28 statement, Iran's average oil exports dropped from 2.5 billion barrels per day in 2011, to 1.5 billion barrels per day in 2012, representing a quarterly loss of approximately $8 billion.[13] From an initial analysis, these figures would indicate that the U.S. measures are indeed causing further pressure on Tehran and increasing the cost of its continued intransigence. Moreover, these figures were estimated prior to the EU oil ban coming into force on July 1, which could cause further erode Iran's oil profits. Under the decision of the Council for the European Union, member states were compelled to terminate all oil contracts with Iran by that deadline. The decision also prevents companies registered in the EU from providing the required liability insurance for oil tankers carrying Iranian crude. Approximately 95 percent of the world's liability insurance for oil tankers, which can run into the billions of dollars, comes from EU companies. As a result, even states that were granted a waiver from the United States to continue importing Iranian oil without penalty may have to arrange alternative insurance guarantees.

Affected states are working around this restriction in a number of ways. Japan passed legislation in June allowing the state to act as guarantor for the tankers; India, on the other hand, is accepting insurance arrangements provided by Tehran. Some states have temporarily zeroed out their imports while considering alternative insurance options. South Korea, for example, decided that sovereign guarantees were too expensive, but is reportedly considering accepting shipments of oil from Iranian insured tankers. In the immediate aftermath of the sanctions implementation, however, Seoul is not importing any Iranian oil.[14]

The South Korea case, for one, exemplifies the multiplier effect of simultaneous sanctions regimes. Despite receiving a waiver from the U.S. that allowed Seoul to continue importing Iranian oil, South Korea may be unable to exercise this option due to provisions of the EU sanctions. Given the potential magnifying impact of non-US sanctions, it will be incumbent upon policymakers in Washington to continuing to monitor the impact of these sanctions on Iran's oil exports and the global price of crude. Should the price drastically increase due to concerns over shortages, then, despite selling less, it could mitigate the economic pressure on Iran and reduce their incentive to negotiate with the P5+1.

Additionally, if the administration is not careful when considering the application of sanctions and the granting of waivers, it risks retaliatory measures both from Iran and its international partners. China, for instance, in a statement after their waiver was granted, indicated that they would continue to import oil based on their economic needs. If the administration were to impose financial restrictions on Chinese banks that continue to purchase oil from Iran, U.S. trade with China could be severely impacted. Yet, if China does not continue to reduce its consumption of Iranian oil over the next six months, when the time comes to renew the Beijing's waiver, the White House could be placed in a difficult position, given that it is required by American law to not renew the waiver unless Beijing has made a "significant reduction" from the amount of oil it imported at the time the first waiver was granted.

Furthermore, the Obama administration is likely to face intense domestic political pressure not to grant future waivers unless the state in question demonstrates a continued reduction of Iranian oil imports. After the announcement of the first Chinese waiver, for instance, Senator Robert Menendez, (D-N.J.), a co-sponsor of the Central Bank sanctions, said that, "we will expect to see additional significant reductions by China and other nations that are continuing to purchase Iranian petroleum or petroleum products in order to qualify for future exemptions."[15] It's reasonable to assume that Republican Congress members will only be more insistent on this issue. On the other hand, the American electorate has historically been unkind to incumbent politicians seeking reelection when oil prices are high.

Finally, if Washington allows China to continue importing oil from Iran without a visible reduction, the United States could lose some of the leverage against Iran that is driving the latter's return to negotiating table in the first place.

The offer to repeal these sanctions in return for Iranian concessions on its nuclear program is also one of the P5+1's most crucial bargaining chips when negotiating with Iran. Here too, however, the U.S. and its allies face a delicate balance. Just as when considering the amount of pressure to apply when imposing sanctions, the P5+1 must carefully weigh the amount of sanctions relief they are willing to offer for specific concessions. If sanctions are repealed too quickly and in return for too little, the parties risk losing their leverage over Iran without achieving the concessions they seek. On the other hand, if the P5+1 powers do not offer Iran enough sanctions relief, they risk Tehran calculating that it does not benefit enough from the negotiations to continue them. In either scenario the United States does not achieve its primary goals, including halting Iran's production and accumulation of uranium enriched to 20 percent and achieving Tehran's full compliance with IAEA inspections and safeguards.

Indeed, many analysts have argued that the P5+1's proposal during the most recent rounds of talks does not offer enough reciprocal benefits for the types of concessions they seek from Iran. According to Iranian diplomats involved with the negotiations, the P5+1's most recent proposal, which the United States supports, insists Iran agrees to three conditions: halting all uranium enrichment to 20 percent levels[16], shipping its entire existing stockpile (over 100 kg) of 20% enriched uranium out of the country, and closing its heavily fortified Fordo enrichment plant located in the mountains near the city of Qom. In return the P5+1 offered to ease restrictions on the sale of spare civilian aircraft parts to Iran, provide fuel for Iran's research reactor, which produces medical isotopes, and cooperate with Iran on technical issues, such as acquisition of a light water reactor to produce medical isotopes and nuclear safety projects. This proposal offers few tangible benefits in terms of sanctions relief. Moreover, in some analysts' opinion, the P5+1 are demanding far more from Iran than they are offering in return, giving Iranian policymakers little incentive to agree to the proposal.

