

SANCTIONS AGAINST IRAN:
KEY ISSUES

BRUCE W. JENTLESON

A CENTURY FOUNDATION REPORT

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INTRODUCTION

On December 23, the United Nations Security Council unanimously approved Resolution 1737, imposing multilateral sanctions on Iran as part of the diplomatic strategy for getting Iran to comply with the Nuclear Non-Proliferation Treaty (NPT) and the requirements of the International Atomic Energy Agency (IAEA). This resolution followed Resolution 1696 (approved July 31), which placed pressure on Iran to suspend its enrichment-related and reprocessing activities, including research and development, as well as numerous reports by the International Atomic Energy Agency (IAEA) critical of Iranian claims of a strictly peaceful and commercial nuclear energy program.¹ The Resolution 1737 sanctions, largely targeting the nuclear sector, were a compromise among the Security Council Permanent-5 (P-5): they are more limited than what the United States and the EU-3 (Britain, France, Germany) had pushed for, yet more than Russia, China and others had favored. A sixty-day deadline was set—February 21—by which, if Iran does not fully comply, the Security Council commits to “adopt further appropriate measures.” The package of economic, security, and other incentives as formally proposed by the EU-3 in June and as endorsed in Resolution 1696 also are reiterated in Resolution 1737.

At one level, Iran has responded defiantly. Resolution 1737, Iranian President Mahmoud Ahmadinejad exclaimed, was no more than “a piece of torn paper.” Announcements were made of stepped-up plans for the nuclear program, including building three thousand centrifuges at the Natanz facility, one of the sites of particular concern. But we also have seen signs of concern within Iran about the economic impact and diplomatic ramifications of the country being subjected to such UN action. These have included the rebuke Ahmadinejad’s party received in the December 2006 municipal and

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Assembly of Experts elections as well as some statements and actions by other key Iranian leaders.

Sanctions are not the only part of the strategy being pursued to prevent Iranian nuclear proliferation. And nuclear proliferation is not the only issue with regard to Iran, and particularly between the United States and Iran. With U.S.-Iranian tensions now heating up in Iraq, and so much of the Middle East seemingly ever more unstable, the sanctions issue is being affected by a host of other pressures and positions, and may well be overtaken by other events.

But while other factors are in play, it is clear that sanctions are part of the mix. So while acknowledging this broader context, the sanctions issue still needs to be addressed. This report accordingly reviews key developments thus far and addresses possible sanctions-related next steps. It does so within a strategic framework informed both by the Iran case and by sanctions strategy more generally. Various sanctions options are identified, along with economic and other incentives. P-5 and other multilateral politics are discussed, as is Iran's domestic politics and economy.

The main points of this report are as follows:

- UN-mandated sanctions are a crucial element in a successful multilateral strategy for a peaceful and cooperative resolution of the crisis that would prevent Iran from developing nuclear weapons. Their importance is as much for their political credibility of manifesting multilateral solidarity as for their economic impact.
- The steps taken so far as embodied in Resolutions 1696 and 1737, while limited and less than optimal, are significant in themselves and provide a base on which to build. Unless Iran complies with the mandated terms of full and sustained suspension of enrichment, reprocessing, and other proliferation-related activities of concern by the February 21 deadline, the Security Council needs expeditiously to take next steps in imposing further sanctions.
- While there is some flexibility in which sanctions to impose next, serious consideration should be given to broadening and tightening the nuclear sector sanctions, multilateralizing some of the U.S. and Western European sanctions on financing and lending, and adding initial sanctions on equipment, technology, and financing for the oil and gas sector.

- Getting Russian and Chinese support for additional sanctions is difficult. Those who dismiss the possibility, though, also did so for Resolution 1737. While both Russia and China do have interests that run counter to additional sanctions, they also have interests that cut in the other direction. Gaining their cooperation will take concerted and deft diplomacy, not an easy task but an achievable one if the Bush administration is serious about a diplomatic solution.
- Economic and other incentives, particularly U.S. security reassurances disavowing regime change, need to be offered, and credibly so, to make clear the benefits of cooperation, not just the costs of non-cooperation.
- Iranian domestic politics do not clearly cut one way or the other. The nuclear issue is not so high a priority across the board that support for it is unequivocal, nor will it be supported at any price. However, the use of military force against Iran likely would set off a rallying effect around both the regime and a nuclear weapons program.² This is one way in which the presence of regime change as an option has a counterproductive effect on current diplomacy.
- Sanctions do carry risks. But not imposing them carries greater risks, both for the particular issues of international peace and security raised by Iranian nuclear capacity and more broadly for the roles of the UN Security Council and the International Atomic Energy Agency as central multilateral institutions.
- More positively, successful resolution of the Iran case would signal the international community's intention to uphold this bedrock nuclear weapons regime and build confidence in the Security Council's determination to strengthen and reinforce it against other possible violations. It also could be the kind of demonstration of political will and efficacy of the Security Council that can have a positive effect on other conflicts, both as a deterrent for crisis prevention and as a catalyst for conflict resolution.

Barry Posen, in a separate Century Foundation report, addresses the issues a nuclear Iran would raise. While Posen sees these as "a difficult but not impossible policy problem," he also acknowledges that "for many reasons, it would be better if Iran had neither nuclear weapons, nor the enabling technologies

that would permit it to build nuclear weapons.”³ Thus, while it may well be that there is no strategy—economic sanctions or some other approach—that can stop Iran from developing nuclear weapons capacity, doing so still is the optimal objective.

ANALYTIC FRAMEWORK: CRITERIA FOR SANCTIONS SUCCESS

The question is often posed of whether sanctions “work.”⁴ There is no blanket answer. Most studies give sanctions about a 30 percent overall success rate. India was a case in which the sanctions imposed by the United States and some others following the 1998 nuclear weapons tests did not reverse nuclear proliferation; Libya was a case in which sanctions (U.S. and European restrictions starting in the 1980s, UN ones first imposed in 1992) helped to curb proliferation as well as to get Libya to end its support of terrorism.⁵ In these and other cases, the success of sanctions has depended on a number of key criteria, most particularly:

- *Achieving both economic impact and political credibility.* Sanctions must not only have or threaten to have significant economic impact. They also must send a strong message of political credibility.
- *Objective of policy change, not regime change.* Sanctions do not work for regime change (for example, the U.S. embargo against Cuba). Indeed, if a target believes it has reason to be concerned about regime change, whether for reasons of history, current policy, and/or rhetoric, even keeping regime change “on the table” is likely to be counterproductive to achieving policy change. The Libya case is instructive in the positive on this point.
- *Multilateral support.* Historically, the most frequent cause of the failure of sanctions has been other states acting as alternative trade partners for the target state. This is all the more problematic amidst globalization. Weak multilateral support also undermines the political credibility crucial to sanctions success.
- *Carrot and stick reciprocity.* Sanctions need to be paired with economic incentives, which are more than just not imposing the sanctions. Other manifestations of reciprocity also are important, including phased sequencing

such that the target neither gets too much for too little, nor too little for too much.

- *Time frame.* Sanctions can take time to have impact. In the Libya case, a mid-1990s assessment would have been that they were not working. In the end, though, they did have significant impact.
- *Enforcement.* Even the toughest sanctions are not worth much if they are not effectively enforced. They can be broken by illicit networks (for example, the A. Q. Khan network), by governmental “wink and nod” decisions, and by the sheer technical and operational difficulty of closing off all relevant channels of economic intercourse and keeping them closed off.

These are difficult conditions to meet. On top of that they have two further qualifiers. One is that states targeted with sanctions still may be able to resort to counterstrategies that can reduce both the economic and political impacts. Economic strategies include turning to alternative trade partners and tapping or developing domestic capacities for economic substitution. Politically, the threat of a “foreign enemy” can be exploited to facilitate internal political solidarity as well as to rationalize repression. On the other hand, sanctions may sufficiently hurt the interests of key groups within the society such that they bring their own pressures to bear on the regime to make concessions that would avert or remove the sanctions.

