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Testimony Presented By

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At Hearings On

ISSUES INVOLVING S.277 - THE COMPREHENSIVE IRAN SANCTIONS ACT OF 1995

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Thank you for inviting me to testify before your Committee on S.277, *The Comprehensive Iranian Sanctions Act of 1995*. The bill is intended to tighten the existing restrictions on U.S. trade with Iran, imposed in October 1987, which prohibit the importation of virtually all Iranian goods into the U.S. and the exportation to Iran of goods and equipment with "military applications." S.277 would prohibit U.S. companies and nationals from engaging or participating in any business transactions anywhere in the world with Iranian firms or nationals. The stated intent of the bill is to force Iran to cease its documented violations of human rights, its support of international terrorism and its efforts to acquire nuclear weapons.

I would like to discuss three aspects of S.277:

- What effect would it have on the Iranian economy?
- How would it affect U.S. companies currently engaged in legitimate trade with Iran?
- What effect could it have on U.S. companies currently not trading with Iran?

Iran's Revenues Will Be Unchanged: Unilateral Embargoes Don't Reduce Exports

The "total trade embargo" called for in Section 3 (a) of the bill would of course primarily affect Iran's oil exports. In 1994 Iran exported about 2.6 million barrels per day of oil at a value of approximately $13 billion. Some 600 thousand barrels per day of these exports, worth some $3.5 billion, were purchased by a number of U.S. companies for refining, resale or trading outside the U.S. These transactions are legal under the existing U.S. trade embargo on Iran and are publicly reported. Yet, they seem to be the principal stated motivation for the proposed tightening of the embargo in S.277.

There have been frequent references to the large sums of money paid by U.S. oil companies to Iran, presumably strengthening the existing regime. There is no doubt that if Iran lost 600 thousand barrels per day of exports its economy would be weakened. However, the implied assumption that if U.S. companies could no longer purchase these volumes (as would be the case under S.277) Iran's oil export volume and value would decline substantially, is not borne out by the facts, in our view.

The reason is the same that caused Iran very little harm following the reinstatement of the U.S. import embargo in October 1987: no other country joined the U.S. embargo and a unilateral trade embargo of a globally traded fungible commodity is by definition ineffective. The U.S. Administration at the time was fully aware of this. Then-Energy Secretary John Herrington was reported to say that the embargo would have little practical effect on stemming Iran's crude oil exports unless there was large-scale cooperation from other countries. As we know, there was none. There is currently no indication that any oil importing country has any intention to change its position on Iranian oil imports.

From an economic point of view this refusal to impose an embargo on Iran is, in fact, a rational posture for an oil importer. With Iraqi oil exports still barred by the U.N. and with most OPEC members approximately maintaining their assigned production quotas, the world oil market is in rough balance at current prices. Any substantial extraneous supply reduction, such as an effective multi-lateral embargo of Iranian crude sales, would inevitably raise world oil prices which would obviously not be in the interest of any oil importing country. Historically, extraneous market interventions have often caused disproportionately large price increases.

Another reason that the European Community and Japan, the principal importers of Iranian oil, remain unwilling to curtail Iranian oil imports is that Iran is an important export market for these countries. In 1992 Europe exported nearly $13 billion and Japan $2 billion to Iran. By comparison, U.S. sales were only $0.8 billion. Any restriction on Iranian oil imports would affect these countries' exports to Iran, both economically and politically.

Thus, while passage of S.277 might cause a very short term dislocation for the 25% of Iran's oil exports bought by U.S. companies, the world oil market would quickly redistribute Iranian oil to other markets and/or customers and restore any temporary imbalances. The fact that both Iranian Light and Iranian Heavy crude are mainstream crudes that most refiners can readily process is also a positive factor in redistributing the U.S. companies' share of Iranian exports. If the Iranian National Oil Company (NIOC) cannot find new outlets at suitable prices immediately, it can temporarily put more oil into storage tanks, a routine procedure in the world oil market.

To sum up this part of my testimony, the escalation of the U.S. trade embargo on Iran called for in S.277 would have no measurable sustained impact on the Iranian economy, largely because other oil importing nations will not actively support the U.S. policy.

U.S. Companies Will Lose Flexibility and International Competitiveness

Now let us examine what the proposed embargo would do to U.S. companies currently engaged in Iranian oil trade. In the broadest sense it would be a mirror image of the bill's impact on Iran. The affected U.S. companies would have to switch to non-Iranian supply sources for the approximately 600 thousand barrels per day lifted from Iran last year. Over time they would be able to do so. Since most of their Iranian oil transactions are under term contracts they would probably have to declare *force majeure* to break their contractual obligations.

