Economic Sanctions, Oil, and Iran

Statement by

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Before the Joint Economic Committee
United States Congress
Hearing on "Energy and the Iranian Economy"
July 25, 2006

Iran has long been an important player in world oil markets. Today, it is the second largest producer and exporter of oil among the members of the Organization of Petroleum Exporting Countries (OPEC). Iran exports about 60 percent of its annual oil production of about 4 million barrels of per day.

Iran has been a major beneficiary of recent developments in world oil markets. World oil prices have soared in response to (1) rapid growth in global demand, fed by voracious new users in China and India; (2) declining oil production in the OECD area; and (3) security concerns in important producing areas such as Iraq and Nigeria. While oil production has surged in Russia and increased moderately in Saudi Arabia, the increased volumes have not been enough to forestall a sharp tightening of global supply/demand balances that have propelled a massive increase in world oil prices.

Over the past decade, the volume of Iran's annual oil exports has averaged almost 2.5 million barrels per day. Over this period, the prices of Iran's light and heavy crudes have increased almost four-fold from about $16 per barrel in 1995 to the current level of more than $60 per barrel. As a result, the value of Iran's oil exports has grown from about $15 billion in 1995 to more than $46 billion in 2005 (see table 1).

Iran now pockets an extra $30 billion of oil export revenues compared to a decade ago. Oil profits fuel the Iranian economy; they also finance Iranian investment in weapons development and support for terrorism. What is good news for the ayatollahs is not so good for the United States. We are paying a high price for these developments and not just at the pump. Petrodollars make Iran more capable of pursuing its nuclear ambitions and funding Hezbollah and other terrorist organizations, and more immune to US economic coercion.

US policy has tried to blunt Iranian adventurism for several decades through international diplomacy and economic sanctions. International cooperation with US initiatives have been modest, and extensive US unilateral sanctions against Iran—

codified in the Iran and Libya Sanctions Act of 1996—have not achieved their difficult goals. Despite this checkered past, some US political leaders are now calling for broader economic and/or military responses to the ongoing Iranian nuclear program and support for Hezbollah. In formulating the appropriate US response to these outrages, the Congress should reflect on our past sanctions experience as well as the new diplomatic and economic conditions that will constrain the effectiveness of new US and multilateral measures.

US Economic Sanctions against Iran: Experience to Date[1]

The United States first imposed economic sanctions against Iran in response to the hostage crisis of 1979-1981. The comprehensive trade and financial sanctions eventually provided a crucial negotiating chip to win the release of the American hostages on the day of President Reagan's inauguration.

A few years later, Iran was implicated in the terrorist bombing of a Marine Corps barracks in Lebanon. Iran was added to the US list of countries that support terrorism. In incremental steps, the United States imposed new restrictions on US trade with Iran targeted primarily at limiting development of the Iranian oil industry and thus its capability to fund terrorist groups. Subsequently, concerns about Iran's nuclear power programs prompted additional US sanctions to impair the military potential of Iran, particularly regarding the development of chemical, biological, and nuclear weapons. The Iran and Libya Sanctions Act (ILSA) of 1996 supplemented these measures with additional restrictions on foreign companies that undertake new oilfield investments in Iran.

Overall, sanctions have not prompted Iran to renounce the use of terrorism or the acquisition of nuclear weapons. While other industrialized countries also implemented narrowly targeted trade sanctions designed to limit Iran's access to products and technologies that could support the production and delivery of nuclear, chemical, and biological weapons, they continued to trade extensively and invest in Iran. Meanwhile, other countries supplied Iran with arms and nuclear equipment and technologies.

The ILSA sanctions did lead some companies to defer bidding on new contracts to develop Iranian oil and gas properties. US sanctions deserve some of the credit, but most of Iran's problems in attracting new investment were caused by self-inflicted wounds created by its own domestic policies. Despite these problems, Iranian oil production has grown modestly over the past decade since ILSA was enacted.

The appendix to this statement provides a chronology of the key events in the decades-long sanctions effort. It sets out a troubling story that brings to mind Yogi Berra's insightful commentary: "it's déjà vu, all over again". The same problems confronting US policy two decades ago now again dominate the headlines: funding

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[1] This section draws heavily on the Iran case study from the forthcoming 3rd edition of *Economic Sanctions Reconsidered,* by Gary Hufbauer, Jeffrey Schott, Kimberly Elliott, and Barbara Oegg (Washington: Institute for International Economics, forthcoming 2007).

terrorists in Lebanon, testing North Korean missiles, and Iran's pursuit of nuclear weapons. Economic sanctions have not blunted Iran's foreign adventurism, though they undoubtedly have inhibited the task and made it more costly to pursue.