The other key additional condition is synergy between the sanctions and other elements of the overall strategy. Sanctions never comprise a strategy in themselves, but rather are a part of a broader strategy. They can be *a* reason why policy change occurs, or why a strategy fails, but either way sanctions never are *the* reason. In the Libya case, for example, sanctions were combined with other elements that effectively blended carrots and sticks, coercive credibility, and trust-building diplomacy. A report such as this therefore must take into account others that address various parts of the overall Iran strategy, including the other reports commissioned by The Century Foundation.⁶

Related to this is the debate over whether sanctions are or are not diplomacy. The argument has been made in the Iran case as well as others that, as a coercive measure, sanctions are antithetical to diplomacy. This reflects the concept of diplomacy found in Sir Harold Nicolson’s classic definition as “the management of international relations by negotiation.”⁷ We may reach a point

where such an approach suffices for international peace and security. We have not been there in the past. We are not there yet. Economic sanctions and other coercive measures, including threats or limited uses of military force, have proven to be complementary and not necessarily contradictory to the negotiations dimension of diplomacy (carrot and stick), as in strategies of coercive diplomacy.⁸ Sanctions may be good diplomacy, they may be bad diplomacy—but they are part of diplomacy.

CURRENT POLICY CONTEXT

U.S. sanctions against Iran go back to the 1979 hostage crisis. They have been added to and occasionally subtracted from in the years since.⁹ The gist is that the United States currently bans most trade and investment between itself and Iran: total U.S.-Iranian trade is less than \$250 million (2004), compared to roughly \$25 billion in EU-Iranian trade. U.S. import exceptions include nuts, caviar, carpets, and Iranian oil refined in third countries. Export exceptions include agricultural goods and medical supplies, subject to interagency review. Financial sanctions prohibit loans or credit by American financial institutions, opposition to most lending to Iran by multilateral development banks (MDBs) to which the United States contributes, and continued freezing of an estimated \$17 billion in Iranian assets in the United States. The one main exception has been disaster relief. The United States contributed \$125,000 through relief agencies following two earthquakes in Iran in 1997, another \$350,000 in aid following the June 2002 earthquake, and \$5.7 million following the December 2003 Bam earthquake that killed an estimated 400,000 people and destroyed 90 percent of the city's buildings. This included 68,000 kilograms of supplies flown in to Bam on U.S. military cargo flights.¹⁰

The United States also has sought to restrict trade by Western Europe and others through claims of extraterritorial application of U.S. law. The Iran and Libya Sanctions Act (ILSA), first passed in 1996, imposed penalties on foreign companies investing in Iran's or Libya's energy sector; the most recent reauthorization dropped Libya, with which diplomatic relations have been reestablished, but tightened the Iran energy sector sanctions and extended them through 2011. The extraterritorial aspects of ILSA have been particularly controversial, as

claims of extraterritoriality long have been, such as, for example, the 1981–83 Soviet Siberian gas pipeline and splits on this issue even between Ronald Reagan and Margaret Thatcher.¹¹ Other legislation has similarly authorized secondary sanctions on foreign entities that assist Iran's WMD programs.

While Europe has had some sanctions against Iran, for many years it pursued trade out of both commercial motivations and a political-diplomatic strategy ("critical engagement" as the strategy was called in the 1990s). The main shifts towards sanctions were precipitated by revelations starting in 2003 of apparent evidence that Iran was pursuing the development of nuclear weapons in violation of its NPT commitments. There also was a sense among such European leaders as German Foreign Minister Joschka Fischer and French President Jacques Chirac that after (actually, amidst) Iraq, Europe had a strong strategic interest in taking the lead on Iran to demonstrate that it did recognize a strategic threat when there was one (Iran possibly yes, Iraq no). The EU-3 was established by Britain, France, and Germany, along with the European Union Commission, to initiate high-level negotiations with Iran. These negotiations had some initial successes including Iranian agreement to suspend nuclear-enrichment, partially and intermittently. But especially after the 2005 election of President Mahmoud Ahmadinejad the negotiations got much rockier.

On June 6, 2006, in an effort at a major breakthrough, EU High Representative Javier Solana presented Iran with a package including a mix of sanctions and incentives, with support from the United States, Russia, and China (EU-3). U.S. support for the EU-3 June 6 package policy was part of the shift from the Bush administration's earlier "axis of evil" regime-change position and general unwillingness to negotiate. The new position also posed a qualified willingness to negotiate directly with Iran if it first suspended all uranium enrichment and reprocessing. China and Russia also supported the June 6 package. Among the sanctions were denial of visas for Iranians involved in Iran's nuclear program and for high-ranking Iranian officials; a freeze on assets of Iranian officials and institutions; a freeze on Iran's assets abroad and a ban on some financial transactions with Iran; a ban on sales of advanced technology; a ban on arms sales; a ban on sales to Iran of gasoline and other refined oil products; and an end to support for Iran's World Trade Organization (WTO) application. Among the reported incentives: negotiations on EU-Iran trade agreements and acceptance of Iran into the WTO; easing of U.S. sanctions to permit sales to

Iran of commercial aircraft or aircraft parts; sale to Iran of a light-water nuclear reactor and guarantees of nuclear fuel; possible light-water research reactors for medicine and agriculture applications; an Iran-EU “energy partnership,” including help for Iran’s modernization of its oil and gas sector and for building oil export pipelines; support for a regional security forum for the Persian Gulf, and support for the objective of a WMD-free zone for the Middle East; and the possibility of eventually allowing Iran to resume uranium enrichment, if it complies with all outstanding IAEA requirements and can prove that its nuclear program is purely for peaceful purposes.

Russia also had tried to broker a deal. In March 2006, it reportedly proposed that Iran suspend all uranium enrichment on its own territory and in return be allowed to undertake “limited research activities” in cooperation with Russia at facilities within Russia and with IAEA intrusive inspections. This was to be a reasonably long-term temporary arrangement (close to a decade), recognizing Iran’s claim to nuclear energy rights yet also affirming international concerns about military diversion. The proposal got some limited interest in Iran and Europe, but was opposed by the United States and by the EU-3.

With Iran continuing to resist a negotiated settlement, and the IAEA continuing to deliver critical reports, on July 31, the UN Security Council adopted Resolution 1696 by a fourteen-to-one vote (Qatar opposed, no abstentions). While the resolution “demands” that Iran “suspend all enrichment-related and reprocessing activities, including research and development,” the Security Council did not abide by its own August 31 deadline. Other putative deadlines followed, but nothing firm. The IAEA continued to report concerns about Iranian compliance. Its late November report indicated Iran was continuing to test new uranium enrichment equipment that could double research and development capacity. A further report said inspectors had made no progress in resolving the origin of previously discovered traces of highly enriched uranium and also had discovered traces of plutonium. Iran was said to be moving ahead with efforts to enrich uranium while refusing to answer critical questions about its nuclear program.

Despite the earlier shift in U.S. policy doubts still persisted about how genuinely committed the Bush administration now was to the diplomatic route. UN Ambassador John Bolton was still in a lead role, with attendant issues of both style and substance, until the Democratic victory in the 2006 congressional

election largely precluded his re-nomination and prompted him to resign. President Bush's signing of the Iran Freedom Support Act on September 30 was alternately interpreted as an effort to reinforce the negotiations by keeping pressure on or an effort to undermine negotiations through the bill's intonations of regime change. On the other hand, around the same time, the administration approved a license for General Electric to export spare parts for jet turbine engines to Iran Air in response to passenger safety concerns.

