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# Adjusting to Sanctions

*Jahangir Amuzegar*

## THE TOLL IN IRAN

THE AMERICAN-DRIVEN sanctions against Iran were meant to transform the “backlash state” into a law-abiding, cooperative, and constructive member of the world community. Washington expected trade and investment restrictions to cripple the productive base of the economy and curtail Iran’s ability to support international terrorism or acquire sophisticated military hardware. Economic hardship and fiscal austerity would demoralize the population and turn it against the regime. And domestic popular discontent and external political isolation, Washington hoped, would bring the clerical leadership to its senses.

Inadequate hard data make an objective assessment of the sanctions difficult. Supporters of the policy claim that the cost to Iran has been immense, even greater than expected; critics dismiss the policy as self-defeating and divisive. What is certain, however, is that the economic, psychological, and political impact of the American sanctions has not produced the anticipated results or transformed the regime. Although the comparison may seem invidious, the Iranian economy under sanctions is in certain respects healthier and more stable than many developing economies the United States has assisted. Militarily, Iran appears to be stronger now than in 1989, and is certainly less vulnerable than some U.S. allies in the region. The embargo has isolated Washington rather than Tehran.

Iranian officials concede that the boycotts have caused some economic “difficulties” but do not give details of their nature or magnitude.

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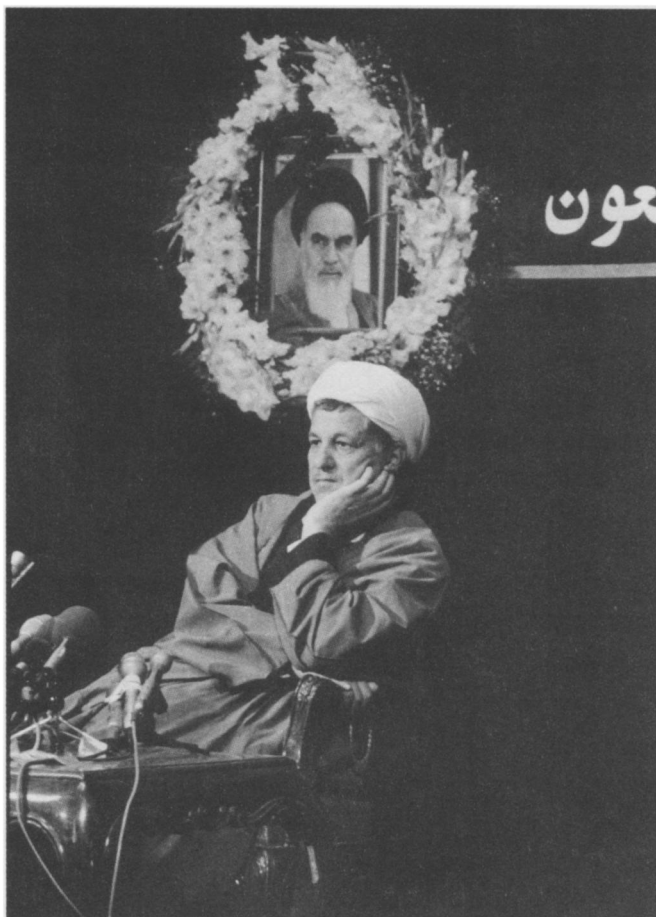
The affected areas, however, are not hard to identify. Finding non-U.S. buyers for Iranian oil and non-Americans to invest in Iran's offshore oil and gas fields has not been cost-free. Banned imports from the United States have been obtained through third parties at extra cost or substituted for from lower-quality sources. Replacing or renovating defense, industrial, and oil equipment based on American

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components has been more expensive or less satisfactory. Rescheduling of short-term arrears on debt to other countries has taken place under less favorable terms. Some foreign investors have shied away from lucrative projects in Iran under the threat of U.S. retaliation. Normal credits from international financial organizations have been delayed or canceled. Scheduled long-term foreign loans have been postponed. Foreign technological assistance in some sensitive areas has been withheld. Business confidence in Iran has been shaken, and the climate for foreign and domestic investment in the country has cooled.

