Negotiations on Iran’s Nuclear Program

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Hearing before the
Senate Foreign Relations Committee

Washington, DC
February 4, 2014
Chairman Menendez, Ranking Member Corker, members of the Committee, on behalf of the Foundation for Defense of Democracies (FDD), thank you for inviting me to testify today on the implementation of the Joint Plan of Action with Iran and the impact of sanctions relief on the negotiations over Iran’s illicit nuclear program. I am honored to be testifying alongside David Albright, whose work I hold in the highest regard.

Introduction

Following the announcement of the Joint Plan of Action (JPOA) and the signing of the implementation agreement, Obama administration officials have repeatedly stated that, despite the “limited, temporary, and reversible” sanctions relief,¹ Iran is “not open for business,”² that the United States is not significantly easing sanctions on Iran,³ and that existing sanctions will be enforced in a “very aggressive manner.”⁴ At the same time, Iranian President Hassan Rouhani has been aggressively courting foreign companies, including at a recent appearance before the global business and political elite in Davos, Switzerland.⁵ Iran’s nuclear chief Ali Akbar Salehi has boasted, “The iceberg of sanctions is melting while our centrifuges are also still working.”⁶ Despite this, the Obama administration and its European allies are confident that, with the Geneva agreement that addresses Iran’s illicit nuclear program having been implemented on January 20, 2014, their carefully constructed Iran sanctions’ architecture will not be eroded—that is, until they decide to lift the toughest sanctions in exchange for a final nuclear agreement.

Their argument is this: Should Iran renege on the deal, the limited concessions the United States and other world powers are offering Iran in exchange for the dismantling of its illicit nuclear program are easily reversible. They are alsoadamant that the total value of sanctions relief is only $7 billion. “It’s not going to be hard for us to turn the dials back or strengthen sanctions even further,” President Obama claims, adding that he would “work

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with members of Congress to put even more pressure on Iran, but there’s no reason to do it right now.”

Regrettably, the administration and its allies may be miscalculating on these fronts as my testimony outlines. Bijan Khajehpour, a Vienna-based Iranian investment manager close to the Iranian government, noted “the beginnings of a ‘gold rush’ mood in Tehran.” Whether or not that view is yet fully justified, he has correctly identified the early stages of a shift in market sentiment that the interim agreement unintentionally but predictably triggered.

Although the Obama administration is correct that most sanctions measures remain in place, recent macroeconomic trends, changes in market sentiment, economic gains in specific sectors subject to sanctions relief, and worrying signals of large-scale sanctions-busting by U.S. partners indicate that economic pressure on the Iranian government is diminishing. If Iran’s economy recovers, the pressure on Iran’s leaders to follow through on a nuclear deal lessens. At that point, President Obama may discover that he has lost negotiating leverage and can’t turn sanctions off-and-on like a “dial.”

The Obama administration has already dispatched Treasury’s top sanctions official, David Cohen, to global capitals to convey the message to policymakers and the business community that nobody should rush to Tehran just yet. There are no more able and committed public officials than Under Secretary Cohen and his sanctions enforcement team. But can they restore fear in the international markets and prevent a psychological shift, both inside and outside Iran, which weakens American negotiating leverage?

The Obama administration is further cementing the impression of an Iranian economy that is open for business by blocking the Nuclear Weapon Free Iran Act, legislation co-sponsored by 59 Democratic and Republican senators and a House bill that passed in July 2013 by a vote of 400-20. Senators have tried to strengthen the administration’s hand by introducing “sanctions-in-waiting” legislation to keep a Sword of Damocles over international markets, to enforce Iranian nuclear compliance, and to impose an economic cost on Tehran if its continues its terrorist and ballistic missile activities.

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11 Statements from the Chairman and Ranking Member of the House Committee on Foreign Affairs as well as the full text of the legislation, HR 850 Nuclear Prevention Act of 2013, are available on the Committee’s website, accessed January 31, 2014. (http://foreignaffairs.house.gov/bill/hr-850-nuclear-iran-prevention-act)
The proposed legislation would lend credibility to the administration’s message—that this is the wrong time for companies to go streaming back into Iran. It would also impose a heavy price on sanctions-busters who bet prematurely that Iran will comply with its Geneva nuclear commitments, not launch or support terrorist attacks directly or by its proxies against Americans, not test intermediate-range or long-range ballistic missiles that threaten America and our allies, and meet the international community’s requirements for an acceptable deal within 12 months.

With the White House committed to blocking any new congressional measures, the Obama administration is making a bet that it can prevent the unraveling of the sanctions regime and maintain a strong negotiating hand to peacefully resolve the Iranian nuclear crisis. That is a dangerous bet, particularly when miscalculation could mean the most dangerous state sponsor of terrorism in the world getting its hands on the world’s most lethal weapon.