Iranian statements and actions were doing more to exacerbate than to ameliorate tensions. President Mahmoud Ahmadinejad's speech at the UN General Assembly in September and other statements and actions, including the Holocaust denial conference held in Tehran in December, continued to provoke and threaten. Statements from Ali Larijani, Iran's chief nuclear negotiator, were not providing much basis for getting the negotiations started again; neither were most other Iranian positions and statements. There occasionally were more encouraging statements, such as Foreign Minister Manouchehr Mottaki's suggestion in late October that Iran might suspend enrichment during negotiations. A few days later, though, this view was rejected by Larijani, with his assertion, "I am in charge of nuclear issues."¹²

The nuclear weapon test by North Korea on October 9 further complicated the Iran nuclear issue. Sanctions proponents cited Resolution 1718, passed within days, condemning the North Korean nuclear test and imposing sanctions on arms and missile- and nuclear-related goods, as well as bilateral aid and trade sanctions by China, as key reasons North Korea returned to the six-party talks. Sanctions opponents argued that less should be imposed on Iran since it has done less, being suspected of development of nuclear weapons but not having tested them. When the six-party talks did resume in Beijing in December, the North Koreans were quite focused on the U.S. financial sanctions imposed earlier on North Korean accounts in Macau's Banco Delta Asia SARL. This played both ways in the sanctions debate, for opponents an example of sanctions' counterproductivity and for proponents an example of impact.

Throughout the fall and well into December, press accounts were of major disagreements among the P-5 nations and poor prospects for any UN Security Council sanctions. In this context the very passage of Resolution 1737 on December 23 was an important achievement. Its key provisions:

- while reaffirming Iran's right to the development of nuclear energy for peaceful purposes, repeatedly reiterates "serious concern" about possible military aspects to the Iranian nuclear program, including noncompliance with Resolution 1696 and IAEA regulations and processes;
- shifts from Article 40 of the UN Charter, which had been the basis for Resolution 1696, to Article 41, which explicitly mentions sanctions as a policy tool;
- imposes limited sanctions on the Iranian nuclear sector, focused on proliferation related goods and technology (enrichment, reprocessing or heavy water-related), and those that could contribute to the development of nuclear weapons delivery systems, as specified in accompanying documents;
- prohibits related technical assistance, training, financial assistance, and other services, as their relevance is determined by individual states;
- targets financial assets freeze on selected organizations and individuals closely related to the Iranian nuclear program;
- calls on states to exercise vigilance and prevent proliferation-related training and education programs for Iranian nationals;
- reiterates the comprehensive package including economic, security, and other incentives as formally proposed in the EU-3 June 6 package and as endorsed in Resolution 1696 as still the basis for an overall agreement, "for a long-term comprehensive agreement which would allow for the development of relations and cooperation with Iran based on mutual respect and the establishment of international confidence in the exclusively peaceful nature of Iran's nuclear programme";
- sets a sixty-day deadline (February 21, 2007) for "full and sustained suspension of all activities mentioned in this resolution, as well as on the process of Iranian compliance" with the IAEA requirements;
- states that Iranian suspension of all enrichment-related and reprocessing activities will be reciprocated with suspension of the sanctions, and that the sanctions will be revoked if Iran is determined by the IAEA and the Security Council to have fully complied;

- does not make further sanctions automatic, instead “underlines that a further decisions will be required”; and
- states that the “further appropriate measures” that may be taken are under Article 41, staying well short of Article 42 and its potential uses of military force.¹³

While not mentioned explicitly, a compromise was reached over Russian contracts for the Bushehr nuclear complex. These contracts, worth over \$800 million, go back a number of years. The agreement reportedly was to allow Bushehr to go ahead as well as allow possible new contracts with a reaffirmed commitment by Russia to ensure non-proliferation at or through Bushehr.

The fact that the Security Council did go as far as it did in Resolution 1737 was significant. In acting, the Security Council did fulfill at least in part its threat to do so, and did so with P-5 unanimity (no abstentions, not just no veto). It moved to Article 41. It strongly affirmed UN-IAEA solidarity. It set the criteria for compliance as “full and sustained suspension of all activities mentioned in the resolution.” All of this did make for some of the political credibility as well as potential economic impact essential for sanctions to have success.

Still, the sanctions were more limited than the United States and the EU-3 had been pushing for. Some of the specifics of the nuclear sector sanctions were left to the determination of individual states. The financial freezes did not cover as many individuals and organizations as proposed. States were called on “to exercise vigilance” over nuclear-related training and education programs in which Iranian students and professionals participate, but were not ordered to prohibit such participation. The sanctions do not touch such other major sectors as oil and gas and overall finance. And it took almost four months beyond the purported deadline for even this action to be agreed to.

Moreover, while the Security Council vote was unanimous, the press release announcing it delineated varying interpretations among the P-5 as to its meaning and significance:¹⁴

- The United States stressed the “unambiguous message that there were serious repercussions for its [Iran’s] continuing disregard and defiance of the Security Council.” It claimed that the text “was not open to interpretation,” that it compelled all member states to impose the delineated sanctions. “In

the face of non-compliance by Iran, the United States would not hesitate to return to the Council for further action.”

- The United Kingdom set the context as Iran having previously “simply thumbed its nose at the Security Council and defied international law.” It also laid the marker that if “Iran did not change course, the Council had committed itself, in today’s text, to further measures,” whereas if it did comply it “would open the way for the European Union and Iran to open a new and wider relationship to their mutual benefit, and to the benefit of international peace and security.”
- Russia stressed the significance of Resolution 1737 as “support of the Council for the activities of the IAEA on the issue at hand,” and “that the restrictions introduced by the Council applied to the areas of concern of the Agency” and with its own multi-billion dollar Bushehr nuclear reactor in mind it stressed that “cooperation with Iran in areas not restricted by the resolution should not be subjected to its terms.” Russian thinking on next steps was stated as being “convinced that a solution could be found exclusively in the political and diplomatic spheres. In that context, the measures should be taken in line with Article 41 of the Charter, and not permit the use of force.”
- China stressed that the sanctions “were limited and reversible,” and intended by the Security Council “to encourage Iran to engage with them, leading to the development of relations and cooperation with Iran based on mutual respect and establishment of international confidence in the peaceful nature of its nuclear programme.” Chinese support was for sanctions as a means not an ends, to “spur a new round of diplomatic efforts.”

Iranian statements from Ayatollah Ali Khomeini, the Supreme Religious Leader, as well as President Ahmadinejad have been defiant and acerbic. Comparisons to Israel were drawn. Iranian rights to peaceful nuclear energy were invoked. An official government spokesman pledged that plans for bringing three thousand centrifuges on line by March were moving ahead, and enrichment was continuing. Yet there also were some indications of less than full solidarity within Iranian politics. Ahmadinejad’s party suffered substantial setbacks in elections held in December for municipal councils and the Assembly of Experts, getting less than 20 percent of the vote in each. The main

issue was economic discontent. In ensuing weeks, 150 of 290 members of the Majlis signed a letter criticizing Ahmadinejad's economic record. In addition, student protests were picking up for the first time in many years. One former nuclear negotiator, Hossein Moussavian, warned of the severe consequences that defiance of the UN could have. "We can say inside the country that this resolution is illegal, but we have to have a correct understanding of the international community's considerations."¹⁵ Another Majlis group sent another letter blaming Ahmadinejad's inflammatory rhetoric for the sanctions. Even more significantly, leading clerics were among those criticizing Ahmadinejad for exacerbating Iran's economic problems, at least indirectly including Supreme Leader Khamenei through a newspaper known to reflect his views, which editorialized that the UN Resolution "is certainly harmful for the country," that it was "too much to call it 'a piece of torn paper,'" and that the nuclear program required diplomacy that is "sometimes toughness and sometimes flexibility."¹⁶