Economic Sanctions against Iran: Next Steps

The Congress is now considering extension or expansion of the ILSA sanctions against Iran. Drawing counsel from the IIE study on sanctions, based on 25 years of research and the authors' personal experience in formulating US sanctions policies in the late 1970s and early 1980s, I believe the current law should be renewed as is. But members of Congress should make a realistic assessment of the benefits that can be obtained through the deployment of sanctions.

Can sanctions stop Iran from eventually developing a nuclear weapon? Probably not. Iranian leaders have been developing this capacity for more than two decades—despite diplomatic entreaties, limited economic sanctions, and the threat of military strikes. They believe that nuclear weapons will bring them regional dominance and that—just like India and Pakistan--the West will grudgingly accept their accession to the nuclear club without significant retribution.

Nonetheless, history shows that targeted sanctions can push back the day of reckoning. Since the Nuclear Non-Proliferation Treaty entered into force in 1970, four countries have acquired nuclear weapons: Israel, India, Pakistan, and North Korea. The latter three were subject to significant US sanctions and some multilateral measures. Economic sanctions did not prevent proliferation but collective denial by Western powers of key ingredients of the bomb maker's art—reprocessing technology, centrifuges, tubing, metallurgy, timers—substantially slowed the process.

Sanctions will not prevent a determined and well financed country from eventually crossing the nuclear threshold. Even the tightest sanctions regime can be evaded with sufficient incentive. Witness the billions of dollars of goods smuggled into Iraq during Saddam Hussein's reign. Land borders are porous, especially in the Middle East, and sea and air freight are difficult to monitor effectively without intense military operations. With Iran's petrodollar bonanza, it will be able over time to procure the necessary material and technology to achieve its nuclear ambitions.

To be sure, comprehensive economic sanctions against Iraq, which were generally respected by the major powers including China and Russia, arguably contributed to thwarting Saddam Hussein's nuclear program. Since those measures coincided with low oil prices, little economic pain was felt in the world at large, even though Iraqi oil shipments were sharply curtailed. This fact was crucial to global cooperation in enforcing UN sanctions for more than a decade.

Broad economic sanctions, comparable to the isolation of Iraq in the 1990s, are no longer feasible. Unlike the cheap oil of the 1990s, oil prices today are at or near record levels. Given tight global supplies, Iran has greater leverage to counter sanction major oil consuming nations by cutting back its oil exports. Few producing nations have the spare capacity to increase shipments to offset potential Iranian cutbacks, so prices would likely rise sharply. Iran would sell less…and earn more.

For that reason, it's hard to find politicians who would support a comprehensive sanctions strategy. Many Americans would question harsh measures that might push oil above $100 per barrel and trigger a world recession. Europe, China, and Japan have similar concerns and would only endorse sanctions that are paced and mild, not sudden and harsh. Russia will be even more ambivalent, for two reasons: it has gained a lot from the oil price spikes generated by Mid East tensions since its oil production has increased by almost 50 percent since 2000 to 9.5 million barrels per day; and it wants to continue to cultivate Tehran as its best foothold in the Middle East.

So what should we do? The most immediate and obvious task is continued denial of critical components (e.g., cascade centrifuges) for Iran's nuclear industry. The policy already receives support from the major powers but additional efforts should be made to ensure that second tier powers undertake and enforce these restrictions as well. Other targeted sanctions against Iran's ruling class should also be considered, including travel restrictions and overseas asset freezes. These measures will have minimal impact on Iran's financial ability to finance terrorism or build a nuclear bomb. Rather the strategy of limited sanctions, accompanied by coordinated diplomacy, is to let time mellow Tehran's nuclear intentions. This is a less than satisfying result but effectively what we can achieve, given current conditions in world energy markets.

