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The Fallacy of Critical Dialogue

Libya and Iran, Sanctions and Economic Interdependence Peace Theory

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Preface

On Monday, May 15th, 2006, then Secretary of State Condoleeza Rice announced that the United States was removing Libya from its list of state-sponsors of terrorism and would be restoring diplomatic ties with the North African country. "We are taking these actions in recognition of Libya's continued commitment to its renunciation of terrorism,"[1] stated Rice, marking the realization of American foreign policy goals for almost thirty years in regard to Libya. A one time supporter of terrorism and a country with an extensive Weapons of Mass Destruction (WMD) program and an international pariah, Libya completely changed the nature of its relations with the West and the means of achieving its security objectives. On the other hand, Iran has continued to work on developing its nuclear enrichment program, openly supports the terror groups Hezbollah and Hamas, and is frequently accused of supporting insurgent activities within Iraq. In February, US chairman of the Joint Chiefs of Staff announced that Iran had enough low-enriched uranium for a weapon, a conclusion joined by officials of the International Atomic Energy Agency (IAEA).[2] Although Iran has the fissile material required to make a weapon, the IAEA warned in February "that as long as Iran continued to withhold access to documentation, Iranian officials, and sites, the IAEA would be unable to verify whether Iranian nuclear activity was peaceful or not."[3] Since 2006, there have been four UN Security Council resolutions calling on Iran to stop its enrichment of uranium, to no avail.

Introduction

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[1] "US to Restore Relations with Libya" CNN Online (15 May 2006). 8 March 2009 <http://www.cnn.com/2006/US/05/15/libya/index.html>
[2] Los Angeles Times "Clinton says U.S. diplomacy unlikely to end Iran nuclear program" March 3, 2009
[3] Shipman, Tim "Iran has enough uranium to build a nuclear bomb" *The Telegraph* February 20, 2009

Scholars have done extensive research analyzing the reasons why Libya moved from a state sponsor of terrorism with an extensive Weapons of Mass Destruction program to rapprochement with the West. Extensive analysis exists on the current similar efforts against Iran, but as of yet, no study has compared the economic sanction efforts against Libya directly to those currently with Iran. On a scale of one to four, with four being the highest, the Peterson Institute for International Economics rates the effectiveness of the sanction regime against Libya at a full four.[4] For Iran, the rating of the effectiveness is only two. There are considerable similarities between the nations. Both Iran and Libya are Muslim nations with authoritarian governance and a steady supply of oil capital. Economic sanctions have been levied against both starting in the late 1970s.

This research paper seeks to find what key differences between the economic sanction regimes levied against Iran and Libya led to the latter country's rapprochement with the West and why the former country remains intransigent. This paper will first analyze existing literature on the efficacy of economic sanctions as a tool of international policy. Secondly the paper will highlight the similarities between Iran and Libya including their history, mode of government, economic systems, and note any main differences that could affect the efficacy of sanctions. Thirdly, this paper will analyze the history of the sanctions levied against Libya and their economic effects and do the same treatment for Iran. The research has led to the conclusion that the most important difference between sanctions levied against Iran to Libya was that there lacked significant multilateral support for sanctions to Iran. Secondly, critical dialogue has failed Europe,

[4] Peterson Institute for International Economics *Case Studies in Sanctions and Terrorism* accessed online Januar 21, 2009 < http://www.petersoninstitute.org/research/topics/sanctions/libya3.cfm#assessment>

extensive economic ties have not led to significant reforms with Iran. For any sanction regime to have a success of achieving a major political objective, it needs to have multilateral support; unilaterally it will fail and secondary boycotts are not practical.

Literature Review

A few theories exist as to why Libya changed and Iran has not, and this research paper will examine the assumptions these theories are based on:

Gary Samore of the Institute for Strategic Studies in London sees that "The disarmament agreement with Libya is a dramatic victory for traditional non-proliferation diplomacy—the use of incentives and sanctions to persuade governments to abandon weapons of mass destruction programmes in exchange for political and economic rewards."[5] Samore argues that this approach can work for Iran if the US engages the Muslim nation diplomatically, using economic sanctions and economic benefits in exchange for an abandonment of Iran's nuclear activites. The spread of globalization and its economic benefits led Muammar Gaddafi to reassess his countries position and comply with the world's demands to stop sponsoring terrorism and to dismantle its WMD programs. This is evidenced by Libya's current desire to seek membership in the WTO. An extension to this theory, as purported by Joseph Cirincione, Carnegie Endowment for International Peace, is that the sanction efforts caused Gaddafi to slowly abandon his belief in Arab Nationalism and anti-imperialism as an alternative to Western based capitalism.[6]

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[5] Samore, Gary "The test of Gadaffi's lead will be Iran" *The Financial Times of London,* December 22, 2003

[6] Slevin, Peter and Glenn Frankel "Libya Vows to Give Up Banned Weapons; Bush and Blair Hail Results of Nine Months of Secret Talks" *The Washington Post,* December 20, 2003

Some scholars argue that the sanctions succeeded against Libya because of the multilateral backing and international sanctions levied against Libya. The US imposed a sanction regime on Libya but the UN also levied tough sanctions on Gaddafi. Ambassador Martin Indyk, who was directly involved with clandestine negotiations with Libya during the Clinton administration, assesses the situation and argues that the "United Nations and US sanctions that prevented Libya importing oilfield technology made it impossible for Mr. Gadaffi to expand oil production. The only way out was to seek rapprochement with Washington." [7] UN Sanctions in particular, after the Lockerbie incident on the prohibition on the sale of oil equipment and technology and a ban on financial transfers "hit Gaddafi where it hurt the most, undermining his government's ability to extract and export its main source of revenue."[8] Jon B. Wolfsthal of the CSIS International Security Program sees that China and Russia's support of Iran, as well as the extensive business European countries do with the country, are greatly hampering any effort on change with Iran.