The Bush administration has taken a number of steps to impose additional U.S. sanctions, particularly financial ones, which go beyond but are said to be consistent with Resolution 1737. These especially involve prohibitions on American financial institutions doing business directly or indirectly with Iranian banks, organizations, and other entities involved in nuclear-related activities. While direct prohibitions on American financial institutions doing business with Iran were longstanding, the new regulations add the extraterritorial dimension of including foreign branches of American banks, American citizens working at foreign banks, and a claim over any dollar-denominated transaction. One immediate application has been against Bank Sepah, "the financial linchpin of Iran's missile procurement network."¹⁷ Similar restrictions had been imposed earlier against Bank Saderat, a major Iranian bank banned from even indirect access to the U.S. financial system because the bank was believed to be providing funds to Hezbollah. The broader goal is to pressure European and other international banks into a net calculation that doing most any business with Iran is commercially unwise compared to possible American fines and other retributive measures. Already in 2006 at least two European banks, Credit Suisse First Boston and UBS, decided they would not do any new business with Iran. It is not yet clear whether the EU-3 and others in Europe will collaborate on such measures, though. European countries tend not to have comparable laws authorizing their governments to impose such

financial controls. Such measures also re-raise extraterritoriality with its political tensions.

Moreover, the Bush administration has been taking numerous steps heightening concerns whether it is more generally moving towards confrontation with Iran. With the appointment last November of Defense Secretary Robert Gates, who had co-chaired a 2004 Council on Foreign Relations task force that had recommended efforts at greater engagement and possible rapprochement with Iran, and then the recommendations for a diplomatic initiative from the Iraq Study Group (ISG), prompted in part by unofficial discussions former Secretary of State James A. Baker had in his capacity as ISG co-chair with Javad Zarif, Iran's UN ambassador, there had been some thinking that U.S. policy might be shifting. Recent weeks, though, point to a shift towards an even harder line. The only mention of Iran in President Bush's January 12 speech on Iraq was to warn it against interference. The next day American troops raided an Iranian office in the Kurdish region of Erbil, seizing five Iranians and their files and computers. And in early January, a second Navy carrier battle group has moved into the Persian Gulf.

These and other developments are making the debate over the sanctions issue all the more complicated. They make it even more likely that February 21, the sixty-day deadline set by Resolution 1737, will arrive without the issues having been resolved, and the international community facing key decisions on whether to impose additional economic sanctions.

STRATEGIC FRAMEWORK: TWO IRAN SANCTIONS SCENARIOS

As part of the initial draft of this report as presented in early October 2006 at an off-the-record meeting of a number of UN ambassadors and other diplomats, two main scenarios were posed: (A) The UN Security Council goes ahead and imposes sanctions, or (B) it does not impose them. Modified versions of these scenarios still pertain as a way of setting the strategic context before getting into specific sanctions options, with the core question now being whether further sanctions should be imposed if Iran does not comply with Resolution 1737.

(A) ADDITIONAL UN SANCTIONS IMPOSED***Potential Risks***

- *Antagonize rather than intimidate, and Iran escalates.* Iran withdraws from the Nuclear Non-Proliferation Treaty (NPT) and more aggressively pursues nuclear weapons. Iran retaliates with an oil embargo that targets key countries and/or more generally drives world oil prices up (Iran is OPEC's second largest oil and gas producer); and, unlikely but possibly, it blocks the Straits of Hormuz.
- *Domestic backfire.* Sanctions feed Iranian nationalism, de-legitimize domestic opposition to the clerical regime more broadly, silence political voices opposed to nuclear armament, and provide a further rationale for regime repression.
- *Convey international community weakness, not strength.* If the next set of sanctions is still quite limited, as a further "least common denominator" for agreement, they could be seen as a sign of the shallowness of international unity and thus damage political credibility.
- *United States escalates.* Even if sanctions are imposed, but they are less than what the United States wants and/or they fail to get Iranian cooperation, the United States may claim it tried diplomacy but it failed, and that it now is more justified in moving to military force.

Potential Benefits

- *Diplomatic success.* Sanctions work along with the overall strategy. After initial bluster, Iranian authorities agree to a deal that verifiably bars weaponization. The Iran nuclear proliferation crisis is resolved.
- *Momentum toward rapprochement.* The success on non-proliferation opens the way for exploring a broader rapprochement between Iran and the West, and even Iran and the United States.
- *Weaken the more extreme Islamic revolutionaries.* The deal comes about by forces inside the regime overruling Ahmadinejad. Or Ahmadinejad comes around. Overall Iranian reformers who seek improved relations with the West and more moderate Islamism at home are strengthened.

- *Positive effect on other conflicts.* The demonstration of political will and of the efficacy of the UN strengthens Security Council credibility in ways that can have a positive effect on other conflicts, both as a deterrent for crisis prevention and as a catalyst for conflict resolution.
- *Positive effect on the non-proliferation regime.* Taking action to bring Iran into complete and transparent compliance with its obligations for exclusively peaceful uses of nuclear energy under the NPT would signal the international community's intention to uphold this bedrock nuclear weapons regime and build confidence in the Security Council's determination to strengthen and reinforce it against other possible violations.

(B) SANCTIONS NOT IMPOSED

Potential Risks

- *Convey international community weakness, not strength.* The UN Security Council yet again made a threat, and yet again did not deliver on it. "They will do their best, and so will we," Iranian President Ahmadinejad stated back in November. "In the end, the winner is whoever stands more firmly."¹⁸
- *Strengthen the more extreme Islamic revolutionaries.* With international pressure lessened and no obstacle to nuclear weapons development, Ahmadinejad comes out looking triumphant, having stood up to the West and stared it down.
- *Weaken sanctions more generally.* With an eye to other potential cases, UN credibility is weakened from having not delivered on the threat, further constricting the future utility of sanctions.
- *U.S. military action.* The United States claims it tried diplomacy but it failed, and that it now is more justified in moving toward military force.
- *NPT regime unravels.* The lack of any international response to a serious challenge to the NPT regime by a country—especially in a region as volatile as the Middle East—that reaped nuclear benefits from adhering to it and then moved to break out from it will likely trigger a broader disintegration of the non-proliferation regime and erosion of the international taboo against nuclear weapons.

Potential Benefits

- *Diplomatic solution more likely.* Iranian policymakers might take this step away from coercion as conciliatory, not proof of weakness, and in turn seek conciliation.
- *Intra-UN tensions reduced.* Assuming the United States does not further press its case, and that the Europeans also pull back, there could be less intra-UN tensions, at least overtly.

As a net assessment, the additional sanctions imposed scenario has the relatively more favorable balance of risks and benefits. The risks are of concern, but the upside potential is greater than for the scenario in which no further sanctions are imposed.

NEXT STEPS: SANCTIONS OPTIONS

It bears re-emphasis that much more is in play than just questions about possible next steps involving sanctions. Sanctions are not the only component of non-proliferation strategy toward Iran. And, as is all too clear, many issues other than non-proliferation are in the mix: the war in Iraq, the Arab-Israeli conflict, the West and Islam, terrorism. Still, a next set of decisions likely will need to be made on sanctions, and this remains the focus of this particular report.

Of course, the UN Security Council could choose to impose comprehensive sanctions: embargo all exports, investment, and other financial dealings with Iran other than medicines and other humanitarian items, and on the import side, boycott Iranian oil and gas, and possibly all Iranian exports. This is virtually certain not to happen, though. Such a move would have little chance of meeting the key criteria for success noted earlier, such as gaining multilateral support and being enforceable. Such measures also would be especially susceptible to the risks noted in the “sanctions imposed” scenario, namely backfiring within Iranian politics, feeding nationalism and discrediting and endangering the opposition, and antagonizing more than intimidating the Iranian regime in ways that could feed escalation.