Table 1. Iran: Petroleum production, exports and revenues, 1995-2005

	Production[a] (1000 barrels / day)	**Crude oil exports**[b] (1000 barrels / day)	**Value of petroleum exports**[b] (millions of dollars)	**Iran light crude**[b] (spot price per barrel, $)	**Iran heavy crude** (spot price per bar $)
1995	3,744	2,621	14,973	16.17	16.26
1996	3,759	2,630	19,441	19.03	18.49
1997	3,776	2,587	15,553	18.24	18
1998	3,855	2,512	10,048	11.97	11.45
1999	3,603	2,291	16,098	17.25	16.93
2000	3,818	2,492	25,443	26.75	26.02
2001	3,730	2,185	21,420	22.9	21.67
2002	3,414	2,094	19,219	23.52	23.09
2003	3,999	2,396	26,124	26.89	26.33
2004	4,081	2,684	34,289	34.6	33.06
2005	4,049	2,700[c]	46,600[c]	50.66[c]	48.32[c]

a. Source: BP Statistical Review of World Energy 2006

b. Source: OPEC, Annual Statistical Bulletin (2004)

c. Source: Energy Information Administration, Department of Energy; price data as of December 30, 2005.

APPENDIX. US Sanctions against Iran: Chronology of Key Events, 1984-2006

23 January 1984	Alleging Iranian involvement in Marine base bombing in Lebanon, US State Department adds Iran to list of nations supporting terrorism, and thus subject to stringent export controls.
26 October 1987	President Reagan invokes section 505 of the International Security and Development Cooperation Act of 1985 and embargoes *all* imports from Iran, prohibits export of 14 types of potentially militarily useful goods, including inboard and outboard motors, mobile communications equipment, electrical generators, hydrofoil vessels.
15 March 1995	President Clinton issues executive order barring US citizens and companies from financing, supervising and managing oil development projects in Iran—blocking Conoco's pending $1 billion investment in Iranian offshore oil project.
30 April 1995	Citing proliferation and terrorist concerns, the White House announces it will ban, effective 8 June 1995, all direct US trade with Iran, as well as an estimated $4 billion in indirect trade, mainly by American companies selling Iranian oil in third countries. French, German and British officials call sanctions the wrong approach and announce they will continue their policy of "critical dialogue" with the Iranian regime. Oil analysts estimate that Iran will have no trouble finding buyers for its exports to replace American companies.
7 March 1996	US and Israeli intelligence sources allege Iranian involvement in a recent wave of terrorist attacks in Israel.
2 May 1996	US military officials charge Iran has acquired Nodong II missiles from North Korea and is building underground bunkers to deploy them.
23 July 1996	The House passes Senate version of the Iran and Libya Sanctions Act (ILSA), which penalizes companies investing over $40 million in one year in Iran's oil and gas sector; after one year, the annual investment limit triggering sanctions drops to $20 million. Potential sanctions include two or more of the following: (1) denial of credits from the US Export-Import Bank; (2) denial of export licenses for controlled goods or technology; (3) prohibition of loans of more than $10 million from US financial institutions for a 12-month period; (4) prohibition of foreign financial institutions from dealing in US government debt or US government funds; (5) prohibition against participation in any US government

	procurement project; (6) import restrictions. Sanctions are required to be in effect for up to two years, and in "no case" can they be applied for less than one year. The President may waive all or part of the sanctions against a foreign company if doing so is deemed to be in the national interest. Bill sunsets five years after enactment unless Congress votes to extend.
19 August 1997	President Clinton issues an executive order that explicitly prohibits re-exports of US goods, technology and services to Iran.
21 February 1998	Despite US objections, Russia decides to expand role in building nuclear power plant in Iran.
22 July 1998	Iran tests a missile with an 800-mile range, capable of reaching Israel. American officials say the "Shahab 3" missile came from North Korea.
25 November 1998	Russia signs an $800 million deal to finish building the Bushehr nuclear power plant in Iran; announces it may bid on three more nuclear reactors for $3 billion. Russia assures US that agreement concerns peaceful nuclear cooperation only.
23 February 1999	US imposes import sanctions on 10 Russian entities for giving assistance to Iranian nuclear and missile programs.
28 April 1999	President Clinton announces that the US will exempt exports of food and medicine from future sanctions imposed by the executive branch. The new rules also apply to food and medicine sales to Iran, Libya, and Sudan, which will be permitted on a case-by-case basis. Specific licensing rules will be drawn up for each country and there will be no US government, funding, financing or guarantees for the sales.
Early Dec. 1999	US officials say that intelligence reports suggest that Iran has recently increased aid to terrorist groups opposing the Middle East peace process.
15 March 2000	President Clinton signs the Iran Nonproliferation Act of 2000 into law. Act requires the president to send report to Congress identifying countries and entities assisting Iran with its weapons programs and gives the president the authority to impose sanctions on these countries but does not make sanctions mandatory. The Act also bars the US from making "extraordinary" payments to the Russian Space Agency to build the International Space Station or any other organization of the Russian government until the president determines that Russia is actively opposing proliferation