Another theory is that Bush's policy of preemption and the invasion of Iraq made Gaddafi worry for his regime's continued existence. This is problematic as Libya offered in 1999 to give up its WMDs before the Iraq invasion and this has not deterred Iran.[9] Threats of military force instead of sanctions, the proponents of this theory hold, would drive Iran to change its ways. Ray Takeyh analyzes that due to Iran's nationalist sentiment and drive to be a superpower, "the notion of acquiescence has a limited utility to Iran's nationalists. As such, for Tehran, its nuclear programme is not one to be bartered

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[7] Indyk, Martin "The Iraq War Did Not Force Gaddafi's Hand" *The Brookings Institution,* March 09, 2004, accessed online March 8, 2009 < http://www.brookings.edu/opinions/2004/0309middleeast_indyk.aspx>
[8] Takeyh, Ray, "The Rogue Who Came in From the Cold" *Foreign Affairs* May 2001/ June 2001 p. 62
[9] Indyk, Martin "The Iraq War Did Not Force Gaddafi's Hand" *The Brookings Institution,* March 09, 2004, accessed online March 8, 2009

away for European investments... The populist appeal of Iran's uncompromising stance, the inherent value of nuclear deterrence to a beleaguered regime and Iran's suspicions of the international community militate against Tehran accepting the latest European mandates."[10] The idea that increased military threats could be necessary will be explored, but it is important to note that Libya also had strong ideology that caused it to support terrorism and develop WMDs, so it is not impossible that the right policies can change Iran. Bolstering the ideological hurdle hampering the efficacy of sanctions against Iran is Akbar Torbat's analysis that "overall, the [US unilateral] sanctions' economic effect has been significant, while its political effect has been minimal."[11]

General History of Sanctions

Economic carrot and stick methods have long been a tool of many nations' foreign policy objectives. Sanctions are often used by the US as "they provide a visible and less expensive alternative to military intervention at the same time they provide an alternative to doing nothing or limiting the US reaction to rhetoric."[12] For the purposes of this essay, I will adopt George Shambuagh's definition of sanctions: "[sanctions] are an economic penalty or cost that is imposed by a sender on a designated target, regardless of the particular form that it takes of the end that is serves."[13]

Economic sanctions are implemented either unilaterally or multilaterally and "increasing levels of globalization and privatization in the world economy make the

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[10] Takeyh, Ray "Diplomacy will not end Iran's Nuclear Programme" *The Financial Times* December, 21 2005

[11] Torbat, Akbar E. "Impacts of the US Trade and Financial Sanctions on Iran" *The World Economy* Vo. 28 Issue 3. March 14, 2005 pp. 407-434

[12] Richard N. Hass ed. <u>Economic Sanctions and American Diplomacy</u> *Council on Foreign Relations* © 1998

[13] Shambaugh, George E. States, Firms, and Power: Successful Sanctions in United States Foreign Policy, New York: State University of New York Press © 1999 (4)

judicious use of economic statecraft against firms and other nonstate actors an increasingly important component of foreign policy."[14] Unilateral sanctions can interfere with or contradict international trade treaties and obligations while the implementation and strength of multilateral sanctions is contingent on every parties' commitment. Unilateral sanctions can incur great economic loss on the United States, but they are a primary tool of United States foreign policy. "Historically, American sanctions primarily have involved prohibitions on domestic companies from conducting business with a targeted country to coerce the target into changing its illicit behavior."[15]

The Peterson Institute for International Economics examined the impact of unilateral U.S. sanctions imposed against twenty-six countries, including Libya and Iran, and concluded that in 1995, the sanctions cost the United States up to $20 billion and $250,000 jobs.[16] Generally, the U.S. business community fears "that a perceived explosion of new unilateral U.S. sanctions would undercut its competitive advantage."[17] Kimberly Elliot in her quantitative research "Economic Sanctions and Threats in Foreign and Commercial Policy" found that of US foreign policy goals between 1914-2000, sanctions had a fifty-one percent success rate for modest goals and only twenty-nine percent for all other goals.[18] Modest goals include forcing compliance with trade agreements or reducing protectionist measures, but include political objectives as well. However, for sweeping goals like regime change, sanctions are not nearly as effective.

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[14] Ibid. (3)

[15] Meghan McCurdy, *Unilateral Sanctions With a Twist: The Iran and Libya Sanctions Act of 1996*, 13 Am. U. Int'l L. Rev. 400 (1997).

[16] Harry L. Clark, *Dealing with US Extraterritorial Sanctions and Foreign Countermeasures,* 20 U. Pa. J. Int'l Econ. L. 117 (1999)

[17] Michael Mussa ed. C. Fred Bergsten and the World Economy December 2006, Washington DC: Peterson Institute for International Economics 66

[18] Kimberly Ann "Economic Sanctions and Threats in Foreign and Commerical Policy" C. Fred Bergsten and the World Economy December, 2006 Washington DC: Peterson Institute for International Economics 65

Sanctions can help modify behavior, but not change the underlying nature of the state. Sanctions are on average more effective the higher the economic costs they incur on other states, and in studies comparing successful to unsuccessful sanctions, the successful ones incurred a fifty percent higher cost to the Gross National Product of a target country.[19] Enforcing compliance also can be a problem, including when multinational corporations are involved but "economic threats and sanctions appear to work best when the demand is not only limited but clearly defined so that compliance can be monitored and more readily enforced."[20] As economic sanction expert and Chairman of the Council on Foreign Affairs Richard Hass concisely sums up, "sanctions alone are unlikely to achieve desired results if the aims are large or the time is short but under the right circumstances sanctions nevertheless can achieve or help to achieve various foreign policy goals ranging from the modes to the fairly significant" and adds, however that "unilateral sanctions are rarely effective."[21] Unilateral sanctions are more of a signal or a gesture as with the availability of other trading partners and economic opportunities, there is only a shift of where business is conducted, without major effects to the target industry.

Another method that intertwines foreign policy objectives and economic relations is the "critical dialogue" approach which is an approach used by the European Union towards Iran. Critical dialogue is a method to continue trade and use diplomacy as a method to change behavior.[22] The fundamental premise behind the critical dialogue approach is the theory that "trade causes peace through increased understanding and

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[19] Ibid. 67

[20] Ibid. 68

[21] Richard N. Hass ed. Economic Sanctions and American Diplomacy *Council on Foreign Relations* © 1998 (198)

[22] Meghan McCurdy, *Unilateral Sanctions With a Twist: The Iran and Libya Sanctions Act of 1996*, 13 Am. U. Int'l L. Rev. 427 (1997).

interdependence. Less trade causes less of both these things."[23] On an individual level, increased cross-national trade creates personal relationships between businessmen each country and leads to cross-cultural understanding. At a broader level is the notion that countries that are increasingly interdependent economically have a decreased financial incentive in going to war with one another due to the economic losses and hardships that would occur. Proponents of this theory do not believe trade sanctions or embargoes should be levied, because of the ineffectiveness of these methods and their counterproductive effect of causing war or more conflict.

