Smart Sanctions Can Work against Iran

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Articles & Testimony

After a fraudulent election and its brutal aftermath, Iranian Supreme Leader Ali Khamenei and his junta must now be persuaded that their pursuit of nuclear weapons will be unbearably costly.

The Obama administration appears poised to implement what Secretary of State Hillary Clinton has called "crippling sanctions" if Iran fails to come to the negotiating table. Sens. Evan Bayh, Joe Lieberman and Jon Kyl, and Howard Berman in the House, have developed sanctions legislation targeting Iran's economic Achilles' heel -- the regime's dependence on foreign gasoline imports for up to 40% of its domestic needs. The bill would provide the president with the authority to sanction foreign companies involved in selling refined petroleum to Iran, including insurance and reinsurance companies. With the administration's approval, it would be quickly passed and signed into law.

Existing Treasury Department efforts to persuade financial institutions to stop their Iranian business offer the model. Treasury leverages what bankers, insurers and energy traders all understand -- the price of risk.

Treasury relies on "smart sanctions" that focus on actors engaged in dangerous or illicit activity that violates international law norms. Since 2006, it has designated more than 40 Iranian entities involved in supporting the regime's WMD-related and terrorist activities, including state-owned banks.

The foreign financial institutions that terminated or reduced their business with Iran over the past three years were not legally bound to comply with U.S. sanctions. But after Treasury revealed Iran's extensive use of deceptive financial practices and front companies, foreign bankers complied. The benefits of their Iranian business were outweighed by the costs of being linked to bad actors, as well as the real risk of losing access to U.S. financial markets.

Financial institutions witnessed what happened to ABN Amro -- the Dutch bank fined $80 million by the U.S. in 2005 for having an inadequate compliance program with respect to the U.S.'s Iranian and Libyan sanctions under the Bank Secrecy Act.

The same approach can be used with Iran's refined petroleum suppliers. The Swiss-Dutch energy giants Vitol and Trafigura, the Dutch multinational Shell, the Indian multinational Reliance Industries, the Swiss trader Glencore and the French energy powerhouse Total can, with the right amount of diplomatic muscle, be persuaded that it's not in their best interests to continue their refined petroleum exports to Iran.

The British, German, Norwegian and Japanese insurance and reinsurance companies that underwrite the gasoline shipments to Iran are also prudent and, given the nature of their business, understand the management of risk better than most.

The real challenge is understanding who are the real beneficiaries in the opaque Iranian energy industry. The links between Iran's Islamic Revolutionary Guards Corps (IRGC), blacklisted by the U.S. in 2007, and the Iranian oil and gas sectors are well documented.

More specifically, there's long been a close relationship between the National Iranian Oil Company and the IRGC, particularly its main construction arm, Khatam ol Anbia (Ghorb). In 2006, for example, Ghorb received more than $7 billion in contracts and has built numerous oil and gas pipelines.

Given the strategic importance of gasoline to the Iranian economy and military, and the opportunity for lucrative profits from a gasoline trade estimated at $6 billion to $9 billion annually, IRGC entities are likely involved either directly in this gasoline trade or through affiliated Iranian entities.

For these companies, recent developments in Washington do not augur well. The sanctions legislation in Congress has overwhelming bipartisan support and policy makers are preparing for a busy autumn in the hope of forestalling a possible Iranian nuclear winter.

If the legislation is passed, it's anyone's guess who could be the first energy trader or insurance company sanctioned. Regardless, none of the refined petroleum players should want to be the next ABN Amro, facing damaging revelations and perhaps worse for trading with designated entities.

The world's bankers understood that the risk of trading with Iranian designated entities is not one worth taking. Iran's refined petroleum suppliers and insurers should draw the same conclusion.

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