

Putting the Squeeze on Iran

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Articles & Testimony

US-Iranian relations are once again headline news after dropping off the radar for several months in the wake of the US National Intelligence Estimate in December 2007. In recent days, media and public attention has focused on the growing US diplomatic overtures to Tehran, as well as the reports about a possible military attack on Iran that continue to circulate.

With all of the focus on the diplomatic and military fronts, there has been little attention paid lately to the middle ground between the two: the US financial campaign against Iran. Financial pressure may be the most important tool the US has in its arsenal to persuade Iran to abandon all of its nuclear ambitions. While the US approach has been successful in raising the financial costs for Tehran of its nuclear ambitions, the regime shows no signs yet of changing course. To succeed in this effort, the pressure will have to be ramped up significantly, making the choice for Iran far more stark than it is today.

One problem with the current US effort to squeeze Iran is that it has largely been limited to one industry -- the financial sector. On this front, the US Treasury has taken the lead and has been quite successful. Over the past two years, the Treasury has made the case to global financial institutions that doing business with Iran is risky business, explaining how Iran is abusing the international financial system by using front companies and deceptive financial practices designed to mask their activities.

Major international financial institutions have been responsive to the Treasury pitch. When confronted with this information, global financial institutions -- particularly those based in Europe -- have taken action, either terminating or reducing their business with Iran. More surprisingly, in recent months, it appears that banks in the United Arab Emirates and China are also beginning to exercise greater caution in their business dealings with Iran.

While these foreign banks are not legally bound to comply with the broad US sanctions against Iran, many have heeded the Treasury warnings for several reasons. First, banks are focused on maintaining stellar reputations, and avoiding the type of specific risk outlined by the Treasury makes sense from a business perspective. Second, since the US is the world's leading financial centre, these banks are not willing to risk losing access to the US market for the sake of maintaining business ties to designated terrorists or WMD proliferators. Financial institutions are particularly eager to avoid being the "next ABN Amro" -- the Dutch bank fined \$80m by the US in 2005 for having an inadequate programme in place to ensure compliance with the US sanctions against Iran and Libya. The Financial Times noted that the fine sent "seismic waves through the international banking system," and the "reverberations are still being felt today."

These US-led efforts have certainly had an impact on Iran, even in spite of booming oil prices (though Mahmoud Ahmadinejad's economic mismanagement has also contributed to domestic problems). Inflation has risen to 25%, and Iranian businesses are carrying cash to pay for transactions, due to difficulty opening foreign currency accounts with non-Iranian banks. Iranian importers are now having to pay in advance for commodities and are no longer able to receive revolving lines of credit, and their costs are up 20-30%. The Iranian banking community has been hit particularly hard by the sanctions and US pressure. Bank Sepah is on the brink of collapse and other Iranian banks

are struggling as well. Bank Saderat has seen its corresponding banking relationships -- which are essential for a bank to operate effectively internationally -- fall from 29 in August 2006 to eight by early 2008.

The US pressure on financial institutions has also scared off many foreign investors. In December 2006, then oil minister Kazem Vaziri Hamaneh confirmed that the industry was having difficulty financing its development projects, since "overseas banks and financiers have decreased their cooperation." As a result, Iran's oil production is falling and likely to decrease further without significant foreign investment. This could be a potentially devastating trend for Iran, as some experts believe that without major foreign investment in Iran's aging oil fields, the country's oil exports could eventually disappear. Iran's deputy oil minister expressed the government's concern, stating that "there will not be any oil for export" within 10 years if the situation did not change.

Unfortunately, the US has not applied the same type of pressure to other sectors. For the US to succeed in changing the decision-making calculus in Tehran, it must greatly broaden the financial squeeze. While banks are now being far more cautious in scrutinising their Iran-related transactions, the same is not necessarily true for other businesses. As a result, Iran has been able to find ways to circumvent the current sanctions, and, most troublingly, continues to have access to sensitive technology and embargoed US and European products. One of the primary ways that Iran has been able to do this is through re-exports -- having products sent to destinations with loose export control restrictions and then shipped from there to Iran.

The United Arab Emirates remains the main re-export capital for Iran because of its free-wheeling business environment and the countries' long-standing economic ties. Thousands of Iranian businesses are located there and are engaged in this type of trade. To give a sense of the scale of this business, the Dubai Deputy Chamber of Commerce and Industry estimated that in 2006 re-exports constituted 60% of the trade between the two countries.

The deputy president of the Iranian business council in Dubai bluntly assessed the sanctions' limitations, saying that they have "virtually had no effect, to be honest. If someone wants to move something -- get it to Iran -- it is easy to be done."

To crack down on this type of trade and further tighten the economic noose against Iran will require the US government to target a number of key industries involved in facilitating international trade, including shippers, distributors, freight forwarders and importers-exporters. The US should press these businesses to scale back or at least more closely monitor possible Iran-related transactions. While these industries are certainly very different than banking, the US should nonetheless use the Treasury model as a guide for how to proceed. As a first step, the US needs to conduct a comprehensive analysis of how Iran is abusing these trade-related industries and the extent to which they are using deceptive practices to circumvent the sanctions. As Stuart Levey, under secretary of treasury for terrorism and financial intelligence, noted: "Iran's nuclear and missile firms hide behind an array of agents that transact business on their behalf."

Particularly important are cases where Iran managed to disguise the fact that the material was intended for its nuclear or ballistic missile programmes, or that entities such as Iran's Islamic Revolutionary Guards were involved.

The US should then conduct outreach to the major players engaged in facilitating trade with Iran and give industry-specific briefings, outlining Iran's reckless behaviour. It will be far more difficult for the companies to do business as usual and to plead ignorance after being on the receiving end of such a briefing. The US should also make clear, as they have with the banking sector, that companies which fail to heed these warnings could be the subject of tough enforcement actions.

Focusing these briefings on Iran's specific illicit conduct is important for another reason. In the past, the US has had little success in persuading others to adopt broad sanctions against Iran, as many countries viewed these punitive measures as politically driven. The difference this time around, according to Treasury undersecretary Levey, is that

the US has tried to make clear that that the issue is not political, but rather about "conduct that's contrary to international law or international standards and norms."

Finding ways to end Iran's nuclear drive is clearly a top priority for the US and for many of its allies. While success is far from guaranteed, an approach that incorporates aggressive economic pressure remains the most likely path to success. For this approach to work, however, the pressure must be considerably stepped up. Putting additional industries on notice that doing business as usual with Iran is no longer possible would be a good step forward.

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