More likely is some further combination of limited and targeted sanctions, across or within six categories: (1) nuclear sector sanctions, (2) oil and gas

sector sanctions, (3) elite interest sanctions, (4) financial sanctions, (5) general economic sanctions, and (6) conventional arms and technology sanctions.

(1) NUCLEAR SECTOR SANCTIONS

These, as noted, are the main sanctions imposed by Resolution 1737. They target:

- proliferation-related goods and technology (enrichment, reprocessing or heavy water-related), and those that could contribute to the development of nuclear weapons delivery systems;
- related technical assistance, training, financial assistance, and other services;
- proliferation-related training and education programs for Iranian nationals; and
- financial assets of selected individuals and organizations closely related to the Iranian nuclear program.

The advantage of nuclear sector sanctions is that they are based on the nature of the export such that preventing acquisition is the objective in its own right without necessarily a further link to trying to leverage policy change. However, they raise three issues. First is that, as also noted earlier, the scope of the nuclear-related sanctions imposed by Resolution 1737 was not as encompassing as could be. The definition of the goods and technology relevant to the nuclear sector could be broader; so too the scope of prohibition of technical assistance, training, financial assistance, and other services. The financial freezes do not cover as many individuals and organizations as proposed. Visas for travel by relevant Iranians could be banned. At one point, the United States proposed a total ban on Iranian students from studying nuclear physics in outside universities.

Second, even the sanctions imposed are not as tightly binding as they could be. The overall language about what is to be prohibited carries the qualifier “if the State determines that such items would contribute to enrichment-related, reprocessing or heavy-water related activities, or to the development of nuclear weapon delivery systems.” While a committee is established to administer the sanctions and an appendix to Resolution 1737 lays out some of the details, this language still

leaves significant discretion to states rather than establish through the UN a fuller definition of what is to be prohibited. Similar discretion still rests with individual states regarding nuclear-related training and education programs in which Iranian students and professionals participate (vigilance but not prohibition).

- Next stage sanctions thus could include broadening the scope of what is included, and tightening the binding nature and reducing state discretion.

Third is the problem of enforcement. Part of this is the inherent dual-use problem that while some materials, equipment and technology can be identified as proliferation-related with some precision, the dual-use nature of many of them makes even some good faith differentiations difficult. Then there is illicit trade. The A. Q. Khan network was extreme but not unique.

(2) OIL AND GAS SECTOR SANCTIONS

Among the sanctions options targeting the Iranian oil and gas sector:

- embargo equipment and technology for Iranian oil and gas exploration, production, refining, and transportation;
- ban on investment in Iran's energy sector;
- boycott purchases of Iranian oil; and
- embargo gasoline and other refined petroleum products exports to Iran.

Oil and natural gas are the heart of the Iranian economy, and thus central to strategies for both sanctions and incentives. Iran's oil reserves are the second largest in the Middle East (10 percent of the world total). Its natural gas reserves are the second largest in the world (16 percent of the world total). Based on 2004 data, oil and gas account for 22 percent of Iran's gross domestic product, 80 percent of its export revenues (\$33 billion), and more than half of its central government revenues.¹⁹ The 2005 world oil price boom boosted oil export revenues by \$15 billion; 2006 data show a further substantial boost for the first half of the year, but a 15 percent drop since then.

Oil exports are about 2.6 million barrels per day (m b/d), of about 4.5m b/d produced. About 47 percent of these exports goes to the Asia-Pacific region, with Japan the leading importer followed by China, South Korea, and Taiwan. Another 44 percent goes to Western Europe, with Italy and France as

the largest importers (the Netherlands also, although this is more the Rotterdam spot market).²⁰

According to the Economist Intelligence Unit, oil production targets in Iranian economic planning are 5.6m b/d by 2010 and 7m b/d by 2020.²¹ But these targets require much greater capital and much more advanced technology than Iran currently has and is likely to be able to provide and produce domestically. The International Energy Agency (IEA) estimates that the Iranian oil industry needs \$77 billion in investment in exploration, production, and enhanced oil recovery through 2030. Iranian oil fields have a much higher natural decline rate (8 percent annual average for onshore fields, 10 percent for offshore fields) compared to the rest of the Middle East and Africa. This combines with poor maintenance and outdated technology for a quite low 27 percent average oil recovery rate. These factors, along with the financial problems plaguing the National Iranian Oil Company (NIOC), lead the IEA to conclude that “Iran is unlikely to attain these production targets without significant inflows of foreign capital and technology.”²² Some see the problem as so stark as to forecast that without new investment Iran risks becoming a net importer of oil by 2010.

Recent reports of “public expressions of disquiet among those who fear that Iran is short of investment in the energy sector” have further indicated vulnerabilities in the Iranian oil sector:

In an unprecedentedly frank set of comments, Oil Minister Mr. Vaziri-Hamaneh said that the major challenge facing the oil and gas industry was lack of funds. His comments were particularly striking as they were made during the ceremony in June at which Ghorb [an Iranian company] was awarded the exploration contract for phases 15 and 16 of the South Pars field, which had previously been envisaged as requiring significant foreign investment. Concern has been raised outside of Iran that its energy sector is not investing sufficiently to increase or even maintain current production levels. In July Iran’s representative at OPEC, Hossein Kazempour-Ardebili, gave a frank interview to the state-run Islamic Republic News Agency in which he said that Iran was behind other countries in the level of its investment in the oil sector.²³

Substantial additional investments also are needed in oil refining capacity. Iran currently is a net importer of over 40 percent of its gasoline and other refined oil products. This is a political not just economic issue because of the substantial subsidies (estimated at \$2.5 billion) being sunk in to keep consumer prices down as low as 9 U.S. cents per liter. The planned increase in refinery output from 40 million liters per day (m l/d) to 92m l/d will require \$15 billion of investment over the next five years. Another option that Iran has been pursuing has been increased gasoline imports on favorable terms from Venezuela as part of the Ahmadinejad–Hugo Chavez quasi-alliance.

Another \$85 billion in investment is needed for the natural gas industry.²⁴ Iran currently is a net gas importer (2.3 billion cubic meters [bcm] in 2003). With such enormous reserves and growing demand in Europe, Iran's export potential is staggering. Gas also is needed for the domestic market to free up more oil for export. Yet the technology and financing for advanced production, for pipelines, and for other aspects are substantially lagging.

Sanctions targeted at the oil and gas sector thus would target Iran's significant vulnerabilities. On the other hand, this is precisely the sector in which European, Asian, and other countries' economic interests in trade and investment with Iran are the strongest. In the natural gas sector, for example, numerous contracts recently have been awarded to foreign companies, including a Chinese-led consortium and German, South Korean, French, Italian, Russian, Spanish, Norwegian, and Malaysian companies. Some, though, have been delayed and disrupted by the uncertainties of the nuclear crisis, as with the breakdown in September of negotiations for Japan's Inpex to invest \$2 billion to develop the huge Azadeghan oil field (26 billion barrels).

Boycotting Iranian oil exports would be the most politically difficult of all the oil and gas sanctions. With so many countries getting so much of their oil from Iran, the self-imposed costs would be far more substantial than acceptable under almost any circumstances. Moreover, even if alternative suppliers could be found, already high world oil prices would be driven even higher.

(3) FINANCIAL SANCTIONS

- Restrictions on lending by international financial institutions (IFIs), particularly the IMF and World Bank;

- freeze on all Iranian assets abroad;
- freeze on the foreign held assets of designated Iranian officials; and
- further restrictions and/or prohibitions on new financing by private sector financial institutions.