There is no doubt that Iran would be in better shape had the United States not resolved to ostracize and cripple it. American economic and political pressures have hurt the Iranian economy, but they have not inflicted irreparable damage. Iran continues to produce its quota for oil set by the Organization of Petroleum Exporting Countries (OPEC), remains solvent, and maintains normal levels of trade and investment with the rest of the world. In fact, various international organizations and foreign media outlets report that economic indicators are healthier than at any time since the early 1990s. High surpluses have been registered in the current account, hard currency reserves are at record highs, and foreign debt payments are being made on schedule. Iran has had some success in raising medium- and long-term financing in Europe, the rial's official exchange rate has been kept stable, import cutbacks have slowed, and the Qeshm and Kish free trade zones have attracted some private foreign investment. Where sanctions were expected to be particularly damaging, their effect has been surprisingly benign. Daily crude oil production in 1996-97 was *higher* than in 1993-94. So were oil export receipts and net foreign assets. As a percentage of GDP, domestic investment was greater, and the budget deficit, external



MAGNUM PHOTOS/JEAN GAUMY

*Still contemplating American sanctions,  
Iranian President Hashemi Rafsanjani*

debt, and trade arrears smaller, after the sanctions, thanks in part to higher oil prices and appreciation of the U.S. dollar.

To be sure, the Iranian economy is not trouble-free. Inflation is unacceptably high. Unemployment and underemployment, particularly among the ever-growing numbers of graduates of the mushrooming diploma mills, combined with severe restrictions on normal social outlets for the youth, are economically debilitating and politically explosive. Cost and price distortions are enormous. Labor and capital productivity are low. There will be more turbulence ahead if the global oil market becomes depressed again. Yet American sanctions have not appreciably worsened any of these ills. And whatever their adverse effects, they have not been strong enough to induce a noticeable change in Tehran's behavior.

The psychological effects of the sanctions have been mixed. There are signs that despite their defiance of the United States, President Hashemi Rafsanjani and his government are wary of the costs of American enmity. They prefer compromise to confrontation and abhor the sanctions even as they claim immunity to them.<sup>1</sup> As a sign of America's displeasure with the Tehran regime, the boycotts have also brought psychological comfort to discontented but passive groups inside Iran as well as the boisterous but ineffective opposition forces abroad, which both long for escalating American pressure that might lead to the eventual overthrow of the revolutionary regime.

On the other hand, U.S. sanctions have created a siege mentality; the regime's remaining supporters have become determined to rely on their own resources and ingenuity. The determination to become self-sufficient in most of their needs heralded a shift to other sources of equipment for exporting oil and stronger ties with Asia, Africa, and Latin America. The kinds of sophisticated goods and services now designed and produced in Iran—increasingly for export abroad—did not exist ten or even five years ago. Supreme Leader Ayatollah Sayed Ali Khamenei has publicly welcomed the U.S. ban as a boon to popular mobilization and self-reliance.

The political impact of U.S. pressure has, if anything, also worked in Tehran's favor. When the United States first imposed sanctions on Iran in the mid-1980s, the Islamic Republic's loyal friends around the world could be counted on one hand. In the mid-1990s, the regime's declared enemies were only two: the United States and Israel. Despite the sanctions—or perhaps because of them—Tehran now has close ties to Russia, China, India, Indonesia, and Brazil, which together account for nearly half the world's population. Relations with most countries in Asia and Africa are friendly, and with the European Community they are businesslike, despite recurrent verbal duels concerning Salman Rushdie and other high-profile human rights cases. There are hundreds of treaties of friendship, cooperation, trade, and cultural exchange with both developing and developed countries on six conti-

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<sup>1</sup>Many interpret Iran's decision to award the Sirri oil fields contract to the American oil company Conoco, for which President Clinton denied approval in 1995, as an olive branch to Washington.

## *Adjusting to Sanctions*

nents.<sup>2</sup> A regime that some American high officials have called an “outlaw state” has been invited to lend its good offices to resolving disputes between Azerbaijan and Armenia, Sudan and Uganda, and other sovereign nations. Tehran has also been active in mediating between ethnic factions in Afghanistan, Tajikistan, Iraq, Bosnia, and elsewhere. Islamic government representatives have won important committee seats in the United Nations and its affiliate organizations in spite of Washington’s objections. Last December the International Court of Justice in The Hague voted 14 to 2 to reject Washington’s plea for dismissal and to hear Tehran’s case against the United States for the deliberate destruction of three Iranian offshore oil platforms in the Persian Gulf in 1987. The Tehran government now feels confident enough about its economy to consider membership in the World Trade Organization.