Conclusion

Sanctions against Iran are clearly impacting the regime's ability to obtain the materials that it needs to continue its nuclear and ballistic missile programs, increasing the costs of Iranian intransigence, and motivating the regime to return to the negotiating table. But given Iran's current behavior under the increasingly multilateral sanctions effort directed against it, namely its continued nuclear advances, sanctions alone are unlikely to produce the discernible change of Iranian behavior that the United States and its allies are hoping for. To achieve progress in these talks, all parties must be willing to negotiate in good faith. While there is a gulf between the negotiating proposals on each side, the differences in positions are not insurmountable. To make progress, however, negotiators must discuss the sequencing of the proposals, namely Iranian concessions on enrichment for sanctions relief and nuclear cooperation, so that the step-by-step process with reciprocal actions that was agreed to at the onset of the talks can be respected. Tehran has demonstrated that its national security policy is driven by cost benefit analysis. U.S. efforts should not focus solely on the "costs" side of this equation, but also provide inducements for Iran to address the international concerns over its nuclear program. On the P5+1 side, this should include a willingness to discuss partial sanctions relief in return for Iranian concessions in areas like halting enrichment to 20 percent and eliminating the current stockpile at this level. Western policymakers should consider offering some sanctions relief, such as reinstating EU insurance for Iranian oil tankers in exchange for suspending 20 percent uranium enrichment. While this is not a repeal of U.S. sanctions, it would ease the economic pressure on Iran's Central Bank by allowing states that received waivers to import Iranian oil without penalty, assuming other means of financing the oil sales can be arranged. In addition, it would demonstrate to the Iranian regime that the United States and the P5+1 are serious about sanctions relief if Iran is willing to take significant steps to mitigate international concerns over is nuclear program.

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[1] As discussed below, the United States has imposed sanctions against Iran almost continuously since 1979. Iran is also subject to international sanctions under the auspices of UN Security Council resolutions, and many other states have imposed further unilateral sanctions against Iran as well. The primary purpose of this piece, however, is to assess the most recent sanctions imposed by the United States, albeit I will briefly discuss the history of sanctions in order to place the current ones in their proper context. .

[2] Since the resumption of the P5+1 talks with Iran, the parties have met three times at the senior political level: first in April in Istanbul, second in May in Baghdad, and finally in Moscow in June. Earlier this month the two sides held an experts-level meeting in Istanbul to discuss the technical aspects of the proposals put forward to address the international concerns over Iran's nuclear program. On Tuesday July 24th, a deputy-level political meeting will be held.

[3] Patrick Clawson, "U.S. Sanctions," *The Iran Primer,* U.S. Institute of Peace Press, Washington, DC, 2010.

[4] This is not to say that there are not humanitarian consequences to the imposition of sanctions on Iran, such as a steep rises in basic goods. The targeted measures that restrict Iran's economic access to global markets have a domestic impact on inflation, which is currently estimated at approximately 20 percent. Marcus George, "Iran Pledges to Counter 'Malicious' Oil Embargo," *Reuters,* July 1, 2012.

[5] Matthew Levitt, "Financial Sanctions," *The Iran Primer,* U.S. Institute of Peace Press, Washington, DC, 2010.

[6] The impact of sanctions on the development of Iran's nuclear and ballistic missile programs is outside the scope of this article, but for further information on these subjects, see the United Nations Panel of Experts Report: "Final report of the Panel of Experts established pursuant to resolution 1929 (2010)," United Nations Security Council S/2012/395, June 12, 2012 And the International Institute of Strategic Studies, "Iran Sanctions Halt Long-Range Ballistic Missile Development," Strategic Comment, Vol 18. Comment 22, July 2012.

[7] The purpose of this section is to provide a brief overview of U.S. sanctions on Iran. It is not a comprehensive list

nor is it intended to give a complete background sanctions instituted by the United Nations or other states. For a more detailed description of U.S. sanctions legislation see: Kenneth Katzman, “Iran Sanctions,” Congressional Research Service, April 26, 2012.

[8] United Nations Security Council Resolution 1696, July 31, 2006.

[9] Despite these sanctions and a declared neutral position in the Iran-Iraq War, the United States secretly sold weapons to the Iranian regime. In 1985 President Reagan authorized a covert program designed to trade arms for American hostages held in Lebanon. For more information on covert program, referred to as the Iran-Contra Affair, see: Lee H. Hamilton and Daniel K. Inouye, “Report of the Congressional Committees Investigating the Iran-Contra Affair,” Select Committee on Secret Military Assistance to Iran and the Nicaraguan Opposition, Washington, DC: 1987.

[10] The legislation does not specify what percentage reduction must be achieved for a state to qualify for a wavier. “Significant” is not specifically defined, leaving room for interpretation by the administration.

[11]The waiver for the European Union states, however, was merely symbolic given the January 2012 decision of the European Council to implement a full embargo on oil imported from Iran for all 27 members of the EU that took effect July 1, 2012.

[12] Hillary Rodham Clinton, “Regarding Significant Reductions of Iranian Crude Oil Purchases,” Washington, DC, June 28, 2012.

[13] Ibid.

[14] Meeyoung Cho, “S. Korea considers resuming Iran oil imports-govt sources,” Reuters, July 13, 2012. http://in.reuters.com/article/2012/07/13/oil-korea-iran-idINL3E8ID1SD20120713.

[15] Robert Menendez, “Menendez Reacts to Exemptions from Iran Sanctions for China and Singapore,” Washington, DC, June 28, 2012.

[16] Uranium enriched to 20 percent is a technical step away from weapons grade uranium, which is enriched to at least 90 percent. Iran claims it requires 20 percent enriched uranium for its Tehran Research Reactor, which produces medical isotopes.