Sanctions have not removed Castro's regime from Cuba, nor did it prevent a second war in Iraq. Saddam Hussein lived a lavish lifestyle while his people were starving due to the sanctions. Indeed, it is easy to conclude that the lowered risk of military confrontation between the China and the U.S. is due considerably to the large amount of trade and interdependence between the nations. However, in terms of human rights in China, the U.S. may have less leverage because it has to weigh the economic risks of taking a hard line on the People's Republic in comparison to the goal of promoting human rights worldwide. Economic interdependence, conversely, can hamper foreign policy objectives and actually lead to more disagreeable behavior by other states. Critical dialogue has failed to halt Iran's march towards nuclear capabilities, and arguably Iran acts more boldly due to Europe's business connections and reliance on oil and energy products with the country.

[23] Graham, Jon L "Trade Brings Peace: An Essay on one kind of peacebuilding" *War and Reconciliation* (Joseph Runzo and Nancy M. Martin eds., Cambridge University Press, 2006)

Libya and Iran: Political and Economic Similarities

Both the modern states of Libyan and Iran were born of revolution. Muammar Gaddafi rose to power in September 1, 1969 in a military coup d'état that instituted the control of the Revolutionary Command Council. In 1977 Gaddafi changed the official name of Libya to the "Great Socialist People's Libyan Arab Jamahiriya" and by February 18, 1994 Gadaffi declared Sharia law would be imposed. Libya is under authoritarian control and there is no freedom of speech per se. The Arab Jamahiriya is ruled by a personal dictatorship and "no decision is likely to be taken unless specifically approved by [Gadaffi]."[24] Libyan foreign policy used to be best described as "being shaped by a mind-set rather than by clearly defined objectives"[25] and it sees the freedom and well being of Libyans and other Arabs as being assured only through radical promotion of their own interests and independence against the outside world. Gaddafi's ideology blended anti-imperialism, Arab nationalism, and Islamic radicalism. Libya initially used chemical weapons against Chad during the 1986-1987 war it had with the country. In March 1990, the U.S. and Germany accused Libya of building a chemical weapons plant at Rabta and in February 1993 the U.S. accused them of building a chemical weapon center at Tarhunah. .

Iran became an Islamic republic in 1979 following the Islamic revolutions of the Ayatollahs. It is controlled by an authoritarian theocracy; however, there are democratic elements. Freedom House ranks the country's freedom index at 6.0 (with 1.0 being the most free and 7.0 the least). Iran is ruled by the Ayatollahs; its Supreme Leader Ali Khamanei rules with his Guardian Council of appointed jurists. The executive and

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[24] Niblock, Tim "Pariah States" & Sanctions in the Middle East: Iraq, Libya, Sudan Colorado: Lynne Reiner Publishers, Inc. © 2001 (84)
[25] Ibid. 19

legislative branches are subject to popular elections, however, the Guardian Council can disqualify contenders, for reasons including their lack of commitment to Islam. The Council has played a central role in keeping "only one interpretation of Islamic values from influencing Iranian law, as it consistently disqualifies reform-minded candidates—including the most well-known candidates—from running for office and scraps laws passed by the popularly elected Majlis (parliament)."[26] Iran has been designated a state sponsor of terrorism for its activities in Lebanon and elsewhere in the world. Like Libya's former foreign policy, scholar Patrick Clawson puts, "leaders of the Islamic republic place great store in their radical foreign policy. It is one of the few remnants of revolutionary ideology that has not been abandoned. And the radical foreign policy does much to puff up Iranian nationalist pride…to be a leader of the Muslim community."[27] The UN Security Council has passed a number of resolutions calling for Iran to suspend its uranium enrichment and reprocessing activities and comply with its IAEA obligations and responsibilities. Resolutions 1737, 1477, and 1803 subject a number of Iranian individuals and entities involved in Iran's nuclear and ballistic missile programs to sanctions. Additionally, several Iranian entities are subject to US sanctions under Executive Order 13382 designations for proliferation activities and EO 13224 designations for support of terrorism.[28] These sanctions will be revisited later in the paper.

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[26] Secor, Laura "Whose Iran?" The New York Times, January 28, 2007 accessed March 22, 2009 < http://www.nytimes.com/2007/01/28/magazine/28iran.t.html?ei=5088&en=df35a74bde394fa1&ex=1327640400&partner=rssnyt&emc=rss&pagewanted=print>
[27] Knoblock 94
[28] CIA Worldfactbook: Iran accessed online March 13, 2009 <https://www.cia.gov/library/publications/the-world-factbook/geos/ir.html#Econ>

Oil revenue is one third of Libya's gross domestic product and ninety-nine percent of its revenues from export.[29] According to OPEC, Iran's oil revenue is $64.9 billion or about 23% of its GDP and about 80% of its export revenue.[30] Natural gas and oil combined make up 70% of Iran's government revenue. Iran currently has economic problems similar Libya in the 1990s: oil prices have dropped to less than $40 per barrel, it has an unemployment rate of 12% and a 26% inflation rate as of June 2008.[31]

Sanctions against Libya

The sanction regime against Libya can be divided into three broad phases, firstly, U.S. unilateralism to isolate Libya from the 1970s to late 1991. Secondly, in 1991-1996 the addition of United Nations sanctions after the Lockerbie incident and other terrorism sponsored by Libya and thirdly, the Iranian Libya Sanctions Act (discussed later in this paper) to the present.[32]

<u>Phase I</u>

When Gaddafi rose to power in a military coup d'état in 1969 and decided to pursue a foreign policy based on radical activism the schism with the United States began. Gadaffi actively supported terrorist groups and revisionist causes, including pan-Arabism and anti-imperalism. In the mid 1970s, the United States imposed an arms embargo and in 1980 closed its Tripoli Embassy; in 1981 the Libya mission to the U.S. was closed. It is interesting to note that during this time, the chief argument against an oil

[29] Clyde R. Mark "Libya: Current Overview of Issues"
[30] OPEC "Iran Facts and Figures (ASB) 2007 accessed online March 13, 2009 <http://www.opec.org/aboutus/member%20countries/iran.htm>
[31] Ibid.
[32] Rose, Gideon "Libya" <u>Economic Sanctions and American Diplomacy</u> *Council on Foreign Relations* © 1998

embargo "was that [the embargo] would not do much to pressure to Libya unless the Europeans joined."[33]

However, in March 10, 1982 the U.S. started boycotting Libyan crude oil imports and established export controls on goods and technology. The boycott was precipitated by the drop of U.S. purchase of Libyan oil from forty to seven percent between 1980 and 1981. Exxon and Mobil both stopped their oil business with Libya. Some U.S. firms continued existing operations but did not explore new fields. Later, the ban was extended to the import of Libyan refined oil products. During this time U.S. exports to Libya dropped from $860 million in 1979 to $200 million in 1984. Imports from Libya dropped from five billion U.S. dollars to only nine million in 1984.[34]