**The Dollar Value of Direct Sanctions Relief**

The Obama administration values the Geneva sanctions relief package at approximately $7 billion. The relief package allows for the release of $4.2 billion in cash from frozen oil revenues; sanctions relief on Iran’s auto sector, petrochemicals sector and precious metals trade (valued by the administration at $1.5 billion); civilian aircraft parts relief; $400 million in Iranian government tuition assistance for Iranian students studying abroad; and the opening of financial channels to facilitate humanitarian transactions. The package also includes the suspension of congressionally-mandated significant reductions in crude oil purchases during the interim period.

An infusion of $7 billion into Iran’s troubled economy might not sound like a lot in today’s world. Indeed, the administration has argued that this direct sanctions relief is small and of little importance for a country with an economy of $1 trillion (GDP in purchasing power parity terms; under $500 billion in nominal GDP) and foreign reserves worth $100 billion.

These numbers, however, do not accurately reflect the full value of the actual sanctions relief. Prior to the agreement, Iran had *fully accessible* overseas cash reserves of only $20 billion. The remainder of the $100 billion was tied up in frozen or semi-accessible escrow accounts. As a result, the $7 billion infusion into Iran’s economy represents a 35% increase in Iran’s fully accessible foreign exchange reserves.

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13 Secretary of State John Kerry, “The P5+1’s First Step Agreement With Iran on its Nuclear Program,” *Testimony before the House Committee on Foreign Affairs*, December 10, 2013. ([http://www.state.gov/secretary/remarks/2013/12/218578.htm](http://www.state.gov/secretary/remarks/2013/12/218578.htm))

The Psychology of Sanctions Relief

The $7 billion in sanctions relief also does not account for the psychological impact that the Geneva deal and sanctions relief is having on markets, business, and investors. The impact of sanctions has always been as much psychological as it has been legal. The efficacy of sanctions is predicated upon a strategy of escalation, and a perception of high risk, where an ever-expanding web of restrictions effectively spooked foreign business from investing in, or trading with, Iran. Fear triumphed over greed as companies viewed Iran as an economic minefield.

Before November 24, 2013, when the framework agreement was signed in Geneva, even those who could conduct legitimate business with Iranian counterparts were hesitant to do so. Driven by fear of economic loss and legal sanctions, they viewed the risks as too high.

But the tide is now turning. Though many legal restrictions remain in place, greed is starting to overcome fear. Sanctions barriers, in key sectors of Iran’s economy like energy, automotive, petrochemical, and aviation, have been significantly reduced or suspended. The White House has blocked new congressional sanctions legislation, sending a signal that it is no longer pursuing a strategy of sanctions escalation, at least for now. This creates a general impression abroad that the White House’s resolve is waning, and that the risks of doing business with Iran are diminishing.

This impression has already improved the economic climate, resulting in some illegitimate deals as companies test the waters. With the expectation of further sanctions relief soon, others businesses might now take risks they would not even contemplate as recently as three months ago. I discuss examples of both below.

The message from Washington is muddled: on the one hand the United States is releasing billions of dollars and lifting sanctions on key Iranian economic sectors. On the other hand, it is telling the business community that no one should rush back to Iran since the limited sanctions relief on offer is only for six months. Despite these warnings, the JPOA itself contemplates a twelve-month negotiating period. It also is not unreasonable to assume that, if more time is needed, the Obama administration could agree to further extend the diplomatic process for additional six-month periods and offer additional sanctions relief to keep the Iranian government at the table. As a result of this muddled message, businesses are looking to get back into the Iranian market ahead of their competitors in ways that may ultimately undermine the sanctions regime.

As a result of the current confusing environment created by the administration’s policies, in order to maintain the efficacy of existing sanctions, Washington will have to sanction

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foreign sanctions-busters, even from P5+1 partners like Russia and China, our European allies, or key Middle Eastern countries such as Turkey. Already, as discussed below, companies from some these countries have challenged Washington’s will to enforce existing sanctions.

Market Recovery and Investor Outlook

There has been an undeniable shift in market psychology, both among Iranian businesses and those companies looking to do business with Iran. The change in Iranian consumer and investor sentiment is reflected in Iran’s economic performance as reflected in modest GDP growth, a marked increase in the value of Iran’s currency, a significant drop in inflation, and a sharp increase in the value of Iran’s stock exchange.

The Iranian economy has shown signs of modest growth and stabilization since Rouhani’s election in June 2013. Indeed, Iran has been on a modest recovery path since its *annus horribilis* of 2012 and the first half of 2013, when the Iranian economy was hit with an asymmetric shock from sanctions targeting the Central Bank of Iran, Iranian oil exports, access to the SWIFT international banking system, the National Iranian Oil Company, shipping and insurance, key sectors of the Iranian economy, and precious metals, amongst others. The poor economic management of the Iranian economy by the Mahmoud Ahmadinejad government further exacerbated these sanctions-induced shocks.

Key economic indicators of Iran’s economic malaise and their subsequent recovery are discussed below.

