

*American Enterprise Institute for Public Policy Research*



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BEFORE THE SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

MINIMIZING POTENTIAL THREATS FROM IRAN:

ASSESSING SANCTIONS AND OTHER U.S. POLICY OPTIONS

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1.

Mr. Chairman, Members of the Committee, thank you for the opportunity to testify before you this morning on recent developments in Iran and future policy options for the United States. I am especially pleased to have the opportunity to comment on S. 908, the Iran Refined Petroleum Sanctions Act, and to commend Senators Bayh, Kyl and Lieberman (not to speak of the 66 other members) who have signed on in support of this important initiative.

During the course of last year's presidential campaigns, the American public was treated to a singularly pointless debate about how to handle Iran's quest for nuclear weapons – a debate that centered on whether and under what conditions the United States should be “sitting down” with the regime in Tehran, as if somehow “sitting down” constituted a policy. In any case, the election was won by a candidate who embraced a markedly different approach to Iran than that of the outgoing Administration. And in our democratic system, the elected President can be expected to pursue the policies on which he campaigned.

For the first seven months of this year, the Congress has been extraordinarily deferential to President Obama, and has been careful to do nothing that might undercut the prospects for success in the direct diplomacy with Iran that he has promised, such as mandating the imposition of new sanctions. And despite Iran's continued defiance of the United Nations Security Council's demand that it suspend its enrichment and other proliferation related activities, the U.N. has been equally reticent.

While the U.S. Congress and the diplomats in Turtle Bay have stood down, however, change has been in the air in Iran. And in keeping with the trends since the revolution in 1979, most of that change has been detrimental not only to American and allied interests, but also to the interests of the Iranian people.

On the nuclear front, Iran has continued its enrichment activities and now claims to have 7000 centrifuges spinning at Natanz, an operational uranium conversion plant at Isfahan, and continuing operations at the heavy water facility at Arak. The IAEA reports that Iran remains uncooperative.

On the economic front, the Iranian Central Bank disclosed this week that inflation is at 22.5 percent. Unemployment, reported at 11.1 percent, is likely close to three times that amount. Gasoline shortages are common, as are electrical outages. Meanwhile, domestic production of basic goods continues to decline, and the Iranian press reports that meat prices go up on an hourly basis and that rice imports – a vital staple – have skyrocketed by 219 percent since March.

The silver lining in economic news for Iran is that trade --and with Europe in particular--which had suffered in earlier years, appears to be rebounding somewhat. But allow me to return to this topic a little bit later.

On the military and paramilitary fronts, Iran continues to refine its delivery systems, and in May tested a ballistic missile, the so-called Sajjil, a solid fuel rocket with a range of 2000-2500 kilometers. Iran continues to arms enemies of the United States inside Iraq, and has continued apace with its financial and military support for terrorist groups like Hezbollah and Hamas.

And finally, on the political front inside Iran, we are all well aware of the aftermath of the Iranian elections, the electoral fraud, the subsequent outpouring from the Iranian people and the brutal

repression and murder of demonstrators by agents of the regime. Events still continue to play out inside Iran. Opponents and suspected opponents of the regime are still being arrested on a daily basis, though the Supreme Leader this week ordered the closure of a particularly infamous illegal detention facility in response to a public outcry.

Even the closest of Iran watchers are unsure of what's next inside Iran. Some have suggested that once out of the bottle, the genie of public unrest cannot be stuffed back in again. While that may be true in some cases, history suggests that after historic revolutionary events like the Hungarian uprising, the Prague Spring, and the Tiananmen uprising, it is actually possible to strangle the genie. In addition, many have failed to take into account the dramatic transformation of the Iranian political scene – a transformation that diminishes the odds of any successful reformist movement and carries critical consequences for our own nuclear diplomacy.