Through the mid 1980s President Regan did not get significant European support in its economic efforts against Iran. United States business operated through subsidiaries based in London and Rome. In 1985 an Israeli airliner hub was attacked in Vienna and Rome, killing 20 and wounding 120, with suspected Libyan involvement. Reagan, faced with Libya's intransigence, continued unilateral sanctions and in January, 1986, he instituted sanctions stopping all American economic activity with Libya and brought home all Americans from Libya. All Libyan government assets in the United States were frozen. In 1986 America launched a bombing raid on Libya in response to a bombing of a London disco that American servicemen frequented where the terrorist activities pointed to Libya. After the raid, European Community members instituted modest diplomatic sanctions on Libya and banned arms sales. In May 1987, the U.S. General Accounting Office issued a report on the effectiveness on sanctions imposed on Libya and found that

[33] Ibid. 130
[34] Ibid. 133

"the practical impact of the US trade sanctions on Libyan oil production is minimal because of the extensive foreign availability of oilfield equipment, services, and supplies…The short term effect of the sanctions on the US oil companies has been a loss of revenue while Libya continues to reap the full benefit of their oilfield operations." [35]

Phase II

In December, 21, 1988 Pan Am Flight 103 exploded in the air over Lockerbie, Scotland, killing all 259 passengers and crew, 189 of which were American citizens. Then 1989, French airliner UTA Flight 772 exploded over Niger killing all 171 passengers and crew. Evidence emerged that it was the work of two Libyan intelligence agents. U.K. and France joined with the U.S. condemning Libya and working for the extradition of two Libyan suspects. The U.N. adopted resolution 748 March 31, 1992 to make Libya extradite the suspects. The Security Council adopted Resolution 748 in January 1992 imposing sanctions on Libya unless the suspects were extradited. Specific measures were to ban on all air links with Libya, and a ban on arms sales. Gadaffi did not comply and in November 1993 Security Council resolution 883 tightened the Libyan aviation industry, ban on exports to Libya on certain equipment that is used for the oil and gas sectors, and a freezing of Libya funds overseas. "The new measures were not designed to cripple the Libyan economy for which a ban on oil sales would be required."[36]

These terror attacks created a sense of urgency in the world, coupled with the fall of the Soviet Union and its influence in the U.N., allowed the Security Council to impose multilateral sanctions. The U.N. sanctions did not have an immediate effect as the United

[35] Quoted in Rose, Gideon "Libya" 134
[36] Ibid. 135

States had not been able to block Libyan oil exports with UN sanctions, as Europe was too dependent on Libyan oil, "but it had managed to secure measures that would progressively degrade the Libyan oil industry over time."[37] These sanctions ended in April 5, 1999, when Libya surrendered two Lockerbie suspects and the U.N. suspended the sanctions the same day.[38] In May 1, 2003, Libya agreed to pay $10 million to each victim, completely ending this phase of sanctions.

Phase I Impacts: Source: Peterson Institute

Year	Measure	Impact
1982	US Oil Embargo	Libya forced to sell oil at 10% less price
1984	Export and Import Controls	30% drop in revenue from nonoil trade to US
1985	Withdrawal of US citizens from Libya	10% increase in replacing American workers- costs $6 million
1986	Freeze of libyan Assets in US	$97 million

Phase II Impacts Source: Peterson Institute

Year	Measure	Impact
1992	UN ban on certain petroleum equipment	$115 million
1992	UN Arms Embargo	$70 million
1992	Air Ban	$90 million

A 1998 official report and study by the Arab League found that the damage to Libya due to the U.N. sanctions was about twenty four billion dollars.[39] However, sanctions did not affect Libya's oil production and the country met OPEC production quotas regularly during the 1990s. Sanctions did indirectly drive up the price on imported goods and international businesses became wary of doing business with Libya. Inflation within two years of the U.N. sanctions rose to fifty percent. The costs of obtaining equipment for oil production and development also

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[37] Simmons, Geoff Libya and The West: From Independence to Lockerbie Oxford: Centre for Libyan Studies 2003 (155)
[38] Clyde R. Mark "Libya: Current Overview of Issues" Libya: Current Issues and Historical Background New York: Nova Science Publishers, Inc. © 2003
[39] Niblock, Tim "Pariah States" & Sanctions in the Middle East: Iraq, Libya, Sudan Colorado: Lynne Reiner Publishers, Inc. © 2001 (63)

rose because of the sanctions and this lead to reductions in government spending elsewhere. Overall, Libya experienced a serious decline in living standards. This was exacerbated by Libya's central mismanagement of the economy and the oil prices dropping off until 1997. Social unrest spread in the country and led to an increase of Islamist sentiment in the 1990s. In the summer 1998 there were two assassination attempts on Gaddafi by Islamists. With the suspension of UN sanctions, European companies were eager to develop Libyan oil. Libya wants to increase oil production to 1970s level and needs 10 billion in foreign direct investment in 2010 to do so.[40]

Sanctions against Iran

The United States has imposed some form of economic sanction regime against Iran since the Islamic Revolution of 1979 and "nearly all of those sanctions have been unilateral U.S. actions without multilateral support."[41] On November 1979, Iran seized the U.S. embassy which led President Jimmy Carter to freeze twelve billion dollars worth of Iranian assets in America. Carter instituted a ban on all commerce and travel between Iran and the U.S., excluding transactions which related to food, medicine, and the media. In 1984 then Secretary of State George Shultz designated Iran a supporter of international terrorism and since this designation economic ties to Iran have been decreasing steadily. In October 6, 1987, both branches of congress passed resolutions banning imports from Iran. The oil embargo immediately ceased the near $1.6 billion in oil revenue to Iran from exporting to the U.S. but as of 2005 this had only contributed to $90 million in

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[40] Mark, Clyde R. "Libya Current Overview of Issues"

[41] Clawson, Patrick "Iran" Economic Sanctions and American Diplomacy *Council on Foreign Relations* © 1998 (85)

damage to the Iranian economy.[42] Due to the fungibility of oil, the welfare loss to Iran was only about ten percent of its previous oil revenues due to the availability of other markets.