**Gross Domestic Product**

Iran’s economy was hammered by tough sanctions measures through 2012 and early 2013. The World Bank estimates that Iran’s GDP shrunk by 2.9% in 2012 and 1.5% in 2013. Iran’s current account balance as a percentage of GDP also dropped steeply from 2.8% to -0.9% as its oil revenues fell sharply.

The Institute of International Finance, which draws on data released by the Central Bank of Iran, estimates that real Iranian GDP contracted 5.6% between April 2012 and March 2013, and nominal GDP fell to as low as $381 billion.

But, Iran’s economy is starting to recover as the most significant effects of the sanctions imposed in 2012 and early 2013 have been absorbed. Although Iran’s economy remains weak, it has begun to stabilize and adjust rather than deteriorate further. According to the World Bank’s *Global Economic Prospects* report, Iran’s real GDP is expected to grow by

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1% in 2014, 1.8% in 2015, and another 2% in 2016. Similarly, the International Monetary Fund estimates Iran’s economy will grow by 1.28% and 1.98% in 2014 and 2015, respectively.

While it is likely that a more competent economic team under Rouhani would have mitigated the severity of the impact of further sanctions, the new Iranian president and his team have benefitted from a less difficult sanctions environment than their predecessor. Sanctions are de-escalating, direct sanctions relief is flowing, and new sanctions, at least for the next twelve months through the Geneva interim period, seem unlikely.

Exchange Rate

A key indicator of the economic climate in Iran, and overall investor and consumer confidence, is the value of the rial. The black-market rial exchange rate experienced a three-year free fall from 10,440 to the dollar in January 2010 to a rate of 41,000 in October 2012, representing a loss of almost 75%. Since Rouhani’s election, however, the black-market exchange rate increased from 36,300 on June 15, 2013 (election day) to 24,865 (as of January 29, 2014). This represents a more than 46% increase in the value of the Iranian currency since Rouhani’s election.

Since the announcement of the JPOA on November 24, 2013, the black-market exchange rate has increased from 29,300 to 24,865 (as of January 29, 2014), representing a 18% increase in value. Some experts, who see the rial as an important “weather vane” for the health of the Iranian economy, have now taken the rial off their list of “troubled currencies,” while acknowledging, “Rouhani’s economic progress in Iran is tentative and likely quite fragile.”

Inflation

Rouhani claims that his administration has brought down the inflation rate from 43% to 28.8%. The Statistical Center of Iran recently announced that the official inflation rate for the 2013 calendar year was 35%, down from the 40% official year-on-year inflation rate that Iran faced before the Geneva talks in November, and a sharp drop from Iran’s

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estimated 62% unofficial monthly inflation rate in October 2012. On a quarterly annualized basis, inflation now has fallen to about 20% as a result of the stabilization in the rial. The significant reduction in Iran’s punishing inflation rate is further evidence that Iran’s economy may be stabilizing from the deep recession of 2012.

**Tehran Stock Exchange**

Since Rouhani’s election, there has also been a surge in the Tehran Stock Exchange (TSE), representing renewed investor confidence. The TSE index almost doubled from 45,000 to over 80,000 points. After peaking at 89,000 at the beginning of January, the index has lost 7% and fallen to 81,905 by January 26, although it appears too early to tell whether this drop indicates a renewed decline in investor confidence, a minor correction, or fear of corruption and insider trading. Another possible explanation for the modest drop is that the recent loosening of financial restrictions is providing Iranians with more investment opportunities, and so they are diversifying their portfolios and moving money elsewhere.

**Trade Delegations and Future Investments**

As the market psychology shifts from fear to greed, companies that previously shied away from Iran are eyeing possible openings and re-openings. Companies that were afraid of the financial and reputational risks associated with doing business in Iran are reevaluating.

Since December 2013, Tehran has received trade delegations and parliamentary missions from more than a dozen countries, all expressing interest in business opportunities in Iran. According to The New York Times, Iran hosted more European delegations in the first two weeks of 2014 than in all of 2013. German companies, which exported around $2 billion in goods to Iran in 2013, are looking to ramp up their

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Iranian activities along with their Dutch, Austrian, Italian, French and other European competitors. And on a visit to Tehran at the end of January, Turkish Prime Minister Recep Tayyip Erdogan pledged to increase bilateral trade to $30 billion by 2015, with a particular emphasis on increasing Turkish exports to rebalance a Turkish trade deficit with Iran valued at $4 billion in the 12 months ending August 2013.

The Director General of Iran’s Trade Promotion Organization, Mehrdad Jalalipour, noted a 70% increase in participation in trade fairs in October and November compared to the previous year. Hotels throughout Tehran are reportedly “fully booked by businessmen from Germany, the UK, [and] other European countries,” notes Sarosh Zaiwalla, the London-based lawyer who represented Bank Mellat in its judicial challenge against EU sanctions. Chambers of Commerce are organizing seminars to help make connections and advance business with Iran. While it will take some time for these activities to generate significant economic activity, they are paving the way for future Iranian growth.