The Islamic Republic still has festering quarrels with Iraq and is embroiled in political conflicts with Algeria, Bahrain, Egypt, Saudi Arabia, the United Arab Emirates, and the Taliban in Afghanistan. Relations with the U.N. Human Rights Commission are also tense; Maurice Copithorne may join Reynaldo Galindo Pol as the second U.N. rapporteur to be declared *persona non grata* in Iran because of reports critical of the country’s human rights record. Nevertheless, its “isolation index” is now the lowest since the revolution.

### WHY THE SETBACKS?

THE REASONS for the evident lack of success of Washington’s containment policy are not difficult to fathom. Historically, economic sanctions have worked only when they have been universal and comprehensive, consistent and credible—in short, leakproof. In this case, none of those conditions has held.

Except with respect to transfers of sophisticated military weapons, the American policy toward Iran has been essentially unilateral. Since 1993, and culminating in the Group of Seven Halifax summit in June

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<sup>2</sup>The inauguration in May 1996 of a rail link between Sarakhs, Iran, and Ashkhabad, Turkmenistan, which included representatives from 40 countries (including 12 heads of state or government), has been trumpeted by Tehran as a “triumph” over U.S. efforts to isolate Iran. So has the participation of 1,500 companies from 54 countries in the 1996 Tehran International Trade Fair.

1995 and the Sharm al-Sheikh antiterrorism summit in March 1996, Washington has tried and failed to enlist its major allies in its campaign against Iran. Reactions to American initiatives have been negative or, at best, noncommittal. The allies regard the U.S. stance of ignoring Iran's legitimate role in the region as unrealistic and the sanctions' uncompromising message of "redeem yourself or be damned" a non-starter. Defying the U.S. secondary boycott legislation under the Iran and Libya Sanctions Act of 1996, the European Union has lodged a formal complaint with the World Trade Organization and even warned Washington of retaliatory measures if it tries to act under the law. American allies like Turkey, Kuwait, and the United Arab Emirates have now expanded commercial links with Iran. Oil and natural gas deals with the countries of the Commonwealth of Independent States have proceeded as planned. Japan, Russia, China, Canada, and others have largely ignored American requests for trade sanctions. Only Israel and a wavering Uzbekistan have answered Washington's call.

American allies may have their own ulterior motives for opposing the containment strategy—desires to safeguard their historical ties with Iran, expand their commercial interests in a lucrative market, or simply assert their political independence from Washington. But their reservations reflect a second flaw of U.S. sanctions: inconsistency, which saps their credibility. The sanctions have sometimes been selective and arbitrary in their targets, and the United States has frequently breached the policy when it suited its interests. Syria has been on the same list of "terrorist states" as Iran, yet high U.S. officials have often courted Damascus. Sudan and Iran were both barred by the Antiterrorist Act of April 1996 from engaging in any financial transactions with U.S. companies; yet Occidental Petroleum was granted a special exemption to enter into a major oil deal with the Khartoum government soon after the bill was signed. On nuclear weapons, North Korea has pursued a development program similar to Iran's, yet Iran has been denied the same right accorded to Pyongyang, under the Nuclear Nonproliferation Treaty, to develop peaceful uses of nuclear energy. On human rights, China and some U.S. friends in the Middle East—Egypt, Pakistan, Saudi Arabia, and Turkey—have been cited by the State Department as some of the world's worst violators, yet they have enjoyed thriving trade and normal diplomatic relations

## *Adjusting to Sanctions*

with the United States.<sup>3</sup> Finally, Washington bitterly declared secondary boycotts to be illegal when the Arab League applied them to Israel, but it now urges its partners to honor them against Iran.

The containment policy has also lacked credibility because of Washington's repeated departures from stated principles. The secret arms deal with Tehran during President Reagan's administration, an aborted attempt at diplomatic rapprochement under President Bush during the release of American hostages in Lebanon in 1991, and the decision under President Clinton to allow Iran to send clandestine arms shipments to Bosnia are flagrant examples. Furthermore, until 1995, the U.S. embargo applied only to a handful of dual-use items and conspicuously excluded oil. Thus, while Washington was exhorting its allies to stop trading with Iran, the United States had become Iran's fourth-largest trading partner.

The final reason U.S. sanctions have been ineffective is that they have not been airtight. Companies and contractors from other Western countries have served as proxies for U.S. subsidiaries abroad. Countries that were not even among the top 25 nations trading with Iran prior to the sanctions now rank fifth and sixth. Shops in Iran are stocked with American goods of every description—many smuggled in, but others imported legally through neighboring countries. Some Iranian exports also have found their way into the American market through third parties and legal loopholes.

