PIRINC

# Oil and Sanctions

**Summary of Comments by**

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**Dr. Gary Sick, Associate Chair, Middle East Seminar**

at the Columbia University Seminar on the Middle East

The Middle East Under the American Umbrella: The Reassertion of Domestic and Regional Imperatives

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*The following is a summary of comments made by PIRINC's Chairman, John H. Lictblau, the discussion leader at the first meeting of the 1996 University Seminar on the Middle East, sponsored by Columbia University's Middle East Institute. This year's topic is "The Middle East under the American Umbrella: The Reassertion of Domestic and Regional Imperatives." Also included are the comments of Dr. Gary Sick, the meeting's discussant. Dr Sick is Associate Chair of the University Seminar.*

Mr. Lichtblau noted that several weeks ago, when he was asked to give tonight's presentation, there was some attention to the pending sale of Iraqi oil under UN Resolution #986 "humanitarian oil sales. Since then the issue of sanctions has literally exploded onto the front page of the papers, and has become part of the US election campaign.

The evening's talk will provide an historical perspective on sanctions policies and sanctions actions with respect to oil and the Middle East in the post World War II period. "Sanctions" means the intervention of a government in the economic investment and trade of a foreign country for punitive or coercive reasons for a very specific purpose, which can range from overthrowing the government to obtaining minor changes in policy.

The first post-war sanctions were imposed from 1951-1953 during the nationalization of the Anglo-Iranian Oil Company (AIOC), a British government entity, under Mossadegh. As a result, the "seven sisters" refused to buy any oil from Iran and AIOC announced it would sue any buyer of Iranian oil. The sanctions were very effective. Exports from Iran, which were at 500,000 - 600,000 barrels per day, went to almost nothing and stayed there until a settlement was reached in 1953-1954, the "50% solution", after the Shah returned and Mossadegh was disposed. Oil exports then rose again, making Iran the second largest exporter of oil. This is an example of sanction over a very specific issue, nationalization.

After this incident, sanctions became the policy of the producers for some time. In 1967 during the Arab-Israeli War, a number of Arab countries boycotted oil sales to the US and various other countries which gave military support to Israel. This was a political issue, and oil was used as a political weapon for the first time. In 1967 the impact of the boycott was very small. However, the next boycott, in 1973 during the Arab-Israeli War, had a big impact. The boycott was structured such that total Arab oil production would be reduced on a monthly basis. One of the reasons why they 1967 boycott didn't work was because there was no overall reduction in total Arab oil production. The 1973 boycott only lasted four months, but it was enough to change the entire world oil market. It became clear that these countries had the power to shut off a supply of oil to the world if they wanted to. There was no later Arab oil boycott, but between 1974 and 1980 there was the constant threat of another boycott, and a rush to develop new fields in higher cost areas.

The next sanctions were imposed by the US in reaction to the Iran hostage crises. In November 1979 when U.S. diplomats were being held hostage we stopped buying oil from Iran. Obviously, one cannot do business with a country that takes one's diplomats hostage. During that period there was no Iranian oil sales to the US, and several European countries supported us. When the crisis was over in early 1981, the import ban was lifted. By that time, however, Iran was involved in a war with Iraq. From this time on sanctions became a consumers' instrument, as the oil market transformed into a buyer's market.

It was primarily the US that inspired the use of oil as a policy instrument. In 1982 the US prohibited oil imports from Libya because Libya was considered to be a rogue country that supported terrorism and sought to purchase weapons of mass destruction. There was the assumption that the US would lead the sanctions effort and other countries would follow, but nobody did. American companies ended up losing their investment in Libya not because of Khaddafi, but because of U.S. policy. The victims of the policy were U.S. companies, not Libya.

The next case of sanctions is late 1987 in Iran. At this time Iran was again considered to be a country supporting terrorism and seeking weapons of mass destruction. We put sanctions on Iranian oil imports into the US. Again, the US expected that it would be the leader and other countries would follow. Not a single other country followed.