Sanctions Relief Case Study #1: Iran’s Auto Sector

The JPOA grants sanctions relief to Iran’s embattled auto sector, the second largest sector of the Iranian economy after energy. Prior to the imposition of U.S. sanctions, Iran’s auto sector was a major source of export earnings, industrial production and assembly, employment, and GDP. Specifically, the auto sector employed some 700,000 Iranians, or 4% of the total Iranian workforce, and accounted for about 10% of Iran’s GDP. or about $50 billion.

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37 “مکان‌های حضور هیات‌های تجاری برلین، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور，بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور，بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، ونکوور، بایرن، آمستردام، و
The U.S. imposed sanctions on the Iranian auto sector on June 3, 2013 because of the dominant role played by Iran’s Islamic Revolutionary Guard Corps (IRGC) in its control of Iran’s major auto companies, Khodro, Saipa, and Bahman. At the time, according to CBS News, Obama administration officials identified the auto sector as an important source of both revenues and dual-use equipment for the Iranian regime and its IRGC-controlled nuclear and ballistic missile programs.

White House spokesman Jay Carney described the auto sanctions and other measures as, “part of President Obama’s commitment to prevent Iran from acquiring a nuclear weapon, by raising the cost of Iran’s defiance of the international community.”

The impact of these sanctions was significant. The imposition of automotive sanctions, the rapid increase in inflation, and the financial and economic sanctions that had already taken their toll, further hammered the sector. According to the Washington Post, auto production dropped by 40%, after its global ranking had already fallen from 13th to 21st in just two years.

The decline was so dramatic that Iranian-born economist Mehrdad Emadi of the U.K.-based Betamatrix International Consultancy stated that the “sector has really been close to collapse because they haven't been able to import the latest capital equipment.”

Sanctions relief afforded by the JPOA could now reverse this rapid decline in both Iranian auto production and exports, alleviating pressure on the Iranian regime and the IRGC.

American sanctions on “Iran’s auto industry, as well as sanctions on associated services,” like insurance, transportation, and financial services, are being suspended, according to

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the JPOA.\textsuperscript{49} The White House estimates that easing auto industry sanctions will yield Iran only $500 million over the six-month interim period.\textsuperscript{50}

The $500 million valuation appears to be derived from expected revenue from exports of Iranian cars. However, it does not account for the total impact of a revived auto sector on the Iranian economy, including cars produced for the domestic market, wages paid, and other economic activity.

Automotive sanctions have impacted much more than just Iranian export revenue. According to the \textit{Associated Press}, these sanctions have led to “some 100,000 Iranian auto workers” being laid off, and plants running “at less than half their capacity.”\textsuperscript{51} With Iranian auto companies reportedly unable to receive parts from their foreign suppliers, the \textit{Financial Times} reported that Iran’s two largest state-run carmakers, Iran Khodro and Saipa, were “suffering from overstaffing—or ‘hidden unemployment,’” as the domestic media call it—due to the decline in output.\textsuperscript{52} In July 2013, an Iranian automotive representative noted that production units had been forced to lay off between 30\% and 50\% of their workforce.\textsuperscript{53}

Sanctions relief, then, is likely to generate direct economic value for the Iranian economy and billions in earnings for the blacklisted Revolutionary Guards. Any recovery in such a critical sector that recently generated about $50 billion annually for Iran’s economy will have a multiplier effect on recovered jobs, wages paid, GDP growth, and improved investor and consumer confidence. Indeed, employment in the auto sector could prove to be the most politically visible form of sanctions relief for Rouhani, who has promised to revive Iran’s struggling economy.

The projected growth of the domestic Iranian auto sector is attracting significant interest from global auto manufacturers in returning to partnerships with Iranian auto companies. Shortly after the signing of the JPOA, Iran held an international automotive conference attended by representatives from German, Indian, Japanese and South Korean auto

companies. As a result of the JPOA, press reports indicated that this conference garnered great interest.

Global auto companies are now poised to reenter Iran and renew business relationships. Major auto manufacturers that formerly invested in the Iranian auto sector, such as France’s PSA Peugeot Citroen and Renault SA, have expressed optimism that they will be able to reap significant benefits in the coming months. Indeed, Renault has already resumed shipments to Iran’s domestic auto company Iran Khodro, while both Renault and Peugeot Citroen are reportedly interested in resuming vehicle assembly and sales with local Iranian partners.

These companies understand that Iran’s auto sector is poised to experience even greater growth on the horizon. An October study by the Boston Consulting Group assessed that Iran had the “theoretical potential to attain an impressive 1.5 million in new-vehicle sales by 2020, which would make it the third-largest Beyond BRIC market.” Such production would be “on par with Canada’s 2012 car sales and well ahead of Italy’s,” according to Canada’s Globe and Mail.