With regard to the first of these measures, the United States has pushed on a number of occasions to restrict IFI lending to Iran. This was one of the issues in the 1990s in which the United States had differences with Europe and Japan. The Clinton administration was able to block some World Bank loans but not others; for example, \$232 million for health and sewage projects was approved in 2000 over U.S. opposition. From April 2003 to May 2005, \$725 million in World Bank loans were approved for various Iranian social and developmental projects, as well as \$400 million for earthquake relief. With its voting share now down below 20 percent, the United States has less leverage within the IFIs than in decades past.

As to freezing additional assets not yet frozen, since the United States has long had such a freeze, any future freeze would pertain to Iranian assets held in other countries around the world. On the one hand, this could have a substantial financial impact. On the other, there are reports that Iranians have moved a considerable amount of their money out of foreign banks and into domestic institutions, beyond the reach of such sanctions.

The tightening of rules on new financing by private sector financial institutions is targeted at Iran's increased interest in commercial financing and lending. In July 2002, for the first time since the Islamic revolution, Iran tapped international capital markets, selling \$500 million in bonds to European banks.²⁵ With oil markets booming Iran has had obvious attractions for financing and investment. The Bush effort to leverage non-U.S. banks through fines and linkages to doing business with the United States, stepped up recently as noted above, goes back a number of years. In 2004, the U.S. Treasury Department fined UBS Warburg \$100 million for unauthorized movement of U.S. dollars to Iran and other sanctioned countries. In 2005, it imposed an \$80 million fine on the Dutch Bank ABN Amro for failing to fully report transactions with Iranian (and Libyan) banks. The actions against Bank Saderat last fall and Bank Sepah and others more recently do appear to be exerting further financial pressure. The pending questions are (a) whether the United States will continue to seek

to leverage non-U.S. financial institutions, and if so what the mix of compliance and resistance will be from banks as well as governments, and (b) whether such restrictions get included in any further UN Security Council sanctions.

(4) ELITE INTEREST SANCTIONS

- Freeze assets of Iranian officials and institutions;
- deny visas for high-ranking Iranian officials and their families;
- ban exports of luxury goods (cars, clothes, air conditioners); and
- mandated reductions in diplomatic exchanges.

These include some of the financial sanctions discussed in the previous category, but with more focused targeting on governmental and other elites. Some refer to these as “smart sanctions,” akin to “smart weapons,” in that they are more targeted and precise in their impact. The general logic is that collateral effects that hurt the people more than the regime can be reduced, and that the chances of multilateral support are greater.

The North Korean reaction to the sanctions against Macau's Banco Delta Asia SARM, which are said to have pinched Kim Jong Il's personal accounts, is seen by some as an example of the impact sanctions targeted at elite interests can have. Policy-makers need to be careful, though, how far to take this: it is questionable how much impact denial of air conditioners has on deeply held ideological beliefs and/or strategic calculations.

(5) GENERAL ECONOMIC SANCTIONS

- End support for Iran's application for membership in the World Trade Organization (WTO),
- ban international flights to/from Iran,
- general restrictions on foreign investment in Iran, and
- boycott traditional Iranian exports, such as caviar, pistachios, and carpets.

These are sanctions geared generally to pressuring the Iranian economy. Admission to the WTO could have broad economic benefits for Iran just as it has had for other countries. It also has political and symbolic significance as a form

of acceptance into such a key multilateral institution. International flight bans also would have both economic impact and political symbolic effect, broadly as well as targeted at Iranian elites. General restrictions on foreign investment are included here as a potential sanction, but given how sweeping such a restriction would be and how difficult to enforce, they are among the least likely.

(6) CONVENTIONAL ARMS AND TECHNOLOGY SANCTIONS

- Ban arms sales to Iran, and
- ban weapons related technology.

While Iran does produce some small arms and even missiles, its indigenuous military industrial complex is not yet able to produce most heavy arms at industrial levels. It imports most of its conventional military weapons, and much of its present weaponry is “worn or obsolete.”²⁶ Since Russia and China are the first and second largest arms exporters to Iran (respectively), they need to be on board if such sanctions are to be effective. They do not seem to be, as demonstrated in Russia’s recent major deal for anti-aircraft missile systems, defended by Putin as defensive systems and with statements that Russia would consider additional such requests.

ECONOMIC AND OTHER INCENTIVES

The point was stressed earlier that other sanctions cases show the importance of carrots as well as sticks. States need to know that there is not only a price for non-cooperation but also benefits for cooperation. The June 6 package proposed by the EU-3 and endorsed in Resolution 1737 follows these lines. The Russian proposal on enrichment and reprocessing, made last fall, also has important economic incentives.

Given existing U.S. sanctions, a number of incentives also could come directly from the United States. It could ease its comprehensive trade sanctions, even leading with oil and gas sector incentives such as licensing oil and gas technologies and dropping opposition to the routing through Iran of one of the central Asian pipelines. It could offer phased release of the \$17 billion in Iranian assets frozen in U.S. banks, perhaps even channeling the funds first

to private financial interests in Iran rather than to the government's central bank.

The most significant incentives are security ones. The EU-3 proposal includes support for a regional security forum for the Persian Gulf and for a WMD-free zone in the Middle East. The main issue is a security assurance from the United States that the goal is policy change not regime change. One of the crucial lessons of the Libya case that applies here as well is that policy change not only is more achievable than regime change but keeping regime change "on the table" is counterproductive to achieving policy change.²⁷

RUSSIA, CHINA, AND OTHER KEY ACTORS

While the United States and Europe have had some differences, since the shift in Bush policy last May, they generally have been able to manage their differences and forge a common policy. It is crucial that this continue. The main differences have been between the United States and the EU on one side and Russia and China on the other. Understanding options for sanctions on Iran therefore requires a closer look at the Russian and Chinese positions as well as those of other countries that could play major roles in Iran's future.

RUSSIA

Russian interests and motivations cut both ways. Three main considerations weigh against sanctions. First is the general Russian inclination to oppose sanctions, often taking the sanctions-are-not-diplomacy view, and reflecting having been the target of sanctions themselves (for example, Western sanctions after the U.S.S.R. invaded Afghanistan in 1980). Clearly, though, given Russia's own use of sanctions in its own disputes with such former Soviet states as Lithuania, Ukraine, and Georgia, and especially amidst its current *energypolitik*, this has to be seen as more utilitarian than consistent doctrine. Still, notwithstanding such inconsistency, the Russians do feel they have an argument to make that in the Iran case as a tactical matter sanctions would be counterproductive to diplomatic resolution.

Second are the economic interests Russia has at stake with Iran. The Bushehr light-water reactor deal is worth \$800 million, and Russia hopes to

sell more reactors. Overall Russian exports to Iran have more than doubled, from \$920 million in 2000 to \$2.08 billion in 2004. Numerous possible energy sector and other deals have been under active discussion. A new billion-dollar arms deal was signed in December 2005; a deal on an air defense system was reported in late 2006. The recent Russian arms deal for anti-aircraft missile systems, and openness to other such deals, already was noted.

Third is the strategic calculus of Russian regional and global geopolitical interests. Iran and Russia have had sufficiently shared regional interests to have cooperated over Tajikistan, against the Taliban in Afghanistan, with Armenia against Azerbaijan. As Shahram Chubin writes, “Moscow considers Iran an important stabilizing element in the region, not least because Tehran has not encouraged radical forms of Islam or fomented troubles in Russia’s south (for example, in Chechnya).”²⁸ Moreover, while not always articulated as such, Russia also often acts on the basis of a strategic interest in balancing against the United States. While Russian strategic interests would not be served by a crisis, they also are not necessarily served by a resolution that is seen as a major success for the United States. Added to this are more specific contentions with the United States, such as against the pointed criticisms of Russia that Vice President Cheney made during his visit last May to Lithuania and other former Soviet republics at the same time that the United States was looking for more Russian cooperation on Iran.