	in Iran. The president may waive sanctions for national security reasons.
17 March 2000	Secretary of State Albright announces that US will lift ban on Iranian non-oil exports such as carpets, caviar, pistachios and dried fruit, and states that US will increase efforts to reach a settlement to all legal and financial claims between the two countries and to reduce barrier to cultural exchanges. US sanctions barring American investment in Iran's oil sector, however, remain in place.
14 April 2000	US government determines that five entities in North Korea and Iran have engaged in missile technology proliferation activities that require imposition of sanctions under the Arms Export Control Act. Sanctions are largely symbolic.
27 July 2001	Congress renews ILSA for another five years, despite opposition from the US business community and the Bush administration. The "ILSA Extension Act of 2001" requires the president to submit a report to Congress within 24 to 30 months on the effectiveness of the sanctions, their impact on other US economic and foreign policy interests and the humanitarian situation in Iran and Libya. European Commission criticizes the ILSA extension and threatens to retaliate if sanctions are imposed against European companies.
13 February 2002	US blocks Iran's bid to join the WTO.
25 July 2002	Under the Iran-Iraq Arms Non-proliferation Act of 1992, the US sanctions nine Chinese companies and one Indian entity for selling prohibited goods to Iran.
21 October 2002	Russian officials refuse an American proposal to lift restrictions on the import of spent nuclear fuel into Russia (which can be reprocessed to make enriched uranium or plutonium for nuclear weapons) in return for Russia's ceasing all atomic cooperation with Tehran, including the construction of the Bushehr reactor.
21–22 February 2003	IAEA Director General Mohamed ElBaradei visits Iran to make nuclear inspections and urge Iran to sign the Additional Protocol to the IAEA Safeguards Agreement, which would require an increase in the transparency of the Iranian nuclear program and provide the IAEA with increased access.
May 2003	Responding to US pressure, Russia informs Iran that it will not deliver the nuclear fuel for Bushehr unless Iran signs the Additional Protocol.

4 June 2003	Russia changes course from its May 2003 announcement, now declaring it will not link the supply of nuclear fuel in Bushehr to Iran's signing of the Additional Protocol.
6 June 2003	IAEA report to its Board of Governors concludes that Iran has failed to meet its "safeguards" obligations by failing to fully account for nuclear material imported from China in 1991.
10 November 2003	IAEA report to its Board of Governors condemns Iran for 18 years of manufacturing enriched uranium and plutonium as part of a secret nuclear program.
18 December 2003	Iran signs the IAEA Additional Protocol.
13 March 2004	IAEA Board of Governors unanimously rebukes Iran for failing to disclose significant aspects of its nuclear program. In February 2004, US investigations into the nuclear network masterminded by AQ Khan of Pakistan (the father of Pakistan's nuclear bomb) uncover Iran's plans to build advanced P2 reactors for enriching uranium. Retaliating against the IAEA rebuke, Iran immediately bars nuclear inspectors from entering the country.
28 October 2004	Iran and China sign a preliminary agreement to allow China's Sinopec Group to develop Iran's Yadavaran oil field in exchange for agreeing to buy 10 million tons of Iranian liquefied natural gas annually for 25 years.
26 May 2005	Prompted in part by Iran's recent nuclear cooperation in negotiations with the EU, the US announces it will allow Iran's WTO membership talks to begin.
4 February 2006	IAEA governing board refers Iran to the UN Security Council over concerns that the country is developing nuclear weapons.
14 February 2006	Iran resumes uranium enrichment. Earlier, Iran announced it would no longer permit surprise inspections of nuclear facilities.

Source: Gary Hufbauer, Jeffrey Schott, Kimberly Elliott, and Barbara Oegg. *Economic Sanctions Reconsidered: History and Current Policy*. Third Edition. Washington: Institute for International Economics, forthcoming 2007.