The White House could be correct that Iran’s auto sector will only generate $500 million in revenue over the next six months. Export revenue growth may be limited by the existing sanctions that complicate international transactions. Growth could be further hindered by the slow ramp-up required in domestic production. And loopholes on insurance, transportation, and banking transactions could be closed by rigorous enforcement. More broadly, given the depreciation of the overall Iranian economy, it is highly unlikely that the auto sector could return soon to its peak levels, when it was contributing about $50 billion in annual GDP to Iran’s overall economy.

But the suspension of automotive sanctions will undoubtedly generate additional economic benefits for Iran, beyond what was stipulated in the JPOA. It is inconceivable that the Iranian automotive sector will fail to contribute to increased GDP over the next


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six months through production, domestic sales, wages paid, and other economic activity beyond the administration’s estimate of $500 million in export revenue.

Even if Iran’s auto sector contributed only ten percent of the sector’s previous $50 billion annual contribution in GDP to Iran’s overall economy, that would be worth $2.5 billion in additional economic activity over the next six months. In this way, Washington may end up providing far greater economic benefits to the Iranian government, and to the IRGC, than has been asserted.

**Sanctions Relief Case Study #2: Iran’s Petrochemical Sector**

The JPOA provides sanctions relief to Iran’s petrochemical sector. According to an August 2013 *Business Monitor International* report, Iran exported $11.2 billion last year in petrochemical products, and it projects an increase of another $1 billion next year.\(^60\) With the lifting of petrochemical sanctions, there is already renewed confidence in the sector. Since October 1, 2013, the market value of companies in this sector surged from $25 billion to $34 billion due to the gains on the Tehran Stock Exchange, the rial appreciation, and the suspension of U.S. sanctions.\(^61\) Between the middle of October and the beginning of December, the sector grew nearly 40%, with a significant spike occurring after November 17 when the P5+1 first appeared to be close to signing an interim deal with Iran.\(^62\)

While an increase in the market valuations of these companies doesn’t necessarily mean an increase in real economic activity, and they could face reversals, it does suggest increased investor and consumer confidence in a sector that, by the volume of total production, grew by 22% for two years in a row between 2011 and 2013 and is projected to grow by almost 10% between 2013 and 2014 and by 10.6% between 2014 and 2015.\(^63\) In fact Iranian customs data shows that even before the JPOA, petrochemicals were the largest of Iran’s non-oil exports in dollar terms.

Growth in Iran’s petrochemical sector is particularly problematic because the largest companies in the industry are owned or controlled by Iran’s Islamic Revolutionary Guards Corps (IRGC), the Iran government, and the Supreme Leader.\(^64\) In fact, of the 14 petrochemical companies that had been sanctioned but are now permitted to do business abroad, Iran’s Supreme Leader Ali Khamenei controls three through his Setad business

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\(^63\) Data is available upon request.

empire. The IRGC is the second largest shareholder in the industry after the Iranian government itself.

Sanctions Relief Case Study #3: Iran’s Oil Exports

Iran’s oil exports have rebounded nearly 60% from historic lows of 761,000 bpd in October 2013, to 1.2 million bpd in January 2014. This should be of particular concern to this Committee, given its involvement in congressionally-mandated oil market sanctions against Iran.

The JPOA suspended U.S. oil sanctions, which required current Iran customers to significantly reduce their Iranian oil purchases to qualify for an exception to sanctions. Instead, the JPOA allows oil sales at current levels, which had already flatlined at around 1 to 1.2 million barrels per day (bpd). This suspension is taking pressure off Iran’s oil sector, which had been close to running out of storage capacity for its production surplus and was in danger of incurring irreparable losses stemming from the forced closure of oil fields if further reductions were enforced.

The $7 billion in sanctions relief valuation does not include the value of this suspension of U.S. oil sanctions over the next six months. FDD estimates that this concession is worth between $4.5 and $5 billion in oil revenue that Iran would have otherwise lost had the significant reduction sanctions continued to be enforced.

Technically, this money would be required to be paid into largely restricted escrow accounts, only available to Tehran to fund bilateral trade with its oil buyers. However, recent revelations from Turkey raise questions about how airtight these restrictions really are. The Turkey-Iran “gas-for-gold scandal” (discussed below) revealed how Iran was able to circumvent these restrictions to access billions of dollars through middlemen and allegedly corrupt Turkish officials.

The $4.5 to $5 billion in projected oil revenue noted above also does not include the real possibility that Iran will successfully circumvent the remaining oil sanctions by selling additional crude under the table. In fact, Rouhani’s 2014 budget, which he recently submitted to Iran’s parliament, is based on the assumption that Iran will sell 1.5 million bpd or approximately twice October 2013 levels.

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Additionally, Iran is likely to benefit from sanctions relief in related sectors. Under the Geneva agreement, Iran also benefits from regaining access to affordable insurance policies for the transportation of its oil and other goods.\footnote{Daniel Fineren, “Iran Nuclear Deal Shipping Insurance Element May Help Oil Sales,” \textit{Reuters}, November 24, 2013. (http://www.reuters.com/article/2013/11/24/us-iran-nuclear-oil-idUSBRE9AN07A20131124)} Insurance premiums on legal shipments will not only go down, but there also is a reasonable chance that Iran will manage to insure more than it is allowed to export.