There also are considerations in favor of sanctions, the most fundamental of which are Russia’s own security interests for not wanting a nuclear armed Iran. “We are categorically opposed to the enlargement of the club of nuclear states,” Russian President Vladimir Putin has stated.²⁹ The risk that a nuclear Iran would further destabilize the already highly unstable Middle East and Persian Gulf region, whether directly and/or indirectly, and politically as well as through a proliferation domino effect, is a threat for Russia, not just the West. Another consideration is whether as sanctions play out they might play into Russia’s own broker-interlocutor role in a settlement, having both the West and Iran coming to it as the pressures and risks mount. Such a path is of course unpredictable and not without risks. But the scenario of Russia as broker is a plausible one, and one that could help Russia in its broader effort to regain greater geopolitical centrality.

Economically, the immediate costs of sanctions notwithstanding, there are potential longer-term costs if the non-imposition makes more likely a crisis that once again demonstrates the volatility of oil prices and supplies. Whatever the short-term economic benefits, if oil prices are pushed too high for too long, the long-term effects could make alternative energy more competitive. This would further complicate Russia's economic growth and development strategies, rooted as they are in oil and gas production and exports.

What is quite clear is that Russia is opposed to resorting to military force against Iran. Its recent anti-aircraft missile sales can be seen as Putin seeking to make that point even more strongly. The strategic logic the Bush administration has pursued in the past may lead it to seek to wield the threat of U.S. military action as if this would make Russia more likely to agree to further sanctions to head such a scenario off. That would be yet another major miscalculation. It is going to be difficult to get Russia to agree to a next tranche of sanctions. There are, though, reasons based on their own interests why this may be achievable—but through deft not heavy-handed diplomacy.

CHINA

China also has factors pointing both for and against sanctions. It has an even stronger general inclination to the sanctions-are-not-diplomacy view, with experiences such as 1989 Tiananmen Square in mind as well as prospective concern about precedents. It has not used sanctions for its own interests as much as the other major powers, its economic power being more newfound than that of Russia, Europe, or the United States, although there has been some exerting of economic pressures against countries with relations with Taiwan.

Economically oil relations are strong and growing stronger. About 13 percent of China's oil imports come from Iran, and China represents 11.4 percent of Iran's oil exports. This trade reportedly increased an average of 74,000 barrels per day in the first four months of 2006, at a time when by comparison Japan's oil imports from Iran were falling. China also has its own investment and joint-venture deals, such as the \$100 billion Sinopec deal for joint development of Yadavaran oil and natural gas and guaranteed supplies as agreed in a 2004 memorandum of understanding and which reportedly has continued to move ahead.

Recent reports have been of a \$16 billion agreement to develop the Northern Pars gas field and build liquefied natural gas facilities. This involves the China National Offshore Oil Corporation (CNOOC), the same company that had its effort to buy the American oil company Unocal rebuffed in 2005. While the Resolution 1737 sanctions do not directly apply, the Bush administration has been pressuring China not to proceed with this deal especially at this time. China's response has been to reaffirm its commitment to a negotiated solution while being noncommittal on energy trade, and raising linkage to sanctions recently imposed by the United States on two Chinese companies for alleged weapons trade with Iran and Syria.

China also is doing its own geopolitical balancing against and in competition with the United States. Its overall Middle East strategy has a strong "geopetrol" dimension to it. It has been cultivating more of a strategic relationship with Iran, including through the Shanghai Cooperation Organization (SCO), where Iran now has observer status. Moreover, as shown in a recent major poll, proliferation is just not as salient a concern for China. Whereas 69 percent in the United States called the possibility of unfriendly countries becoming nuclear powers a critical threat and ranked that second highest among thirteen possible threats, in China it was only 28 percent and a seventh of eleven ranking. On Iranian nuclear proliferation more specifically, 63 percent of Americans were very concerned and 24 percent somewhat concerned (87 percent total), but in China it was only 14 percent and 32 percent (46 percent). As for sanctions as a strategy, 41 percent of Americans approved but only 16 percent in China.³⁰

The major factor that could tilt China toward further support for sanctions if Iran does not comply is its overall "peaceful rise" grand strategy. This strategy stresses China's need for overall international stability and non-negative relations with the United States as context for national development as well as further emergence as a global power. Part of this emphasizes greater roles for multilateral institutions, by which there is an interest in preventing erosion of the IAEA's authority and the unraveling of the NPT. It is worth noting in this regard how, despite its energy and other economic interests in its relationship with Sudan, and notwithstanding its strict views on state sovereignty and non-intervention, China recently has been putting some pressure on the Sudanese government to take steps to end the genocide in Darfur, including allowing a United Nations peacekeeping force in.

JAPAN

Japan voted for Resolution 1696 and issued a statement stressing it “as demonstrating the determined stance of the international community . . . and as an important step in resolving the issue by diplomatic means.” It also voted for Resolution 1737, stating that Japan “appreciates the adoption of this resolution which demonstrates the resolute and concerted stance of the international community towards Iran on this issue. . . . Japan is strongly concerned about the current situation concerning Iran’s nuclear issue, and considers it necessary to address this issue in a resolute manner.”³¹ While Iran has been Japan’s third largest supplier of oil (14 percent of imports), Japan has been showing some willingness to exert its own economic pressure. In March 2006, Nippon Oil, Japan’s largest refiner, announced cuts of 15 percent in oil imports from Iran. More recently Japan reduced its stake in developing the Azadegan oil field—one of the world’s largest, with 26 billion barrels in estimated reserves—from 75 percent to 10 percent. The official Japan Bank for International Cooperation also recently suspended new loans for Iranian projects until the nuclear impasse is resolved.³²

INDIA

India is among the most important of the non-P-5 countries on this issue. Indian-Iranian economic relations have been increasing, particularly in the energy sector and including trade, investment, and joint ventures. India supplies about 15 percent of Iranian gasoline imports. Its state-owned Oil and Natural Gas Corporation is a partner in the Yadavaran deal for a 29 percent stake. Other major projects are under discussion and development including pipelines. Politically and strategically, India has the complexities of its longstanding status as a determined non-party to the NPT, now further complicated by its nuclear cooperation agreement with the United States, including the nonbinding but politically important stipulation attached by the U.S. Congress that India support U.S. policy on Iran. It is not yet clear whether such pressure will be effective or will boomerang within India’s strategic self-concept of foreign policy independence. India also has its own security reasons and interests for seeing Iran as “an important, largely dependable regional state.”³³

PERSIAN GULF COUNTRIES

Other Persian Gulf countries provide 25 percent of Iranian gasoline imports and thus would have an important role in any embargo on refined oil products. Most also are fellow OPEC members and have a corresponding combination of shared and competing interests. Their main importance in a sanctions regime actually would be in their willingness to cooperate with enforcement measures, both those that might be mandated by the UN Security Council and those under the U.S.-led Proliferation Security Initiative. Their broader importance is in the extent of their cooperation with any regional security measures, whether as continued efforts to deter Iranian proliferation or, if Iran does get nuclear weapons capacity, as part of the kind of containment strategy discussed by Barry Posen.³⁴ Two mid-January developments may have given Iran pause in this regard. One was the joint statement with Secretary of State Condoleezza Rice by the leaders of the major Sunni states—Saudi Arabia, Egypt, and Jordan—opposing Iranian acquisition of nuclear weapons and at least tacitly other Iranian efforts to extend its influence (although not strongly endorsing U.S. policy in Iraq). The other was the meeting between Ali Larijani and Saudi King Abdullah reportedly along the same lines, and including an unwillingness to cut OPEC production to raise prices and help the Iranian economy get the boost it needs.

SANCTIONS “COALITION OF THE WILLING”

If Iran does not comply with Resolution 1737 and the UN Security Council does not take significant next steps on further sanctions, some in the United States have been arguing for a sanctions “coalition of the willing” to do so. The impact the additional financial sanctions the United States has imposed is cited as basis for why such action could have its own economic impact.