In 1992 the Iraq-Iran Arms nonproliferation act significantly tightened restrictions on US exports to Iran, exports defined so broadly that could be possibly used militarily that it could include "everything developed in the computer age."[43] During President Clinton's early years his policy was criticized as "feel good containment", a policy that made the United States feel good but did not make Iran feel bad enough to change its behavior. Clinton's policies banned certain economic relations with Iran while allowing other relations to continue. This policy experienced a radical change with the signing of the Iran Libya Sanctions Act (discussed in detail in the next section of this paper) and in 1997 Clinton signed executive orders that banned U.S. exports to third countries if those goods were destined to be re-exported to Iran.

Iran Sanctions and Impacts Source: Peterson Institute

Year	Measure	Impact
1984	Oil import embargo	$90 Million, 10% decrease in price
1992	Restrictions on technology exports	$40 Million
1995	ILSA	$350 Million

The Iran Libya Sanctions Act: An Exercise in the Futility of Unilateral Sanctions

In March 7, 1995 the Conoco oil company of Texas entered into a contract to help assist the development of the Sirri Island oil field of Iran. President Clinton issued an executive order to prohibit companies from assisting the development of petroleum

[42] Peterson Institute "Case Studies in Sanctions and Terrorism: Iran" accessed March 22, 2009 http://www.petersoninstitute.org/research/topics/sanctions/iran3.cfm#economic
[43] Ibid. 86

resources in Iran to prevent Conoco from performing this contract. Eventually the Houston-based oil company withdrew but later that year, Total SA, a French company, took Conoco's place in the contract.[44] The result of this unilateral sanction was obvious failure. Iran's Sirri field still was developed and money that would have gone to the United States went to a French firm. The Total SA case is indicative of the fact that "U.S.-imposed economic isolation has failed to stem the tide of Iranian-sponsored fundamentalist terrorism or discourage investment by foreign entrepreneurs in Iranian business ventures. All along, however, principle has been pursued at the expense of American enterprises and financiers."[45] The blatant failure and unfair nature of this type of U.S. economic sanction led to a novel approach in US foreign policy with the passage of the Iran Libya Sanctions Act (ILSA) of 1996, which passed unanimously 415-0 in the House. ILSA was an attempt by the administration at extra-territorial application of U.S. economic sanction law by punishing companies that dealt with Iran and Libya. The President could now punish the French company, Total SA, for its involvement in developing Iranian petrol.

According to ILSA, the President must impose sanctions on "any person" who makes an "investment" of $40 million or more that "directly and significantly contributes to the enhancement" of the ability of those countries to develop their "petroleum resources."[46] In the case of Libya, exports to the country beyond petrol investments are also sanctionable offenses. [47] The word "any" includes non-U.S. persons which provides

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[44] Zedalis, Rex J, *The Total SA Case: The Meaning of Investment Under the ILSA,* 92 A.J.I.L. 539 (1998).
[45] Ibid 540
[46] Michael A. Asaro, *The Iran & Libya Sanctions Act of 1996: A Thorn in the Side of the World Trading System,* 23 Brooklyn J. Int'l L. 506 (1997).
[47] Harry L. Clark, *Dealing with US Extraterritorial Sanctions and Foreign Countermeasures,* 20 U. Pa. J. Int'l Econ. L. 111 (1999)

for the extra-territorial application of ILSA's sanction provision.[48]. This type of sanction is also referred to as a "secondary boycott"[49] where the U.S. sanctions companies that deal with the Iranian and Libyan regimes but not boycotting Iran or Libya exclusively.

Sanctionable persons include foreign companies, foreign individuals, and in some circumstances foreign nations. The President may also impose sanctions upon any person he determines to be a successor entity, parent, subsidiary or affiliate of a sanctioned person. There is a mens rea requirement to impose the sanctions, meaning that the President must find a parent or subsidiary company knowingly made a prohibited investment that violated ILSA.[50] Investment, defined under Section 14(9), excludes contracts to buy or sell goods, technology, or services, unless the contract is related to petroleum.[51] However, ILSA states that contracts of "responsibility" for the development of petroleum resources in Iran or Libya such as managerial services are sanctionable and in the "event a contract to provide financing can be considered as resulting in the financier's taking on "responsibility for" development, it is sanctionable."[52] Contracts that were created before ILSA are not prosecuted.

ILSA provides the President with six different types of sanctions to apply to violators of the act with the requirement that at least two of the sanctions be implemented. The President can[53]

1. Prohibit credit assistance from the Export-Import Bank to the sanctioned party

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[48] Ibid 102
[49] Harry L. Clark, *Dealing with US Extraterritorial Sanctions and Foreign Countermeasures,* 20 U. Pa. J. Int'l Econ. L. 111 (1999)
[50] Lucien J. Dhooge, *Meddling with the Mullahs: An Analysis of the Iran and Libya Sanctions Act of 1996,* 1998 27 Denv. J. Int'l L. & Pol'y 2 (1998).
[51] Marc C. Hebert & Bracewell & Patterson LLP, *Unilateralism as a Defense Mechanism: An Overview of the Iran and Libyan Sanctions Act of 1996*, 5 Yearbook of Int'l Law 15 (1996)
[52]Zedalis, Rex J, *The Total SA Case: The Meaning of Investment Under the ILSA,* 92 A.J.I.L. 541 (1998).
[53] Summary of sanctions from Michael A. Asaro, *The Iran & Libya Sanctions Act of 1996: A Thorn in the Side of the World Trading System,* 23 Brooklyn J. Int'l L. 506-507 (1997).

2. Refuse export licenses

3. Prohibit U.S. financial institutions from issuing loans over $10 million

4. If the sanctioned party is a financial institution, not to use it as a repository for U.S. funds

5. Prohibit the U.S. from entering in procurement contracts with the sanctioned party

6. Restrict imports from the sanctioned party

Ostensibly ILSA appears like a US attempt to dictate the economic security policies of other countries, but "ILSA's legislative history indicates that a primary goal of the statute is the establishment of a multilateral approach to containing the Iranian threat."[54] Section 9(a)(1) which states that, once the president determines that he is obligated to sanction a foreign "person," he is urged to "initiate consultations immediately with the government with primary jurisdiction over that foreign person." ILSA also gives an additional ninety day delay on sanctions if the President certifies to congress that the government of the sanctioned person is taking actions to rectify the situation. [55] The President also has the ability to choose to waive sanctions as he sees fit. Thirty days prior to granting a waiver, the President must notify all appropriate congressional committees.[56] A testament to ILSA's attempt at encouraging multilateral compliance is due to the fact that "unless the president has the power to remove sanctions or the threat of sanctions, foreign nations will have no incentive to come to any sort of agreement with the United States."[57]

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[54] Michael A. Asaro, *The Iran & Libya Sanctions Act of 1996: A Thorn in the Side of the World Trading System,* 23 Brooklyn J. Int'l L. 519 (1997).
[55] Ibid. 517
[56] Lucien J. Dhooge, *Meddling with the Mullahs: An Analysis of the Iran and Libya Sanctions Act of 1996,* 1998 27 Denv. J. Int'l L. & Pol'y 43 (1998).
[57] Michael A. Asaro, *The Iran & Libya Sanctions Act of 1996: A Thorn in the Side of the World Trading System,* 23 Brooklyn J. Int'l L. 518 (1997).