The reduced transaction costs may lead to additional boosts in exports, or at least reduce the oil price discount that Iran had to offer and the insurance premiums that Iran had to pay to sell its crude. The suspension of shipping and insurance sanctions also means that Iran now can cease to rely on foreign-owned vessels to transport goods, freeing up shipping capacity to deliver its oil.

\textit{Sanctions Relief Case Study #4: Iran’s Financial Sector}


Furthermore, the EU has authorized a ten-fold increase in its authorized threshold—from €40,000 to €400,000—for transactions with banks in Iran.\footnote{European Union, Factsheet, “E3/EU +3 Nuclear Negotiations with Iran: Terms of the Agreement on a Joint Plan of Action, Including Measures to be Undertaken by the European Union,” January 17, 2014, page 3. (http://eeas.europa.eu/statements/docs/2013/131219_02_en.pdf)} Vigorous enforcement by the European Union as well as by the U.S. Treasury will be necessary to ensure that Iran does not exploit loopholes—as Tehran appears to have done with Turkey’s state-owned bank Halkbank, Turkish gold traders, and middlemen to access more than $100 billion in an elaborate “gas-for-gold” scheme.\footnote{Jonathan Schanzer & Mark Dubowitz, “Iran’s Turkish Gold Rush,” \textit{Foreign Policy}, December 26, 2013. (http://www.foreignpolicy.com/articles/2013/12/26/irans_turkish_gold_rush)}
A Case Study in Sanction Enforcement Failure: Gas-for-Gold

Turkey’s Islamist government is being rocked by the most sweeping corruption scandal of its tenure. Roughly two dozen figures, including well-connected business tycoons and the sons of top government ministers, have been charged with a wide range of financial crimes. The charges ballooned into a full-blown crisis on December 25 when three ministers implicated in the scandal resigned, with one making a dramatic call for Prime Minister Recep Tayyip Erdogan to step down.

The drama surrounding two personalities was particularly notable: Police reportedly discovered shoeboxes containing $4.5 million in the home of Suleyman Aslan, the CEO of state-owned Halkbank. Authorities also arrested Reza Zarrab, an Iranian businessman who primarily deals in the gold trade, and who allegedly oversaw deals worth almost $10 billion last year alone.

The gold trade has long been at the center of controversial financial ties between Halkbank and Iran. Research conducted in May 2013 by the Foundation for Defense of Democracies and Roubini Global Economics revealed the bank exploited a “golden loophole” in the U.S.-led financial sanctions regime designed to curb Iran's nuclear ambitions.

The scheme was elaborate, yet straightforward. The Turks exported some $13 billion of gold to Tehran directly, or through the UAE, between March 2012 and July 2013. In return, the Turks received Iranian natural gas and oil. But because sanctions prevented Iran from getting paid in dollars or euros, the Turks allowed Tehran to buy gold with their Turkish lira—and that gold found its way back to Iranian coffers.

For more on this, see: Jonathan Schanzer & Mark Dubowitz, “Iran’s Turkish Gold Rush,” Foreign Policy, December 26, 2013. (http://www.foreignpolicy.com/articles/2013/12/26/irans_turkish_gold_rush#sthash.gukDBhir.dJKBFFbD.dpbs)


This “gas-for-gold” scheme allowed the Iranians to replenish their dwindling foreign exchange reserves, which had been hit hard by the international sanctions placed on their banking system. It was puzzling that Ankara allowed this to continue: The Turks—NATO allies who have assured Washington that they oppose Iran’s military-nuclear program—brazenly conducted these massive gold transactions even after the Obama administration tightened sanctions on Iran’s precious metals trade in July 2012.  

Turkey, however, chose to exploit a loophole that technically permitted the transfer of billions of dollars of gold to so-called “private” entities in Iran. Iranian Ambassador to Turkey Ali Reza Bikdeli recently praised Halkbank for its “smart management decisions in recent years [that] have played an important role in Iranian-Turkish relations.” Halkbank insists that its role in these transactions was entirely legal.

The U.S. Congress and President Obama closed this “golden loophole” in January 2013. At the time, the Obama administration could have taken action against Halkbank, which processed these sanctions-busting transactions, using the sanctions already in place to cut the bank off from the U.S. financial system. Instead, the administration lobbied Congress to make sure the legislation that closed this loophole did not take effect for six months—effectively ensuring that the gold transactions continued apace until July 1. That helped Iran accrue billions of dollars more in gold, further undermining the sanctions regime.

In defending its decision not to enforce its own sanctions, the Obama administration insisted that Turkey only transferred gold to private Iranian citizens. The administration argued that, as a result, this wasn’t an explicit violation of its executive order.