For some years now, the Iranian Revolutionary Guard Corps has quietly and systematically taken over the reins of power inside Iran. There have been creeping signs of this transformation for several years—the takeover of the Tehran airport by the IRGC in 2004, followed by their takeover of the country's mobile phone operations. But increasingly, with the full backing of the Ahmadinejad government – and apparently of the Supreme Leader – the IRGC has come to dominate all sectors of Iranian life, including the economy, the military and domestic politics. On the economic side, what that ultimately means for countries and companies is that if you are doing business in Iran, you are probably doing business with the IRGC.

More importantly, however, the IRGC today is not just the exporter of the Revolution and the protector of the regime. The IRGC has become the regime. The clerics so hated by the Iranian public – for their repression, their corruption, and their incompetence – are all but gone from the Iranian political scene. Ahmadinejad purged the last cleric from his cabinet this weekend, Intelligence Minister Hojjat al-Eslam Gholam-Hosseini Ezheh-I.

What does this mean for the Iranian nuclear weapons program, for the Obama administration's hopes of engagement, and for the Iranian people themselves? It's hard to find any good news. Engagement with the new breed of Iranian leader will likely resemble engagement with the previous breed of Iranian leader, but without the trappings or finesse. IRGC veterans have little appreciation for the diplomatic minuets so enjoyed by previous presidents Rafsanjani and Khatami. Indeed, these veterans of the Iran-Iraq war, many younger and brought up entirely under the Islamic Republic, publicly scorn the value of trade, free markets, or relations with Europe and the United States.

It is always possible that the regime has a surprise in store for us – and the Iranian Foreign Ministry reports they soon will offer a package aimed at assuaging the “economic, cultural and moral crises” of the world. Some optimists here in the United States and in Berlin, Paris and London have persuaded themselves that it is only the hardliners in Iran that can successfully deliver a credible deal to the Europeans and the Americans – something on the Nixon-China, Sharon-Gaza scenario. This optimism ignores every statement made by the government's own ministers, spokesmen and supporters, but time will tell.

Meanwhile, however, the regime continues to progress toward a nuclear weapons capability. The unclenched fist offered by the Obama administration has been rebuffed, and no serious response has been proffered to repeated invitations. Iran chose not to join the G8 meeting despite an offer

from Secretary of State Clinton. Indeed, the regime explicitly attempted to embarrass Obama by leaking the President's personal and private letter to Supreme Leader Khamenei to an American newspaper.

The time has come to reassess the value of the current U.S. policies. But let's be clear – this should not be a repudiation of engagement (though I myself doubt its merits), but an acceptance of the reality that the free pass engagement on offer by the Obama administration has bought little more than time for Iran to install more centrifuges. Speaking softly in the absence of a big stick—our approach for the past six months—will not bring the current Iranian leadership into serious negotiations, nor will it stop them from their pursuit of nuclear weapons. .

In part because of our silence, the decline in trade between Iran and certain countries of the European Union – now Iran's second largest trading partner after China – has begun to reverse itself. Germany and Italy are among the worst offenders, though Germany deserves particular censure because of its place at the table in the all-important EU-3+3 talks with Iran. The Wall Street Journal reported last October that the "German-Iranian Chamber of Industry and Trade counts about 2,000 members, including such big names as Siemens and BASF [about which more later]. In the first seven months of [2008], Germany's Federal Office of Economics and Export Control approved 1,926 business deals with Iran -- an increase of 63% over last year. During that same period, German exports to Iran rose 14.1%. For the record, French exports went up 21% during the first six months of [2008], but they are still worth less than half of Germany's €2.2 billion of exports. Britain's exports to Tehran, only a fraction of Germany's trade with Iran, fell 20%."

More troublingly, the increases in trade with Europe have been dwarfed by the explosion in Iran-China trade. There are deep and wide economic ties between the two, and AEI's Iran Tracker project (IranTracker.org) reports that more than 100 Chinese state companies operate in Iran, with bilateral trade reaching over \$27 billion in 2008, a 35% increase over 2007. Our report goes on to detail, among other transactions:

- A 2008 China National Petroleum Corporation (CNPC) - National Iranian Oil Company (NIOC) \$1.76 billion deal to develop Iran's North Azadegan oil field
- In March 2009, a \$3.2 billion gas deal, in which China's LNG and a Chinese-led consortium will build a line to transport liquid Iranian gas from the South Pars Gas Field
- In June 2009, a \$5 billion Iran-Chinese National Petroleum Corporation gas deal to develop Iran's South Pars Gas field.