Although these provisions intended to bolster the President's diplomatic ability to induce foreign country compliance with its sanction efforts, internationally ILSA was not seen at all as a diplomatic tool. Multilateral support was especially lacking on Iran. Europe insisted on continuing trade with Iran because they argued that Washington's Interests are "exaggerated hostility based on domestic politics rather than strategic interests" and that engaging Iran would be more effective in changing Iranian behavior.[58] Backlash to ILSA soon rendered the act mute. As then Acting Assistant Secretary of State C. David Welch cautioned, ILSA would be counterproductive because "the cost of unilaterally enforcing the ban and absorbing the retaliatory measures by other governments would be far too high."[59]

Canada amended its Foreign Extraterritoriality Act so that the country would fine and punish domestic businesses that followed laws from another country.[60] The EU disagreed fundamentally with America's method for dealing with Iran through economic sanctions and diplomatic isolation, and instead believed in the "critical dialogue" approach to continue trade and use diplomacy as a method to change behavior.[61] European Union Trade Commissioner Sir Leon Brittan saw that ILSA would "establish the unwelcome principle that one country can dictate the foreign policy of others."[62] On October 1, 1996, the European Union's Council of Ministers announced it support of retaliatory measures against ILSA by using regulations that would forbid EU companies

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[58] Clawson, Patrick "Iran" Economic Sanctions and American Diplomacy *Council on Foreign Relations* © 1998 93

[59] Meghan McCurdy, *Unilateral Sanctions With a Twist: The Iran and Libya Sanctions Act of 1996*, 13 Am. U. Int'l L. Rev. 409-10 (1997).

[60] Lucien J. Dhooge, *Meddling with the Mullahs: An Analysis of the Iran and Libya Sanctions Act of 1996,* 1998 27 Denv. J. Int'l L. & Pol'y 5 (1998).

[61] Meghan McCurdy, *Unilateral Sanctions With a Twist: The Iran and Libya Sanctions Act of 1996*, 13 Am. U. Int'l L. Rev. 427 (1997).

[62] Ibid. 415

from complying with the act.[63] The EU issued Council Regulation in November of 1996 that laid out four countermeasures against ILSA. The regulation forbids persons or companies complying directly or indirectly with the sanctions, people are required to report if any sanction activity is harming EUs, and formal non-recognition of judgments from ILSA. Most important to this regulation is "clawback" rights where the EU has the power to recover any damages caused to persons by application of these sanctions.[64]

As ILSA was signed into law, the US was already embroiled in a similar case involving the Helms-Burton Act in front of the WTO. The Helms-Burton Act is similar to ILSA in that it also involves secondary boycott measures applied to foreign nationals and companies that do business with Cuba. The WTO dispute settlement body heard the case but eventually the EU and US suspended the arbitration for negotiations.[65] No extra-territorial application of the Helms-Burton Act was applied to major US trading partners. If a WTO dispute was held, the US would face considerable difficulty proving the legality of ILSA under its obligations to international trade. As signatories to the WTO, each member country has the right to trade with any other member. The cornerstone of the GATT and WTO, established in Article I of the GATT, is the Most Favored Nation status whereby each member country treats every other member country as if it was their most favored trading partner. The import and export sanctions of ILSA would fall under Article I because they constitute "rules…in connection with importation and

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[63] Marc C. Hebert & Bracewell & Patterson LLP, *Unilateralism as a Defense Mechanism: An Overview of the Iran and Libyan Sanctions Act of 1996*, 5 Yearbook of Int'l Law 25 (1996).
[64] Harry L. Clark, *Dealing with US Extraterritorial Sanctions and Foreign Countermeasures,* 20 U. Pa. J. Int'l Econ. L. 82 (1999)
[65] Michael A. Asaro, *The Iran & Libya Sanctions Act of 1996: A Thorn in the Side of the World Trading System,* 23 Brooklyn J. Int'l L. 511 (1997).

exportation."[66] Both ILSA's export and import sanction measures would violate Article XI because it does not allow a member country to place prohibitions or restrictions on the importation or exportation of goods from another member country.[67] Revoking export licenses and restricting imports pursuant to sanctions two and six of ILSA do not fall within the scope of the allowed regulations under Article XI.

The government procurement sanction set forth in ILSA violates the Agreement on Government Procurement in the GATT. The Agreement sets a national treatment standard requiring the government to consider procuring services from any company from another member country as if it was a domestic company.[68] ILSA would thereby discriminate against companies who dealt with Iran and Libya and require the US not to employ their services. The US could try to defend ILSA by citing GATT Article XXI which states that a member may take any action which "it considers necessary for the protection of its essential security interests…taken in time of war or other emergency in international relations."[69] Since ILSA was passed only two years from the conclusion of the Uruguay Round which created the binding WTO dispute settlement procedure, if the US used this argument, it could seriously undermine the WTO as the international organization as it was just gaining prominence. By using the security exemption, the US

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[66] Michael A. Asaro, *The Iran & Libya Sanctions Act of 1996: A Thorn in the Side of the World Trading System,* 23 Brooklyn J. Int'l L. 531(1997).
[67] Georgia McCullough Mayman, *The Iran and Libya Sanctions Act of 1996: Enforceable Response to Terrorism or Violation of International Law,* 19 Whittier L. Rev. 152 (1997).
[68] Lucien J. Dhooge, *Meddling with the Mullahs: An Analysis of the Iran and Libya Sanctions Act of 1996,* 1998 27 Denv. J. Int'l L. & Pol'y 51 (1998).
[69] Quoted in Meghan McCurdy, *Unilateral Sanctions With a Twist: The Iran and Libya Sanctions Act of 1996*, 13 Am. U. Int'l L. Rev. 419 (1997).

would set a precedent for other nations to abandon compliance with the GATT whenever they are in a political dispute.[70]