This is a flawed argument. It is one thing for the United States to add on to UN sanctions with additional ones going further but do so consistent with the UN resolution. This is the case for the Bank Sepah and other financial sanctions. But to act in the face of a UN decision not to, or even a non-decision of the issue still being under debate, runs fundamentally counter to the critical role political credibility plays in the effectiveness of sanctions and the crucial importance of multilateral support for achieving that credibility. Economic impact also is much more likely when alternative trade and financial partners are reduced if

not eliminated. These are basic parameters, as noted earlier, for achieving sanctions success.

IRANIAN POLITICS AND ECONOMY

As noted earlier, a key factor in whether sanctions bring about policy change is how they play out politically and economically within the target state. Iranian politics are neither “static or monolithic,” as Gareth Smyth writes in his Century Foundation paper.³⁵ The lack of consensus among Iran experts on the dynamics within Iran is reflected in our earlier scenarios in which one version had sanctions strengthening the more extremist revolutionaries and another weakening them.

Analysts vary on how vulnerable the Iranian economy might be to sanctions. On the one hand, oil prices at \$70 a barrel obviously have helped Iran. Profits were up 300 percent, from \$15 billion to \$45 billion. This has helped finance domestic subsidies and other of the socioeconomic promises that actually were the keys to Ahmadinejad’s election. CIA estimates of Iranian foreign exchange and gold reserves are at \$40 billion, compared to \$25 billion in 2003 (with 60 percent of those reserves non-dollar).

On the other hand, the Iranian economy has significant weaknesses: double-digit inflation and unemployment, and jobless rates especially high among young males and with one million young Iranians coming into the job market every year; poverty estimates of 25 percent to 40 percent of the population; 25 percent to 30 percent interest rates. The Fourth Development Plan (2005–2010) calls for \$20 billion in new investment to meet job creation needs. The oil and gas sector has its huge technology and capital needs as already indicated. Falling world oil prices had left the Oil Stabilization Fund with less of an inflow and more of an outflow, and down 50 percent by some estimates. The overall Iranian private sector is saddled with a 20 percent decline in the stock market since Ahmadinejad became president. The recent rate of decline has been even steeper. In early January one Iranian newspaper reported that the number of traders was down 46 percent since Resolution 1737. Nor was the problem only a financial one; the Ahmadinejad regime’s mismanagement reportedly had the economic ministries “in a state of chaos.”³⁶ The December 2006 elections show

that the Ahmadinejad regime, elected largely on economic discontent and not nuclear programs, is already finding that as so many other populist regimes have that the fervor of its appeal wanes over time, absent tangible improvements in the quality of life.

A study by the Center for International and Strategic Studies posed the competing political analyses well. On the one hand is the view of Ahmadinejad as having substantial political strength: “The forces at the top of the Iranian government might have been able to restrain Ahmadinejad early in his term, but the president’s clear popularity and his populist bona fides now allow him to outmaneuver his original handlers and give him genuine job security.” On the other hand is a view of greater pragmatism underlying the rhetoric: “Were Iranian actions to result in unacceptable costs to the Iranian government, the Iranian leadership would either pressure Ahmadinejad to restrain himself on the international stage or else remove him from office. Iran’s foreign policy is not irrational at all; instead, it is guided by a keen and dynamic assessment of Iranian national interest.”³⁷

Various Iran experts and other analysts reinforce both assessments. Kenneth Pollack goes beyond the conservatives/reformers categories to distinguish within conservatives between revolutionary hardliners and pragmatic technocrats whose highest priority is the Iranian economy. Shahram Chubin sees the hardliners as “disproportionately powerful, vehement, and vocal,” while still seeing the possibility that “a decent compromise package, however, could be sold domestically.” Nicholas Kristof sees the Iranian regime as second only to Burma in home unpopularity. But so far it has been able to intensify repression, including shutting down newspapers, purging university faculties, and taking more political prisoners without much apparent resistance. Others describe the politics inside Iran in terms of those whose priority is Iran as the vanguard of the Islamist revolution and those whose priority is the strength and solvency of the Islamic Republic of Iran.³⁸

Developments since sanctions were imposed bear this mixed analysis out. While there was no expectation that these initial sanctions would turn the tide, many felt they would be manipulated to consolidate support in Iran for a harder line. But while defiant statements and actions have come largely as expected, we also have seen signs of concern about the economic impact and diplomatic ramifications of the country being subjected to such UN action as discussed

earlier. Thus, on balance it does seem that the domestic politics of the nuclear issue are not as much stacked in favor of nuclear weapons acquisition as some claim. It is true that the nuclear program goes back to the Shah, and that it does tap Iranian nationalism and Persian cultural pride. But it is not so high a priority across the board that support for it is unequivocal or at any price.

What likely would set off a rallying effect around both the regime and a nuclear weapons program is the use of military force. Even parts of the population not supportive of Ahmadinejad would either be pushed into support by an attack on their homeland, or would feel compelled to come over for fear of being accused of being anti-Iranian. This is another way in which the overhang of the military threat has a counterproductive effect on current diplomacy.

CONCLUSION

As noted at the outset, there is much more to the dynamics of the Iranian issue than just the sanctions debate. Indeed, the sanctions issue may be overtaken by increasing confrontation between the United States and Iran in Iraq. It may well be that there is no strategy—economic sanctions or other—that can stop Iran from developing nuclear weapons capacity. Doing so, though, still is the optimal objective. Sanctions are not the only key aspect of such a strategy, but they are one of the keys. Resolutions 1696 and 1737 were important steps that while limited on balance have contributed to the overall non-proliferation objective. But Resolution 1636 was temporal, needing the follow-on of Resolution 1737. So too for Resolution 1737: unless Iran complies with its terms by the February 21 deadline, the Security Council will need to expeditiously take next steps in imposing further sanctions.

Getting Russian and Chinese support for additional sanctions is difficult. Those who dismiss the possibility, though, also did so for Resolution 1737. While both Russia and China do have interests that run counter to additional sanctions, they also have interests that cut in the other direction. Gaining their cooperation will take concerted and deft diplomacy, not an easy task but an achievable one if the Bush administration is serious about a diplomatic solution. While there is some flexibility in which sanctions to impose next, serious consideration should be given to broadening and tightening the nuclear sector

sanctions, multilateralizing some of the U.S. and Western European sanctions on financing and lending, and initial sanctions on equipment, technology, and financing for the oil and gas sector. It is crucial that this be done through further Security Council action. The United States and Western Europe may choose to impose additional sanctions, but consistent with the general criteria for sanctions success, firm and concerted multilateral action is essential both to having substantial economic impact and carrying significant political credibility.

Tactical flexibility also is possible in the negotiations for suspension of sanctions as reciprocation if Iran suspends all enrichment-related and reprocessing activities, and revocation if Iran is in full compliance as determined by the IAEA. Economic and other incentives, particularly U.S. security reassurances disavowing regime change, need to be offered, and credibly so, to make clear the benefits of cooperation, not just the costs of non-cooperation.

Sanctions do carry risks, but having made the commitments that it has, the UN would put its own credibility at risk by not following through. One does not have to buy into the Bush administration's tone and tenor, and especially not its contrarian objectives, to acknowledge this point. UN-mandated sanctions have the potential to contribute to a successful multilateral strategy for a peaceful and cooperative resolution of the crisis that prevents Iran from developing nuclear weapons, demonstrates the efficacy of the UN, and strengthens the non-proliferation regime at a time when it sorely needs strengthening.

NOTES

1. Mark Fitzpatrick, "Assessing Iran's Nuclear Program," *Survival* 48:3 (October 2006); Shahrām Chubin, *Iran's Nuclear Ambitions* (Washington, D.C.: Carnegie Endowment for International Peace, 2006).
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