Pulling Tehran's Purse Stings

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Articles & Testimony

Introduction

This week European and U.S. leaders met for a one-day EU-US summit in Washington. While disagreements remain between these key allies in several areas, particularly climate control, the parties highlighted their coordinated efforts to press Iran to suspend its uranium enrichment program as a sign of strong ties. The most promising aspect of this coordinated strategy to deal with Iran is a multilateral, graduated and targeted sanctions' regime that is already showing signs of success. For it to be fully successful, however, international consensus on the next round of sanctions -- due May 23 -- must be stronger still; the sanctions must have sharper teeth; and they must be accompanied by outreach to the private sector.

Iran's recent seizure of British navy highlighted the international community's need to identify means of dealing with an increasingly confrontational Iran. It also revealed the limited nature of the military and diplomatic options available to contain Iran. But putting the financial squeeze on the regime in Tehran feeds on existing domestic discontent within Iran and could induce Iran to abandon such objectionable and threatening activities as seizing foreign troops operating along its border with Iraq, sponsoring terrorism, and producing weapons of mass destruction and the missiles to deploy them.

While maintaining both military and diplomatic options -- with the former as a measure of last resort and the latter as the preferred tool of choice -- the international community should apply carefully considered, calibrated and targeted financial measures against Iran, to include not only graduated sanctions but also efforts to leverage existing market forces. Together, these targeted financial measures -- focused on expressly illicit conduct -- offer the most flexible, regime-hostile-people-friendly, and realistic tool available. Employing these in a graduated manner demonstrates that the purpose of such measures is not simply to punish Iran but to encourage a change in the regime's behavior.

Existing Sanctions and Ways to Expand Them

On March 24 the UN Security Council unanimously approved new sanctions against Iran for refusing to suspend its nuclear program. These sanctions target a number of organizations, including a major Iranian bank and elements of the Islamic Revolutionary Guard Corps (IRGC) and its subsidiary, the militant Qods Force. Sanctions such as these can be extremely effective, marshaling international consensus to pressure Tehran. Iran was clearly shocked that Russia and China supported UN sanctions. But graduated sanctions are only as credible as they are consistent: Tehran's refusal to alter its behavior related to its nuclear program must result in another round of graduated and targeted sanctions. New sanctions should include binding travels bans (current resolutions merely call for "vigilance" when listed people travel) and sanctions against IRGC companies and the Iranian banks that facilitate financial transfers for the regime's illicit activities.

Meanwhile, a parallel effort, aimed at leveraging market forces to impact Iranian behavior, is equally important and effective. While in the business of making a profit, foreign financial institutions and private industry have a responsibility to their shareholders to balance profit margin and risk and a strong self-interest in avoiding reputational risk.

Global security aside, avoiding business with Iran is smart business because it represents a heightened investment risk. Iran engages in a variety of deceptive financial practices to deliberately conceal the nature of its illicit business. Iran's Bank Sepah, for example, requested that other financial institutions remove its name from transactions when processing these transactions in the international financial system. And according to the State Department, "there are currently no meaningful anti-money laundering controls on the Iranian banking system." Moreover, according to the report, Iran claims to have established a financial intelligence unit but there is no evidence it exists. Investors in Iran have no reason for confidence that their investments are not used to support terrorism or proliferation activities. It should therefore not surprise that the OECD raised the risk rating for Iran in early 2006.

Financial institutions are eager to maintain branches in New York City, which provides the U.S. Treasury Department significant leverage over their activities worldwide. The Treasury bears the responsibility of protecting the U.S. financial system from abuse, and is therefore very concerned when financial institutions and corporations continue to engage in business with Iran even after they are made aware of the regime's deceptive financial practices and other risky behavior. U.S. officials have therefore met with much success discussing global risk and appropriate due diligence with governments and the private sector alike. This strategy shows early signs of success. Banks like UBS, HSBC, Standard Chartered, Commerzbank and others have decided to cut or curtail dealings with Iran.

In the event banks and corporations do not determine that the investment, reputational and litigation risks outweigh the potential profit of investing in Iran, the fact that these institutions want to conduct business in the United States often leads them to conclude that putting their U.S. business at risk is not worth the investment in Iran. Sharply focused on its responsibility to protect the U.S. financial system from abuse, Treasury Undersecretary Stuart Levey recently warned, "Those who are tempted to deal with targeted high risk actors are put on notice. If they continue this relationship, they may be next."

The Sanctions' Real Impact

Already there are signs of domestic discontent within Iran, and targeted financial measures could produce further political pressure within Iran. According to the Economist Intelligence Unit, the nuclear crisis "is imposing a heavy opportunity cost on Iran's economic development, slowing down investment in the oil, gas and petrochemical sectors, as well as in critical infrastructure projects, including electricity." This assessment stands in stark contrast to the findings of a 2003 World Bank report on Iran, which noted the "daunting unemployment challenge" facing Iran and concluded: "Unless the country moves quickly to a faster path of growth with employment, discontent and disenchantment could threaten its economic, social and political system."

Targeted financial measures give teeth to that threat and put a high cost to Iran's continued belligerency. Pulling Tehran's purse strings, in tandem with diplomatic and military overtures, may well lead to a change in the decision-making calculus of the regime in Tehran.

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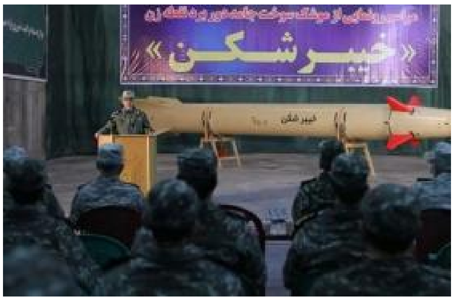

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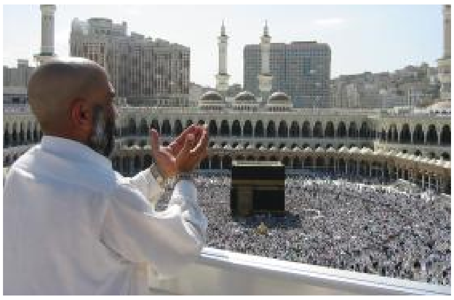

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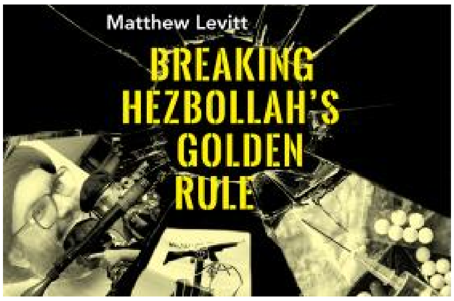

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