Due to the backlash and the WTO troubles ILSA would face, in 1998 President Clinton announced that he would waive trade sanctions against European firms that invested in Iran.[71] ILSA's intent to encourage multilateral participation with the economic isolation of Iran and Libya completely backfired. The consultation provisions in ILSA anticipated conflict with other nations' economic practices and sought to solve them, but the indignation and backlash of the other countries rendered the efficacy of these diplomatic measures mute. However ILSA's May 1995 ban on dealing with Iran did have an immediate impact on Iran. Iran was not able to sell about 400,000 barrels of crude a day and of the oil it could sell it had to sell at discounts of 30-80 cents a barrel. Foreign lenders such as commercial bankers and government export credit agencies became more wary to loan to the Iranians.[72] The Peterson Institute of Economics case study on sanctions against Iran found that the threat of ILSA's extraterritorial sanction provisions scared some foreign investment, and there was about a 5% drop in investment due to the fears.[73] This study of ILSA (now just the Iran Sanctions Act) teaches the importance of multilateral backing to economic sanctions.

Current Sanctions against Iran and Iran's Economic Environment

On March 12 in a message to Congress, President Barack Obama announced that he was going to renew the Iran Sanctions Act stating that "the actions and policies of the

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[70] Peter L. Fitzgerald, *Pierre Goes Online: Blacklisting and Secondary Boycotts in US Trade Policy,* 31 Vand. J. Transnat'l L. 85 (1998).
[71] David A. Gantz, *Globalizing Sanctions Against Foreign Bribery: The Emergence of a New International Legal Consensus*, 18 NW. J. INT'L L. & BUS. 467 (1998)
[72] Clawson, Patrick "Iran" 94
[73] Peterson Institute "Case Studies in Sanctions and Terrorism: Iran" accessed March 22, 2009 http://www.petersoninstitute.org/research/topics/sanctions/iran3.cfm#economic

government of Iran are contrary to the interests of the United States in the region and pose a continuing unusual and extraordinary threat to the U.S. national security and economy."[74] The current UN sanctions against Iran focus exclusively on banning the export to Iran of materials or information that could be used in assisting its nuclear program and the sanctions have some punitive measures to be levied against businesses that engage or develop Iranian nuclear capabilities. As of March, 2009, the UN, the US, and the EU have imposed sanctions on 171 different Iranian businesses that have been accused of being involved in nuclear development.[75]

Source: American Enterprise Institute

Year	Number of Transactions	Value of Transactions
2000	103	$50,895,000,000
2001	92	$25,809,000,000
2002	45	$8,214,000,000
2003	60	$22,235,000,000
2004	70	$182,725,000,000
2005	71	$24,609,000,000
2006	20	$5,515,000,000
2007	42	$109,594,000,000
2008	18	$4,572,000,000
Total	153	$265,223,000,000

International Business transactions have continued throughout the 21st Century. The American Enterprise Institute for Public Policy Research (AEI) reports that as of 2008, international business transactions in Iran totaled over 153 transactions and over $265 billion (see chart).[76] Germany has the most business transactions with Iran, with 72

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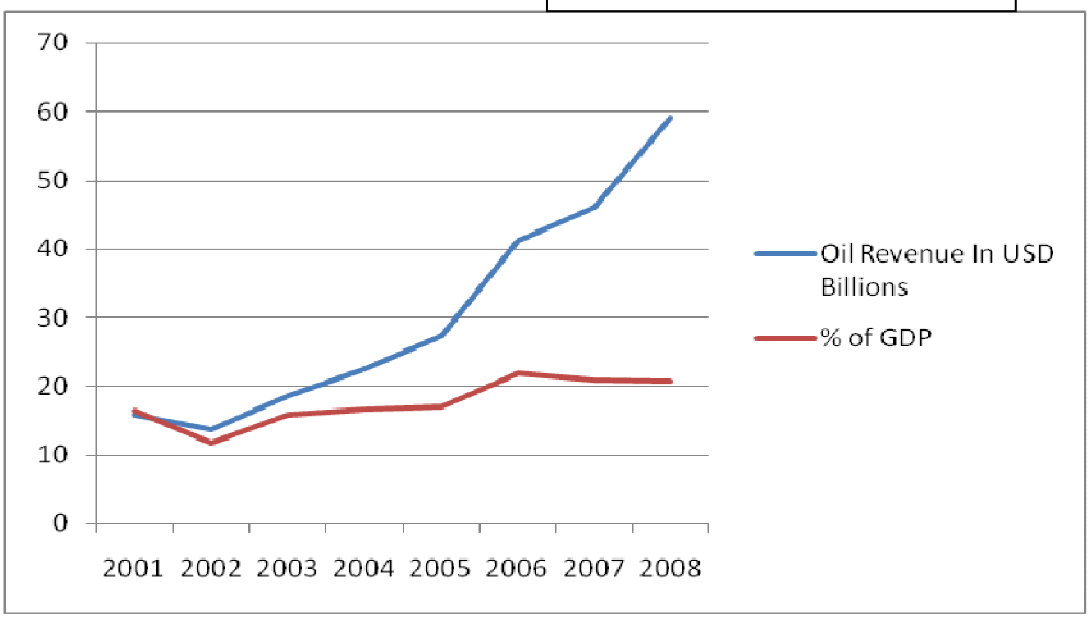
[74] "Obama: U.S. to continue sanctions against Iran," Xinhua, March 13, 2009, <http://news.xinhuanet.com/english/2009-03/13/content_11002887.htm>

[75] Iran Watch "Tracking the world's efforts to punish Iranian proliferators" March 6, 2009 accessed online March 22, 2009 <http://www.iranwatch.org/ourpubs/bulletin/unscmatrix.html>

[76] The American Enterprise Institute for Public Policy Research "IranInteractive" March 22, 2009 <http://www.aei.org/IranInteractive>

transactions alone over this period while China has had financially the most business with Iran, with over $122 billion in business transactions during this period. In addition to Germany and Iran, India and Japan have extensive economic ties with the country. In 2008 Iran's GDP was at $383 billion and the International Monetary Fund's World Economic Outlook for 2009 predicts that Iran's GDP will increase by 5% in the next year.[77] However, with the effect of the current financial crisis on the price of oil and availability of investment, Iran may only have a 2.4% growth rate in GDP in 2009, the lowest it has experienced in a decade.[78]

Iran's Oil Revenue Peak in 2008, based on data from OPEC



Iran is the world's fourth largest producer of oil and second largest OPEC producer. It has 10% of the world's proven oil reserves and 15% of the world's natural gas. Despite its massive oil production, Iran lacks enough refinery capacity to meet domestic needs and must import refined oil to solve this issue. In February 2007 Iran's oil

