

Estimating the Effects of Comprehensive U.S. Sanctions on Iran

by [Patrick Clawson \(/experts/patrick-clawson\)](/experts/patrick-clawson)

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ABOUT THE AUTHORS



[Patrick Clawson \(/experts/patrick-clawson\)](/experts/patrick-clawson)

Patrick Clawson is Morningstar senior fellow and director of research at the Washington Institute for Near East Policy.



Brief Analysis

Secretary of Defense Perry's statements in Bahrain today highlighting the "potential threat" of Iran's deployment of "8,000 military personnel . . . anti-ship missiles, air-defense missiles and chemical weapons" on disputed Persian Gulf islands will renew debate over imposing comprehensive economic sanctions on Iran. A key element of that debate is the argument that sanctions would have no effect on Tehran but would impose a considerable burden on the United States. This claim is not accurate: unilateral U.S. sanctions would cost Iran money. Lost revenue could affect Iranian actions, and the forgone business would be no great loss to the U.S. economy.

How Sanctions Would Cost Iran Money . . .

Comprehensive U.S. sanctions on Iran would reduce Iran's foreign exchange receipts several ways:

- **Oil Trade.** Iran sells about one-fourth of its exported oil to U.S.-owned firms. In the event of sanctions, Iran would have to sell this oil to other oil companies. Iran would have no difficulty finding other buyers for the oil, but the loss of access to U.S. firms will have a price for Iran. U.S. firms are prepared to offer slightly better terms than firms from other countries, which is exactly the reason why Iran has been selling to the U.S. companies. When it can no longer sell to the U.S. firms, Iran will lose that extra margin. The exact size of its margin is unclear, but most probably less than \$50 million per year -- admittedly small relative to Iran's oil income (\$12-15 billion, depending on oil prices.)
- **Planned Oil Swaps Involving Iran and Former Soviet States.** The U.S.-led consortiums producing oil in Kazakhstan and Azerbaijan are planning to ship oil to Iran across the Caspian Sea. Iran would use that oil in its northern cities, especially Tehran, while increasing the export of Iranian oil from the Gulf. This swap arrangement, which could start in a matter of months, is supposed to be temporary. But nothing lasts as long as a temporary deal. Iran will earn several tens of millions of dollars a year in profits and cost-savings from this arrangement. These swaps have all the earmarkings of being another Conoco case -- the U.S. government signals the U.S. oil firms that the deal is permissible, but when the public announcement is made, the political reaction is such that the U.S. government has to feign shocked indignation.
- **Oil Field Renovation and Expansion.** Iran's oil fields are old; production will decline unless Iran develops more

difficult-to-reach offshore areas and/or uses sophisticated techniques to recover more oil from aging fields.

European oil technology is about as good as the United States, but Iran has found that U.S. firms offer good terms for oil equipment, as testified by Iran's desire to use Conoco over the French firm Total for developing the fields off Sirri Island. Now that President Clinton has ordered U.S. firms not to invest, European firms will step in, at a somewhat higher cost to Iran.

- Investor Confidence. Comprehensive U.S. sanctions will add to the impression that Iran is a politically risky place to do business. European investors and bankers are already hesitant about Iran because of its heavy indebtedness, and Iranian businessmen are worried about increasing government restrictions. It is possible that comprehensive U.S. sanctions would trigger a further run on Iranian currency, which has already lost a third of its value in the last three months.

In short, sanctions would cost Iran tens of millions, if not a hundred million or more dollars a year in export revenues and in capital invested in the country.

. . . And the Effect on the Islamic Republic's Behavior

Because comprehensive U.S. sanctions could reduce Iran's income by several tens of millions of dollars each year, the pressure on the Iranian budget, already under tight constraints, would be even greater. This could force Iran to decrease its military spending, given the difficulties of making adjustments elsewhere, e.g., on food supports and social welfare projects.

Indeed, one of the unsung accomplishments of the current U.S. policy towards Iran is its success in forcing Iran to curtail its ambitious 1989 plan for acquiring a large-scale modern military. Iran planned to buy \$10 billion in arms in 1989-1993, primarily from the Soviet Union. The arms purchases had to be cut in half when Iran was locked out of world capital markets, thanks to both its own incompetent economic practices and to U.S. pressure not to make politically-motivated loans to Iran. The difference in military potential is highly significant. Today Iran is a threat in certain areas, mostly terrorism and weapons of mass destruction. Had Iran carried out its 1989 plan, its conventional forces would pose an even more urgent and worrisome threat than they currently do.

The impact of comprehensive U.S. sanctions should not be oversold, however. While they may reduce Iranian military spending some, there is no prospect that the Islamic Republic would fall because of sanctions. The fate of the Islamic Republic will be decided largely by internal factors, over which the U.S. has little or no influence.

Iran's Shrinking Economic Relevance

Some argue that the U.S. should woo Iran because it is the strategic prize in the Persian Gulf region. As far as economics are concerned, this view is outdated: Iran is no longer a country with great economic significance.

Iran is not an oil superpower. Iran produces less oil today than it did in 1970. While production has soared in other parts of the world, it has steadily declined in Iran. In 1970, Iran produced almost 9 percent of the world's oil; today, it produces only about 5 percent. Moreover, it has to invest several billion dollars a year just to maintain its present output.

Iran is not a lucrative market. Iran's imports in 1994 were little more than \$12 billion, which was less than it imported in 1977. Iran's imports in 1994 were less than one-half of one percent of world imports, whereas in 1977, its imports were 1.5 percent of the world total. The simple fact is that Iran's economic importance faded along with its oil wealth.

No one action by itself will bring about the change Washington wishes to see in Iran and in Iranian behavior. But the best chances of success, especially over the long term, come from a firm stance in defense of U.S. principles. The bitter lesson of the last 15 years, learned from experiences like the Iran-Contra affair, is that the United States

cannot expect moderation in Iranian foreign policy if it extends a hand of friendship.

Patrick Clawson is a senior fellow at the Institute for National Strategic Studies of the National Defense University and an adjunct scholar at The Washington Institute. His publications include *Iran's Strategic Intentions and Capabilities* (NDU Press, 1994) and *Iran's Challenge to the West* (The Washington Institute, 1993). The views expressed here are purely his own. ❖

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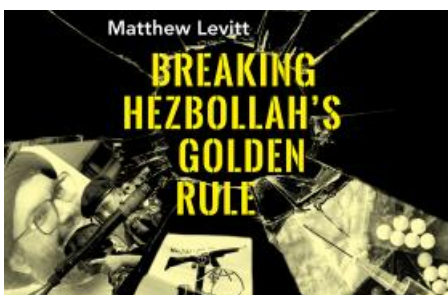
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