

Testimony of

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Chairman Dodd, Ranking Member Shelby, committee members, thank you for the opportunity to appear before you today to discuss the utility and applicability of targeted financial measures as part of a strategic policy, leveraging all elements of national power to deal with the threats presented by Iran's nuclear program.

As a former Deputy Assistant Secretary of the Treasury who participated in the department's outreach to the private sector as early as 2006, I am often asked why I support the use of targeted financial measures – both formal sanctions and informal outreach to the private sector – if the use of these tools has not stopped Iran from pursuing a nuclear weapon. If these efforts have neither altered the decision making of Iranian leaders nor disrupted Iran's ability to continue developing its nuclear program, then are they really effective?

The answer is that targeted financial sanctions were never intended to solve the problem of Iran's pursuit of nuclear weapons. Sanctions are no silver bullet. On their own, these financial tools can only do so much. But coupled with other tools -- especially robust diplomacy but also a credible military presence in the region -- financial measures can effectively create leverage for diplomacy. That diplomacy should focus not only on Iran, but on Russia, China, our European and Asian allies, the Gulf States, and others.

What can sanctions accomplish? They are intended to advance any of the following three goals: (1) disrupt Iran's illicit activities; (2) deter third parties from knowingly or unintentionally facilitating Iran's illicit activities; and (3) impacting Iran's decision making process so that continued pursuit of illicit activities is reconsidered.

Note, for example, that despite the many problems with the declassified key judgments of the November 2007 National Intelligence Estimate (NIE) on Iran's nuclear intentions and capabilities, the report accurately noted that the tools most likely to alter Iran's nuclear calculus – if any – are targeted political and economic pressure, not military action. According to the NIE, Iran's decision to halt its nuclear weapons program in 2003 was "in response to increasing international scrutiny and pressure resulting from exposure of Iran's previously undeclared nuclear work." The key judgments conclude that the intelligence community's "assessment that the [nuclear weapons] program probably was halted primarily in response to international pressure suggests Iran may be more vulnerable to influence on the issue that we judged previously."

Iran may or may not have actually halted its weapons program. Even if it did, this may actually mean far less than the NIE suggested if what was suspended was a piece of the program that could be quickly resumed at any time, but the potential of such tools to impact the decision making process of key Iranian leaders is worth noting.

That said, recent events suggest that Iran's current hard line leadership sees the pursuit of a nuclear program and ongoing tension with the West as positive things that support their primary objective: regime survival. But even if the goal of altering the Iranian regime's nuclear calculus is not so likely under current circumstances, the other two goals of financial sanctions – (1) constricting the operating environment and making it more

difficult for Iran to engage in illicit activities by disrupting their finance, banking, insurance, shipping and business dealings; and (2) deterring others from partnering with Iran – remain important objectives that can be furthered by employing financial tools.

While some question the wisdom of employing sanctions when the administration is actively seeking to pursue engagement with Iran, and others question the wisdom of employing sanctions that might give the regime a straw man and scapegoat to blame for all of Iran's ills, my own conclusion is just the opposite; this is exactly the time to use financial tools to build leverage for diplomacy.

With the hard-line regime so significantly delegitimized -- to the point that both moderates and hardliners have overtly questioned decisions of Supreme Leader Ayatollah Ali Khamenei -- the regime's ability to easily deflect criticism over the state of the Iranian economy or sanctions imposed over Iran's nuclear program has been significantly undermined. Indeed, the regime faces a far greater legitimacy crisis over its handling of the sham election, the Basij crackdown targeting Iranian citizens, the demonization of protestors by senior leaders, and the incarceration of protestors.

Given that Iran's nuclear program continues to progress, the one thing that is clear is that we do not have the luxury of time. The question is not whether or not to use sanctions, but what sanctions, targeting which entities, using which tools and authorities, and in what order?

To be sure, diplomatic engagement, directly with Iran or with others focused on Iran, whether broad or limited, is severely undermined when Iran is able to pursue its nuclear ambitions, support terrorist groups, and erode security in Iraq and Afghanistan without consequence. As *Washington Post* columnist David Ignatius put it, "[T]hese new, targeted financial measures are to traditional sanctions what Super Glue is to Elmer's Glue-All." Periodically reassessing and adjusting the package of targeted financial measures is the tool most likely to create enough diplomatic leverage to avoid a military confrontation. Short of creating such leverage, negotiation and diplomacy alone will not convince Iran to abandon its nuclear program.

What sanctions should be employed?

First, we should actively seek international consensus on multilateral sanctions through the United Nations that would be ready to be implemented in the early fall should Iran fail to respond to the administration's offer of engagement by the deadline of the G-8 summit and the UN General Assembly that follows shortly thereafter. As important as the entities to be listed will be the unanimity of the decision to impose sanctions, so it is critical that the administration engage in robust diplomatic engagement with China and Russia now.