In the one-year period between July 2012, when the executive order was issued, and July 2013, when the “golden loophole” was finally closed, the Obama administration’s non-enforcement of its own sanctions reportedly provided Iran with $6 billion worth of gold. That windfall may have been an American olive branch to Iran—extended via Turkey—to persuade its leaders to continue backchannel negotiations with the United States,  

which reportedly began as early as July 2012. It could also have been a significant sweetener to the interim nuclear deal eventually reached at Geneva, which provided Iran with another $7 billion in sanctions relief.

Indeed, why else would the administration have allowed the Turkish gold trade to continue for an extra six months, when Congress made clear its intent to shut it down? The ongoing corruption investigation in Turkey could provide a window into some nagging questions about the gas-for-gold scheme. Indeed, it could help explain why the Turkish government allowed Iran to stock up on gold while it was defiantly pursuing its illicit nuclear program—and whether or not the Obama administration could have done more to prevent it.

Case Study on Sanctions Enforcement Challenge: Russian-Iranian Oil-for-Goods Deal

With gas-for-gold in the rear view mirror, Moscow is now posing a similar challenge to the U.S. sanctions regime. Reuters recently revealed a lucrative and illegal oil-for-goods deal between Russia and Iran. The proposed deal, worth possibly $1.5 billion per month or $18 billion annually, would include Russian purchases of up to 500,000 bpd of Iranian oil—boosting Iranian exports by as much as 50%—in exchange for Russian equipment and goods. The deal would ease further pressure on Iran’s battered energy sector and at least partially restore Iran’s access to oil customers with Russian help. And those sums don’t include the potential for further Iranian-Russian illicit finance and sanction-busting schemes that the deal could provide, including the transfer of sanctioned nuclear, ballistic missile, and other military equipment to Tehran, and the establishment of Russian-Iranian financial channels to facilitate other illicit transactions.

The administration has denounced the proposed deal as contrary to the interim agreement and a violation of U.S. sanctions, but will President Obama take on Vladimir Putin, on whom U.S. policy now depends to get both Tehran and Damascus to abandon their WMD programs? If Washington can’t stop this deal, it could serve as a signal to other countries that the United States won’t risk major diplomatic disputes at the expense of the sanctions regime.

As international companies test the waters in an environment of de-escalating sanctions pressure, the Obama administration may find itself facing the difficult choice of permitting sanctions-violations from Russia, China, Turkey, and other key partners and watching the sanctions’ architecture unravel, or sanctioning companies from these countries, including our P5+1 partners, with the potential for severe diplomatic blowback.

**The Impact of Iran’s Economic Recovery on Nuclear Negotiations**

The administration’s dual policy of sanctions and negotiations with Iran has always been based on the idea that economic sanctions can provide leverage to get Iran to the negotiating table to reach a comprehensive nuclear deal that stops Iran’s illicit military-nuclear program. Indeed, Secretary of State Kerry has attributed Iran’s willingness to negotiate at Geneva to the intense pressure of international sanctions.92

It is a credit to the members of this Committee and your colleagues in the House that the United States has the kind of strong, comprehensive sanctions in place that have persuaded Iran to come to the table. Over the objections of the Obama administration and others who argued that the sanctions against the Central Bank of Iran, measures to reduce Iran’s crude oil exports, and sanctions to force SWIFT to expel Iranian banks, amongst others, were either unlikely to have an effect on Iran or were too drastic to consider, you and your colleagues understood that there was a smart way to craft these sanctions to provide Washington with enhanced negotiating leverage.

Yet, now there is significant evidence that Iran’s economy is showing signs of stabilization and modest recovery. Whether due to the overall global economic recovery, better economic management by the Rouhani administration as compared to the Ahmadinejad administration, and/or changing market psychology because of sanctions relief, the result is that the United States may be losing the very leverage that brought Iran to the table.

I am concerned that the P5+1 sanctions relief in exchange for reversible nuclear concessions by Tehran will improve Iran’s negotiating position and therefore lessen the pressure on the regime to come to a long-term, enforceable, negotiated solution. This increases the likelihood of a deal that does not adequately address Iran’s illicit military-nuclear program, leaving Iran with the option, at a time of its choosing, to develop an Iranian nuclear weapon, or requiring the U.S. president or Israeli Prime Minister to use military force to forestall that possibility.

**Policy Recommendations**

In order to preserve our negotiating leverage, the Obama administration will need to convince global companies that it is willing to defend the sanctions’ architecture against violators and impose punitive measures, even against key allies and partners. This could quickly devolve into an untenable situation—putting stress on our alliances, which could erode the leverage we hope to use to convince Iran to make significant reductions in its nuclear program.

Congress can support the administration’s efforts to shore up our economic sanctions and our negotiating leverage by passing the *Nuclear Weapon Free Iran Act* “sanctions-in-
waiting” legislation, which many members of this Committee already support. The purpose of this legislation is to buttress the argument that Iran is not open for businesses, to clearly outline the conditions under which Iran will lose existing sanctions relief (and be hit with additional sanctions) during the interim period, and to establish broad parameters for what constitutes an acceptable nuclear deal.