### WILL TEHRAN CRY UNCLE?

SANCTIONS MATTER not because they can, in their present configuration, bring the Islamic regime to its knees, but because they may handicap it in the race to rapid economic growth. The current U.S. policy is likely to remain largely ineffective, if not counterproductive, unless it is backed by a U.N. Security Council resolution specifically banning exports of oil from Iran and gaining the compliance of all major petroleum-importing countries. Without oil revenues, Iran's economy would

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<sup>3</sup>In extending most-favored-nation privileges to Beijing in 1996, the Clinton administration argued that it had a better chance of influencing Chinese behavior through dialogue and trade than through economic pressure. That is precisely what the European Union has suggested with Iran, but Washington has steadfastly rejected the reasoning in Iran's case.



quickly be paralyzed. However, judging from the European Union's reaction to the U.S. secondary boycott law—the one issue, incidentally, on which the EU membership has unanimously agreed—and given the fierce opposition that Russia, France, and China would likely raise in the Security Council, no such resolution is in sight at the United Nations. Furthermore, an embargo against Iranian oil would likely push crude prices through the roof for a while, another reason all oil-importing nations would resist it. Washington, therefore, may have to go it alone unless its allies and the world community are presented with irrefutable evidence of Tehran's direct involvement in a dastardly terrorist act, such as the June 1996 truck bombing of a housing complex in Dhahran that took the lives of 19 American military personnel. For its part, Iran can live with U.S. sanctions for a long time with much less difficulty than Cuba or Vietnam, although it cannot prosper without Washington's blessing.

In dealing with the Tehran regime Washington has four distinct, and familiar, policy options. At one end of the spectrum, it can discontinue sanctions and follow the easy route of "silence tinged with indifference or disdain," as an old U.S. intelligence hand has suggested. But while attractive, such a policy may be neither practical nor prudent; Iran's multifaceted activities and machinations in the region cannot be ignored, and the regime may not go out without a bang. At the other extreme, Washington may choose a military confrontation with Tehran, as anti-Iran hawks advocate, to roll back the regime. But this option is fraught with incalculable risks, would be internationally insupportable if launched without clear provocation, and would probably be domestically unpopular, particularly if it involved U.S. troop deployments and American casualties.

The third choice is to tighten comprehensive unilateral sanctions. Persistent advocates of the U.S. boycott still argue that Iran is currently weak and vulnerable economically and financially, that it needs a bailout from the West in the form of credits, technology, and management, and that sanctions will work most effectively if other major industrial powers follow—but even unilateral American sanctions can make a big difference. Patience and perseverance are all that is needed.

Assuming this assessment is correct, the get-tough policy is still not risk-free. Enhanced U.S. sanctions may hasten the day of reckoning, but they run the risk of arousing formidable nationalist resistance in Iran.

## *Adjusting to Sanctions*

Serious imbalances and deficiencies plaguing the Iranian economy pose a latent threat to the regime's survival because they give rise to sociopolitical tensions that weaken the rulers' grip on power. With or without the U.S. embargo, the regime is likely to implode eventually unless there is a dramatic change in its domestic Islamic rule and its anti-Western worldview. Therein lies the reason for the regime's survival somewhat beyond its time: not in spite of sanctions, but because of them.

Already sensing a general anxiety across the land about further U.S. economic pressure, the clerical leadership, in a series of smart public relations maneuvers, has blamed the country's economic shortcomings and setbacks on undisguised American hostility toward Islamic rule. Washington's frequent demonization of the government in Tehran has been seized on to demonstrate Iran's unique importance as the defender of the faith and supporter of the oppressed against an arrogant superpower. Taking advantage of the Shiites' historical glorification of martyrdom, the leadership portrays Iran as the victim of a cruel and hostile hegemon. The sanctions themselves are shrugged off as insignificant, but they are highlighted as proof of American hostility.

The regime's appeal to Iranian nationalism, particularly the clever hints that enhanced U.S. sanctions and continued hostility threaten Iran's sovereignty and territorial integrity, has been an effective ploy. Not a single group in the vast array of current opposition to the Islamic government, no matter how hostile to theocratic rule—including die-hard monarchists—wants to see sanctions topple the regime if that means Iran's Balkanization. On no other issue have the disparate groups been so united for so long.