[77] International Monetary Fund "World Economic Outlook" October, 2008

[78] Report Buyer "Iran Business Forecast Q2 2009" excerpt. Accessed online April 14, 2009 <http://www.reportbuyer.com/countries/middle_east/iran/iran_business_forecast_report_q2_2009.html>

minister announced that the country needs $15 billion in investment to satisfy its refined oil need within five years.[79] As of 2008, Iran had amassed $80 billion in foreign reserves from the sale of oil, but the current drop in oil prices have diminished its revenue. As mentioned earlier, according to OPEC, Iran's oil revenue is $64.9 billion or about 23% of its GDP and about 80% of its export revenue.[80] Natural gas and oil combined make up 60% of Iran's government revenue. Iran currently has economic problems similar Libya in the 1990s: oil prices have dropped to less than $40 per barrel, far worse than the 50% drop in oil prices between 1997-1998.[81] Iran has an unemployment rate of 12%, with some experts saying it is actually closer to 30% and a 26% inflation rate as of June 2008.[82] Compounding these problems is Iranian mismanagement of its centrally planned. After the revolution, the Mullahs established charitable trusts called Bonyads which control about 20% of Iran's GDP. The Bonyads were an attempt to fuel money from economic activity to the poor but rather have led to enormous government waste, corruption, and a lack of market potential to spur economic growth.[83] Over 80% of these Bonyads may be losing money.

Conclusion: Can Multilateral Sanctions Overcome Iranian Rejectionism?

As Iranian President Mahmoud Ahmadinejad faces June elections, he has serious economic issues leading to his unpopularity. "The stunning fall of crude from its lofty summer heights of $147 a barrel has already forced Iranian President Mahmoud

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[79] Iran Daily "Iran's oil refining industry needs dlrs 15b investment: Oil Minister" February 17, 2007 accessed online March 22, 2009 < http://www.payvand.com/news/07/feb/1215.html>

[80] OPEC "Iran Facts and Figures (ASB) 2007 accessed online March 13, 2009 <http://www.opec.org/aboutus/member%20countries/iran.htm>

[81] Based on data from **Swivel Data** accessed online April 14, 2009 <http://www.swivel.com/data_columns/spreadsheet/2028111?order_by_direction=ASC&page=2>

[82] OPEC "Iran Facts and Figures"

[83] "Business: A mess; Iranian privatisation", The Economist. London: Jul 21, 2001. Vol. 360, Iss. 8231; pg. 51

Ahmadinejad to introduce unpopular measures."[84] Last year's government budget was based on $80 billion for a barrel of oil, but the drop in oil prices has already reduced daily oil income from about $300 million to just a little over $100 million a day.[85] Ahmadinejad is seen as a failure in many people's eyes as he did not wisely use the money from skyrocketing oil prices to invest in the economy and protect the country from woe during economic downturns. President Obama's new attempt to court the Iranians with diplomatic carrot and stick measures, the U.S. is keeping existing sanctions in place. The United States has realized that multilateral support is crucial for success against Iran, and is "moving to win support for harsher measures....for example, by offering concessions to Russia on other issues in order to win its cooperation in pressuring Tehran."[86] Although Russian cooperation may be hard to gain and an unforeseeable development Iran may feel more inclination to negotiate with Obama if it perceives a possibility of a shift in Russian foreign policy.

The main difference between the sanctions against Iran and those against Libya was the multilateral support the United States gained against Libya from the United Nations. Khomeini is facing high unemployment, high inflation, and economic malaise such as Gaddafi had to deal with in the mid to late 1990s. The Iran Libya Sanctions Act and other unilateral U.S. measures both applied to Gaddafi then, and to Khomeini now. Like Libya, Iran is facing a huge drop in oil prices, directly affecting government revenue. At this point, Libya started seriously considering and moving towards rapprochement with the West; Iran, despite its economic and political troubles, is still

[84] The Associated Press "Iran diverting funds into oil production" March 18, 2009 <http://www.iht.com/articles/ap/2009/03/18/business/EU-Iran-Oil.php>
[85] Ibid.
[86] Karon, Tony "Obama's Overture to Iran: Why Khomenei Won't Budge" *Time Magazine* March 23, 2009

moving full speed ahead with its nuclear development, inflammatory rhetoric, and military and financial support of Hamas and Hezbollah.

The United Nations Security Council applied serious and broad sanctions against Libya, restricting the import of products dealing with oil production and development and imposing a flight ban to the country. The current UNSC sanctions against Iran are limited to nuclear development, and have not slowed the advance of the nuclear program. As Iran seeks to increase oil production and revenue as well as develop its natural gas potential to mitigate its loss in revenue, it can easily do so. Garnering Russia's commitment to ending Iran's nuclear enrichment could be achieved if the U.S. negotiates the development of the anti-ballistic missile system and Russian accession to the WTO, while not backtracking on its commitments to the Ukraine and Georgia.[87]

As the U.S. looks to Russia as a potential partner in containing Iran, the country needs to look at the business involvement of its closest allies, including Germany and France. These European countries actively invest in Iran, especially in energy production. The "critical dialogue" approach touted by the European powers in their dissent from ILSA and the U.S.'s economic containment towards Iran has proven an utter failure. Germany's critical stance towards Iran's holocaust denial and nuclear development has not engendered change while the German country developed extensive business ties. France's similarly critical dialogue towards Iran was not aided by ignoring the Iran Libya Sanctions Act, allowing the French oil company Total SA to develop the Sirri oil field.

U.S. unilateral sanctions have caused significant economic damage, but only multilateral U.N. sanctions effectively hurt Libya. Although some scholars believe that

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[87] Hass, Richard N. and Martin S. Indyk "A Time for Diplomatic Renewal: Towards a new U.S. Strategy in the Middle east" Brookings Institute Press, December 2008

Iran's radical ideology and Nationalism will outweigh any economic incentives, the time is crucial to try the successful approach towards Libya to Iran. Although the economic costs to the sender country are significant, and these prevented an all out oil embargo on Libya, multilateral sanctions restricting oil and natural gas development and the export to Iran of related products should be instituted. The major European powers with significant investment in oil production to Iran should at the very least cease oil development and expansion while only keeping current production active. With Israel seriously considering a military strike on Iran, avoiding the disastrous consequences of a breakout of war or a nuclear Iran is a paramount objective of the world order.

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