In 1992-1993, when it was decided that Libya was guilty of, among other things, refusing to hand over the suspects in the Pan Am bombing of 1988, the Sanctions weapon was used again, this time by the UN. The UN placed sanctions on Libya, but not its oil. Sanctions were placed on air travel, and various technical products, including oil pumps, could not be sold in Libya. Libya was hurt to a limited extent by the UN sanctions, but is still producing 1.5 million barrels of oil per day, and is a vital source of supply for some Mediterranean countries: 30% of Italian oil imports come from Libya and almost half of Libya's exports go to Italy.

In March 1995 the President issued an Executive Order prohibiting American companies engaging in any kind of oil-related business in Iran. Previously Iranian oil could not be imported into the US, but American companies had still been allowed to operate there. This was a preemptive order on the part of the President; at that time Senator Alphonse D'Amato's Bill to impose similar sanctions was being discussed. Again the US said that other countries would join in, but none did.

In July 1996 there was a law passed, a secondary boycott bill, which imposes penalties on foreign companies investing in Libya and Iran. The bill was passed unanimously in the House after the TWA Flight 800 crash. Before, there had been some opposition to it. There is of course no evidence whatever, so far, to link Iran or Libya to the crash.

It is impossible to stop the export of Libyan and Iranian crude oil because it is needed and there would be a world shortage if it were forced off the market. Instead, the idea was that no foreign countries should make any additional investment in the oil and gas sector of Iran and Libya. These third party sanctions are considered offensive and unacceptable abroad because in some ways they affect the sovereignty of the home countries of the foreign companies involved. So far, all countries, as well as the European Union, have rejected these sanctions. Now there are companies from other countries going into Iran again, for example Petronas the national oil company of Malaysia. Turkey has recently made a deal with Iran for a $20 billion gas pipeline project. Turkey claims it doesn't violate the US sanctions law because the money spent on the Iranian side of the border will be spent by the National Iranian Oil Company.

Of course, there are also the sanctions on Iraq which have been in effect since August 1990. These are the only sanctions that really work, since they are fully multilateral UN sanctions. Iraqi oil exports are perhaps 5% of what they were before the war. Effectively, Iraq is no longer an oil exporter. However, the assumption that a country which lived almost exclusively on its oil exports cannot survive economically without them has turned out to be wrong. Six years later, Saddam Hussein still seems to be doing well.

UN resolution #986 raised the idea of permitting small amounts of exports of oil for humanitarian reasons. Everyone thought that this was about to happen, until the flare-up of the situation in Northern Iraq. The UN itself has called off Resolution #986 for the time-being because it is unable to send inspectors there under current circumstances. Whether there will be #986 oil sales in the near future is unclear. This issue has also entered the US election campaign, as Senator Dole criticized the President for allowing Saddam Hussein to sell oil. What happens between now and the end of November is decided not only by what happens in the Middle East, but also by what happens in the US election campaign.

As a general conclusion, one can say that unilateral oil sanctions never work. Iran is selling about as much oil as before, they are producing approximately 3.7 billion barrels per day, which is their capacity. Without sanctions they could have perhaps moved to 4 billion barrels per day. Iran has the second largest natural gas reserve of any country in the world. This is of great interest to countries like Turkey, Afghanistan and Pakistan who wish to build pipelines. These will probably be developed regardless of the US position., as will the gas pipeline from Libya to Italy.

One sanctions policy which works, the UN sanctions on Iraq, is subject to definitional problems concerning the meaning of "works". The sanctions have "worked" in that they have substantially reduced Saddam Hussein's ability to rearm and threaten other countries, but have not "worked" in the sense that his regime is still standing.

The threat of sanctions has now become part of US policy, even though they don't seem to work unilaterally. Thus, there has been some recent advocacy in Congress and contemplation by the Administration to impose sanctions on Nigeria. In this case there is much U.S. investment and trade at stake. We import 700,000 - 800,000 barrels per day from Nigeria, much of it produced by US companies operating there. Just the threat of sanctions is enough to affect American businesses. British and other companies do not need to worry that their government may impose sanctions, but American companies must take this into account when they are making their investment decisions. Furthermore, the U.S., the world's largest oil importer, would be better served by a policy of diversification of supply sources than by attempting to curtail the operations of major existing sources. Still, there may be some overriding reasons why sanctions may be the right policy under some circumstances. This could be discussed this evening.