The legislation is important to pass now, rather than after a collapse of talks, because it dangles a Sword of Damocles over international companies considering a return to Iran. It is a crucial instrument in preventing the shift in market psychology that already is beginning to create economic benefits for Iran. It lays down a clear deadline of twelve months for nuclear negotiations so that Iran does not endlessly prolong the negotiations while reaping further economic benefits as the passage of time weakens the existing sanctions regime and makes companies more confident to enter the Iranian market. And it lays down important parameters by Congress to govern what constitutes an acceptable final deal, including precluding Iran from achieving a nuclear weapons breakout capability and prevented it from pursuing both uranium and plutonium pathways to a nuclear weapon.

While Iran’s Foreign Minister Javad Zarif has threatened to walk away from the table if Congress passes new legislation, it is important to note that such a move would come with steep economic costs for Iran. A recent economic analysis by FDD and Roubini Global Economics estimates that new sanctions could precipitate a major economic shock that leads to a significant depreciation of Iran’s currency, which will fuel inflation and asset bubbles, force fiscal austerity, and send Iran back into a deep recession.

Iran’s economy would risk further deterioration in the following areas:

1) Iran would lose all of the sanctions relief promised under the JPOA, which is worth significantly more than $7 billion.

2) Oil exports would fall to 500,000 bpd, which would be a reduction of approximately 500,000 bpd from current levels, or a loss of about $9 billion in revenues over six months.

3) New sanctions would also hit Iran’s fuel oil, natural gas, and condensates exports, which are valued at about $1.6 billion per month as of May 2013. This would be a further loss of $9.6 billion in revenues.


4) The accelerated depletion of revenues and reserves would likely precipitate another currency devaluation, as Iran runs out of reserves. This would fuel inflation, with recurrent asset bubbles and busts destabilizing the economy further.

5) Wages would fall sharply in real terms as housing and cost of living expenditures continue to rise.

6) A new recession would be likely. As output falls and the government cannot support further economic expansion, Tehran would need to cut government spending.

7) Across-the-board cuts would become necessary in the development budget, just as Tehran implemented in 2012 in non-salary current spending. Subsidy cuts would be likely in the top three high-income deciles of the Iranian economy.

8) Oil income would remain limited to only bilateral arrangements, with most oil revenues effectively locked up by sanctions.

9) Deficit funding through internal loans would be likely, as well as an attempt to use foreign exchange reserves and to loosen monetary policy, particularly if other deficit abatement tools don’t work.

10) With sanctions relief negated, there would be an estimated 50% decrease in annual petrochemical exports from about $12 billion to $6 billion. At minimum, Iran would lose the $1 billion based on what the administration estimates Iran will earn in petrochemical sanctions relief over six months under the JPOA.

11) Iran would also lose potential automotive sector sanctions relief, with a failure to make gains in exports, production, wages, GDP, and other key indicators. This includes a loss of the administration’s projected $500 million increase from auto sanctions relief over the next six months. As noted earlier, it could be far greater than that.

12) Other strategic sectors would suffer as a result of new sanctions legislation. This includes engineering, construction, mining sectors, and others.

13) Imports would decrease to $25-$30 billion from about $40 billion, given budget and hard currency restrictions.

In other words, walking away from the negotiating table would carry significant costs for the Iranian regime. And the longer Iran stays away, the higher the economic costs. Zarif might walk away for show, but unless he and Rouhani believe that they can rescue the economy through nuclear escalation, their no-deal option is still less attractive economically than a negotiated settlement.
With the Obama administration opposing the new Senate and House legislation, senators need to find some way to signal to markets and to Iran that Congress will not accept endless negotiations, the unraveling of the sanctions regime that took so long to establish, and a nuclear deal that does not stop Iran’s nuclear weapons breakout capability. While the current legislation could be effective in reversing market psychology if the sanctions-in-waiting provisions were passed today, these sanctions may be insufficient in six to twelve months time if there is no conclusive nuclear agreement and if Iran is on the path to a sustained economic recovery.

There needs to be a serious and public discussion about what type of sanctions will be required at that point especially since, in areas not adequately addressed by the JPOA, Iran could gain six to twelve more months to advance the military-nuclear elements of its program through nuclear-weapon and ballistic missile research and development. If there is no final agreement, and Tehran successfully uses the interim period to advance this work, it could move more quickly to a nuclear weapons breakout and Washington will have lost critical economic leverage.

At that point, we will need a complete financial and trade embargo implemented within weeks since Iranian nuclear physics will have far outpaced Western economic pressure.

As Robert Einhorn and Ken Pollack have argued, “we need to prepare for the possibility that no agreement will be reached and Iran will attempt to turn that eventuality to their advantage.” Congress needs to work with the Obama administration to develop that strategy. And those consultations need to begin immediately.

Thank you for inviting me to testify today. I look forward to your questions.

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