The U.S. oil companies, however, would not be indifferent to being denied all commercial access to Iran, currently the world's second largest oil exporter (after Saudi Arabia), while their foreign competitors maintain unrestricted access. U.S. oil companies are already handicapped *vis-à-vis* their foreign competitors by the standing, exclusively U.S., prohibition on all trade with Libya, the principal oil supplier in the Mediterranean basin. If Iran were to be added to this restriction it would further reduce the U.S. companies' international logistical flexibility, would at times prevent them from making optimal trading and transportation arrangements, limit their ability to engage in crude price arbitrage transactions, etc.

All of this would put U.S. firms at some unquantifiable but, at times, significant disadvantage with respect to their non-U.S. competitors. In other words, U.S. companies are likely to be more affected by this bill than its intended target, the Iranian economy.

Barriers to Investment Harm U.S. Companies and the U.S. Economy

Next, I would like to discuss the definition in S.277 of the Iranian properties with which U.S. firms would be prohibited to deal. S.277 defines such property as one in which any Iranian national has <u>any</u> interest. This could prevent U.S. participation in any foreign venture in which an Iranian national or business has even a fractional interest. Under certain circumstances, the definition would enable the Iranian government, or a private Iranian firm, to block U.S. participation in a project outside Iran by acquiring, or threatening to acquire, a nominal share in the project. This would provide an obvious incentive for abuse, both private and state-directed, by Iranian firms, nationals or the Iranian government.

A potential actual case is a major oil project in Azerbaijan in which four U.S. companies have a 39% interest and Iran has been offered a 5% share by the Azerbaijan state company SOCAR. The U.S. State Department is on record as opposing the Iranian participation but has acknowledged that under current law U.S. companies are free to invest in the project. Would passage of S.277 prohibit such an investment? If so, passage could either cause Azerbaijan to revoke its 5% offer to Iran in order to retain the 39% U.S. participation or force the U.S. companies to withdraw from the project, with their shares probably going to other Western participants. If the latter were to occur it would also bar U.S. companies from future service and engineering contracts on this major project.

Another major planned project in the area, a gas pipeline from Qatar to Pakistan in which a U.S. company is participating, would also require involvement with Iran since it may traverse Iranian territorial waters. Under S.277 this could be illegal and, hence, could threaten U.S. participation in the project.

It should be pointed out that regardless of whether U.S. companies would actually be blocked by S.277 from participating in these or other projects, the bill itself, if it becomes law, would create an additional risk factor for U.S. companies operating, or planning to operate, in regions where Iran has some political and cultural influence such as the Persian Gulf or the "newly independent countries" adjacent to Iran. Non-U.S. companies would not have to consider this risk factor in calculating the potential attractiveness of an investment in these regions. This, again, could put U.S. companies at a competitive disadvantage.

Another definition in the bill would prohibit the importation into the U.S. of any goods or services which is "in whole or part produced, grown, manufactured, extracted or processed in Iran." In practice, this would be unenforceable for refined oil products imported into the U.S. Most European refineries commingle Iranian crude with many other crudes. Hence, the crude base of the gasoline, jet fuel or diesel oil which these refiners export to the U.S. is likely to contain a share of Iranian crude.

U.S. Companies Have Complied with the Letter and Intent of the Law

My last point is a brief comment on some recent editorial opinions about U.S. oil companies doing business with Iran. The point was made that their purchase of oil from Iran was a legalistic subterfuge to get around the prohibition on the Iranian embargo. Actually, the Presidential Order of October 28, 1987 clearly limited the ban to "imports from Iran." Government officials confirmed at the time that foreign affiliates of U.S. firms were free to handle Iranian oil abroad. Thus the U.S. companies which have been lifting Iranian crudes for foreign destination have clearly acted within the letter as well as the intent of the law.

Some editorials have argued, however, that U.S. companies should have put the national interest before their business interest and ceased lifting Iranian oil even for foreign destinations. I believe this is a misreading of the role of private business in our society. Private companies are not qualified to make national policy decisions. Furthermore, if an individual company did so it would likely find that some of its competitors were not following its path which could hurt its profitability. A consultation with its competitors to shape a common policy may well be considered an act of collusion which would of course be illegal. Thus, companies should do what is in their best economic interest while the government should set the rules under which they operate.