## Comments of Dr. Gary Sick

Dr. Sick began his comments by saying that he will focus on a particular case of sanctions in which he has expertise, the Iranian case. He gave an illustration of a historical case in which a young revolutionary power challenged a world superpower, the US and Great Britain in the War of 1812. The case is a cautionary tale about the experiences of superpowers dealing with young revolutionary powers.

Iran today is in economic trouble, with a $23 billion debt. Approximately 25% of its annual oil revenues goes to debt payment. The Iran leadership is far more timid and less charismatic than Khomeni. Factionalism is present, and popular support has declined. There is a story which has been circulating in Tehran recently in which Rafsanjani tries to call Khomeini for advice so he places a call to heaven. The response says that Khomeini is not there, so Rafsanjani places a call to hell and talks to Khomeini for a long period of time. Later, Rafsanjani gets the bill and asks the telephone company why the first short call was so expensive and the second long call was so cheap. The response is that heaven is a long distance call, whereas hell is local.

There is no question that the US has real grievances with Iran, the hostage crisis was a real humiliation and we have the right to be angry. However, the question is whether anger is the correct basis for policy. As was suggested earlier, there are certain consequences of our policies that are not contributing to our own national interest. Everyone would agree that sanctions have had some effect on Iran, but overall Iran is doing quite well. This must cause us to question if the policy is working and what the policy objectives are.

One of the effects of US policy is that Iran, which typically looked to the West, is now organizing itself to be much more efficient than in the past. Iran is increasingly doing its own manufacturing, and it is not doing it badly. Iran is even selling its technology, Rafsanjani recently returned from Africa where trade agreements were signed in which Iran would provide technical expertise. Another consequence is that Iran is now looking to North and to the East, rather than the West. Iran has made a strategic gamble that its future lies with the states of the former Soviet Union to the north. There is a railway linking the Persian Gulf with Turkmenistan. Iran is betting that as Kazakhstan and others develop their oil industry they will have money to spend. Iran is pushing the idea of an economic cooperation association, which is now located in Tehran. This organization includes Turkey, Pakistan, and all of the "stan" countries of Central Asia. When the United States imposed the embargo on Iran a specific exception was made for an oil swap between Kazakhstan and Iran, and many American companies are involved in developing this. Iranian relations with Russia are good, and it is actively developing relations with China.

One legitimate question regarding sanctions is: "if sanctions are not used, what form of leverage is available to the US?" Sanctions have many advantages. They are relatively cheap, they provide the illusion of action, sometimes they work, those who are hurt are big businesses and oil companies, and oil companies aren't popular with the public and tend to stay silent on the matter. Nevertheless there are alternatives to sanctions.

One alternative to sanctions is to lower the rhetoric against Iran. Iran would probably also be willing to lower the level of rhetoric. There are enough negative things to say about Iran without making up facts. In the latest State Department Report on Terrorism Iran is accused of nine shooting incidents in Northern Iraq, of not having female representative in government, etc. It turns out that there are more women in the Iranian parliament than in the US Senate. There is also universal suffrage. It is true that Iran does not support the peace process, etc. but there is no need to make exaggerated statements about Iran.

Another alternative to sanctions is to listen to our allies and work with them. Critical dialogue got American hostages out of Lebanon. Iran stayed out of the Gulf War as a result of critical dialogue.

Giving Iran a stake in the international economy gives Iran a reason to moderate its behavior. No American policymakers go to Iran. Because of this there is a fixed image of Iran which dates from the early 1980's. Iran is a different place today, and there are many developments in Iran in the direction of the formation of a national interest. Judith Miller and Robert Kaplan have both come to similar conclusions.

The US should set specific goals, such as ensuring that Iran does not acquire weapons of mass destruction, and then determine the best ways to achieve those goals. Sanctions may be the best way to achieve our goals, but if they are not we should consider other possibilities, such as the North Korea example.