The remaining option is to seek a prudent *modus vivendi* with the rogue state. The regime is a religious oligarchy related by blood and financial ties to the bazaar merchant class. Bazaaris' passion is not policy, but profit. For their partners in the leadership, the overarching goal is not ideological rigor but power. Ayatollah Khomeini in 1988 ingloriously accepted the cease-fire in the eight-year war with Iraq that he had vowed to pursue to total victory. His sole motive was to preserve Islamic rule and keep the clergy in power. Any proposal that could

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Iran is economically healthier than many countries the United States has assisted.

strengthen the economy and give the regime a better chance of survival is likely to get a positive response. The reason that this option, despite its many advocates within the foreign policy establishments on both sides of the Atlantic, has not been actively pursued is because its supporters are looked upon as accommodationsists, appeasers, or opportunists. In neither country is the leadership anxious to take the initiative for fear of being labeled sellouts by the opposition.

#### SHARED INTERESTS

THE OUTSTANDING differences on many matters of legitimate national concern—including each country's self-proclaimed manifest destiny (Iran to propagate Islam, America to promote democracy)—may rule out relations of the sort that prevailed between Iran and the United States before 1979. But they cannot mask the significant interests that the two *countries*—as distinct from their *governments*—still share. In spite of mutual assertions to the contrary, regional instability, chaos, and tension are in neither country's political or economic interest. Both countries have a vital interest in the free flow of oil through the Persian Gulf and the avoidance of maritime incidents. Both need each other geopolitically, as the twin pillars of a regional counterbalance to Russia's potentially expansionist aspirations within the Commonwealth of Independent States and toward the warm waters of the Persian Gulf. And, finally, both countries can fruitfully cooperate in developing and transporting the energy resources of the Central Asian states and the Caucasus, reducing those nations' dependence on Russia.

For the moment, these mutual interests may not seem impressive to Washington. After the breakup of the Soviet Union, the defeat of Saddam Hussein and Iraq, and the increase in the supply of non-OPEC oil, Iran may have lost its geostrategic, military, and economic cachet for the United States. Washington may perceive no need to make concessions to establish a dialogue with Tehran, hoping instead to force the regime's hand through comprehensive new sanctions. But the current phase may be transitory. Before long the Russian Federation may again be a superpower, and a post-Saddam Iraq may be just as menacing to its neighbors. Iran, regardless of its governing regime, will remain the Middle East's most populous and second-largest country, surrounded

### *Adjusting to Sanctions*

by 15 neighbors with which it shares land borders or bodies of water, a major global energy source with 10 percent of the world's oil and 15 percent of its natural gas, a pivotal player both in the region and within OPEC, and a gateway to Central Asia. In a region where national interests are increasingly defined in terms of shifting national alliances and coalitions, a strong, integral Iran may be sorely needed as a constructive force if there is to be stability and progress. The ultimate effects of the U.S. containment policy must be regarded in that light.

Assuming that Iran's territorial integrity and political independence are in the United States' own long-term national interests, a change in the containment policy may be a reasonable insurance premium. Washington may wish to reactivate the long-standing offer of a dialogue between duly authorized representatives, in a confidential manner, without preconditions. Should this option be chosen, a strategic reassessment would be in order. To be effective and credible, the dialogue must avoid going into a long wish list of expected changes in bilateral behavior and instead single out one or two issues of crucial importance to both parties, such as nuclear proliferation, the Arab-Israeli peace process, and the U.S. military presence in the Persian Gulf. The United States should give the Islamic Republic some reasonable incentives for cooperation, such as the release of frozen assets or new loans from the World Bank, and clear disincentives for intransigence, including intensified political pressure or even more drastic action. Under this policy of *reciprocal response*, each offending behavior may be dealt with through *quid pro quo*, without bestowing a seal of approval on or resorting to a blanket condemnation of either party's overall position.

Should Washington decide that its containment policy is the right course and Tehran continue its anti-American belligerence, the current stalemate will continue. Without a strong consensus among U.S. allies and a tacit understanding with Russia and China not to help Iran, and without convincing the regime's opponents that Iran's territorial integrity will not be jeopardized by U.S. sanctions—that the end of the Islamic Republic will not be the end of Iran—the boycott might still not reach its goal by the year 2010 or even 2020, if the Chinese, Vietnamese, and Cuban experiences serve as precedents. ☹