New multilateral designations should focus on entities engaged in illicit conduct in support of Iran's proliferation program, in particular those already designated unilaterally by the United States. For example:

- Bank Mellat. Bank Mellat was designated by the United States in October 2007 for providing banking services in support of UN-designated Iranian nuclear entities, namely the Atomic Energy Organization of Iran (AEOI) and Novin Energy Company. A multilateral designation would go far in constricting the activities of the banks foreign regional offices in South Korea, Armenia, and Turkey.
- Bank Melli. As FINCEN noted in a March 2008 advisory to the financial sector, “UNSCR 1803 calls on member states to exercise vigilance over the activities of financial institutions in their territories with all banks domiciled in Iran, and their branches and subsidiaries abroad. While Bank Melli and Bank Saderat were specifically noted, the United States urges all financial institutions to take into account the risk arising from the deficiencies in Iran’s AML/CFT regime.” Iran’s largest bank, Bank Melli was also designated by the Treasury in October 2007 for providing banking services to entities involved in Iran's nuclear and ballistic missile programs, including entities listed by the U.N. for their involvement in those programs. Following up on the warning included in UNSCR 1803 with outright designations of these banks would send a strong message.
- Khatam al-Anbya. The U.N. should also follow up on the U.S. and E.U. designations of the Khatam al-Anbya construction company (also called Ghorb), which is one of the most significant of the multiple entities owned or operated by the IRGC that have been designated by the United States. With the increased militarization of the Iranian regime, and the blatant abuses of the IRGC-affiliated Basij militia, now is the time to target IRGC affiliated entities.
- IRISL. The U.S. designation of Iran’s national maritime carrier, the Islamic Republic of Iran Shipping Lines (IRISL), in September 2008, was another key unilateral action that should be made multilateral. IRISL was designated for facilitating the transport of cargo for U.N. designated proliferators and for falsifying documents and using deceptive schemes to shroud its involvement in illicit commerce. And as the State Department noted at the time of the designation, IRISL had already been “called out by the UN Security Council as a company that has engaged in proliferation shipments.”

Multilateral action, however, is not only difficult to achieve but can often lead to lowest common denominator decision making. While international consensus is built for robust action at the United Nations, the U.S. should pursue both unilateral and bilateral financial measures (together with other States or regional bodies like the E.U.) focused on IRGC-affiliated and other individuals and institutions facilitating Iran’s illicit conduct.

The U.S. should also actively support the efforts of multilateral technocratic bodies such as the Financial Action Task Force (FATF), which has issued a series of increasingly

blunt warnings about doing business with Iran. The FATF is a 34 member technocratic body based in Paris which seeks to set global standards on combating money laundering and terrorism financing. The FATF has put out multiple warnings on Iran – the first in October 2007 and the most recent in February 2009. In these warnings, FATF instructed its members to urge their financial institutions to use “enhanced due diligence” when dealing with Iran. In the second warning, the FATF president also urged Iran to address the “shortcomings” in its anti-money laundering and terrorist financing regimes immediately. The most recent warning instructed countries to begin developing “countermeasures” to deal with Iran’s illicit financial activities – an indication of how concerned the international body was with Iran’s behavior in this arena. After one such warning, Iran sent a delegation to lobby FATF (of which it is not a member) but FATF dismissed the Iranian delegation’s claims that legislative changes fixed the regime’s shortcomings, calling the changes “skimpy” and noting their “big deficiencies.”

Informal sanctions, what I describe as leveraging market forces, should be continued and expanded. As my colleague Michael Jacobson has also argued, the direct outreach that Treasury has pursued with the international financial sector should be broadened to include other U.S. agencies and departments, notably the Commerce Department, engaging with a wider array of private sector actors in the insurance, shipping, and other industries. We should continue to think creatively about how to leverage our existing influence to achieve our goals. For example, coupled with additional action targeting IRISL, an effort to convince countries concerned about Iran’s illicit and deceptive conduct to deny landing rights to Iran Air would further constrict Iran’s ability to move funds and material for illicit purposes and isolate the regime internationally. Even in today’s economy, and to a certain extent because of it, the private sector is very sensitive to reputational risk and is acutely aware of its due diligence and fiduciary obligations to its shareholders.

Less Targeted Financial Measures

Targeted financial measures have proven impressively effective at disrupting Iran’s illicit conduct, but given the short timeframe and the rapid progress Iran is making on its nuclear program it may be time to consider more drastic and less targeted measures. Secretary Clinton has spoken about the possibility of inflicting “crippling sanctions” on Iran, and one particularly promising avenue to pursue would be to exploit Iran’s continued reliance on foreign refined petroleum to meet its domestic consumption needs at home. Due to insufficient refining capacity at home, Iran must still re-import the 40% of its domestically consumed petroleum from refineries abroad. The prospect of targeting Iran’s continued ability to re-import this refined petroleum back into the country could be a powerful tool targeting a regime soft spot. Consider as precedent the dramatic failure of the Iranian regime’s gas ration card program in June 2007. The cards were loaded with a six months ration, but many Iranians reportedly used their entire ration within weeks. Indeed, Iran worries each winter about a possible heating fuel shortage and the consequence of not being able to provide the public with sufficient fuel subsidies.

Technology Arms Transfers

We should also focus our attention on developing a more systematic approach for dealing with Tehran's efforts to transfer technology and arms to radical allies in the Middle East and elsewhere, even as Washington seeks to engage Iran. Earlier this year, Cyprus impounded the Iranian-chartered freighter Monchegorsk, a vessel laden with war materiel bound for Syria (and perhaps beyond). The episode highlighted the shortcomings of current UN and European Union sanctions on Iran, and underscores the need to fill the gaps in the available policy tools to deal with Iranian arms transfers to its allies and surrogates. To close these gaps, the United States should work with its allies and the international community on a number of fronts:

- encourage the UN sanctions committee to issue a Security Council communiqué to the UN General Assembly, emphasizing the obligation of all member states, including Iran and Syria, to fully abide by the UN ban on arms transfers;
- work with the EU to expand its current policy banning the sale or transfer to Iran of "all arms and related material, as well as the provision of related assistance, investment and services" to include a ban on the purchase or transfer from Iran of the same;
- work with UN and EU member states to adopt legislation pertaining to Iranian arms and technology transfers, to enable them to fulfill their UN and EU obligations. Encourage regional organizations in South America and South and East Asia to adopt similar resolutions;
- work with the EU and Turkey (the de facto eastern gateway to Europe) to develop an enhanced customs and border security regime to prevent Iranian arms and technology transfers through Turkey;
- engage the private sector to draw attention to the risk of doing business with IRISL, its subsidiaries, and other banned entities. Given Iran's history of deceptive financial and trade activity, extra scrutiny should be given to any ship that has recently paid a call to an Iranian port;
- encourage countries to require ports and/or authorities to collect detailed, accurate, and complete data regarding all cargo being shipped to or through their countries (especially from risk-prone jurisdictions like Iran), to conduct rigorous risk assessments, and to proceed with actual inspections as necessary;
- encourage implementation of the World Customs Organization's (WCO) draft Framework of Standards to Secure and Facilitate Global Trade. The WCO represents 174 Customs administrations across the globe (including Iran) that collectively process approximately 98 percent of world trade. Under the proposed framework, a risk management approach would be implemented for all cargo to identify high-risk shipments at the earliest possible time. Participating members

would benefit from enhanced security and efficiency, and could benefit from lower insurance premiums.

There are signs of success, and with continuing signs of domestic discontent in Iran, targeted financial measures can increase the political pressure on the regime. Indeed, long before the June 12 elections, the US-led campaign had played a role in causing domestic political problems for Iranian hard-liners as well. In September 2007, former president Akhbar Hasehemi Rafsanjani, a moderate opposed to the regime's confrontational approach, was elected as the speaker of the Experts Assembly—the body which chooses and has the power to remove Iran's Supreme Leader. Several days earlier, the Supreme Leader dismissed Yahya Rahim Safavi, the IRGC's commander since 1997, who was blacklisted by the UN in March 2007. Safavi's replacement, Muhammad Ali Jafari, confirmed that Safavi was removed primarily "due to the US threats." Finally, Motjtaba Hashemi Samarah, one of Ahmadinejad's close allies, was removed from his position as the deputy interior minister. Iran's former chief nuclear negotiator, Hasan Rowhani, disparaged the country's growing international isolation and stated that economic sanctions were definitely impacting Iran. Despite high oil prices, he noted, "[W]e don't see a healthy and dynamic economy."

While there are a number of factors contributing to Iran's economic difficulties, including declining oil prices and President Ahmadinejad's mismanagement of economy policy, the response of international financial institutions to the Treasury Department's outreach has been a key reason as well. Many of the major global financial institutions -- particularly those based in Europe -- have either terminated or reduced their business with Iran. More surprisingly, it appears that banks in the United Arab Emirates and China are also beginning to exercise greater caution in their business dealings with Iran as well.

Conclusion

Even as it continues to pursue a nuclear program and other illicit activities, Iran today is financially and politically exposed. While sanctions are no panacea, if properly leveraged in tandem with other elements of national power, the pinch of targeted financial measures could potentially have a very significant impact.