Despite the growing movement for divestment from state sponsors of terrorism, including Iran, global business transactions with Iran continue to flourish. Our Iran Interactive database, which should be back online at IranTracker.org shortly, details 75 major transactions in the last two years, most in the oil and gas or construction and engineering sector, with value in the hundreds of millions, including companies ranging from France's Renault and Peugeot to Germany's Krupp and Siemens, Toyota, Royal Dutch Shell, Gazprom, Hyundai, Spain's Repsol and many more.

Among the more appalling stories, however, is German-Finnish telecom giant Nokia-Siemens delivery of surveillance equipment to Irantelecom -- surveillance equipment surely used to suppress

and arrest opponents of the regime. Nokia and Siemens both do business with the United States Government, and Siemens was the leading contender to receive a contract with possible value in the hundreds of millions to replace rail cars in Los Angeles, a contract that is rightly now at risk.

Perhaps more important than the moral and financial suasion of divestment, however, is the tool that has yet to be used by the international community to persuade Tehran of the wisdom of coming to the table: restrictions on the export to Iran of refined petroleum products and equipment to enhance Iran's own refinery capacity. S. 908 affords the President that opportunity; it doesn't force it on him, which may be an option another Congress will feel compelled to consider. But as a supermajority of the Senate and many in the House of Representatives (who support Congressman Berman's companion bill) have made clear, only the "sword of Damocles" (to use Chairman Berman's phrase) of punitive sanctions will impel the Iranian regime to take seriously the many, many deadlines and redlines announced by the international community.

Iran, as many can detail more persuasively than I, is heavily dependent on imported refined petroleum. Domestic capacity is limited, and while the Ahmadinejad government has identified that weakness and is working to remedy it, it remains a significant regime weakness nonetheless. Using this pressure point quickly and decisively will do more to convince the Tehran government of the world's seriousness than any number of videograms, letters, Hallmark cards or goodwill visits. This is the language they speak, and we must begin to grasp that fact.

Iranian refining capacity, imports and shipping are concentrated in fairly few hands. News reports indicate that supplies come largely from two Swiss firms, Vitol and Trafigura with others from India's Reliance (which has announced it is suspending such shipments – a claim thus far unconfirmed), Shell, BP, France's Total and Swiss trader Glencore.

Then there are the insurers without which these shipments would halt, reportedly including Lloyd's of London, Munich Re of Germany, Steamship Mutual Underwriting Association and the North of England P & I Association of the UK. Indeed, insurers should already be on the highest alert in light of the January interception of the Islamic Republic of Iran Shipping Lines (IRISL) chartered Monchegorsk, stopped at Cyprus carrying weaponry destined for Syria – and most likely to Hezbollah. (IRISL and its affiliates are already under U.S. sanction, and will likely also be sanctioned by the U.N. Security Council this year.)

Companies helping Iran gain refining independence (which could be subject to sanction under S. 908) include the British Universal Oil Products (a subsidiary of U.S.-based Honeywell), Axens and Technip of France, Sinopec of China, Hyundai of South Korea and Aker Kvaerner Powergas of Norway.

Mr. Chairman, even proponents of sanctions recognize they are a blunt tool. Too often, sanctions impact those least likely to be able to change policies. They are not a silver bullet, and they may not deliver an end to the Iranian nuclear program. But we are on a tight timeline. Iran will soon have a weapon that will doubtless preclude any desire on their part to negotiate.

Some, including some at this table and their allies inside the Administration, will argue that sanctions will have the opposite effect...that Iran will not respond well to any pressure, and will be driven away from negotiations. Others will argue that only by slow-rolling our sanctions effort will we be able to

persuade the world of our bona fides and bring them along in the most effective form of persuasion – multilateral sanctions.

These arguments have little basis in history, and even less likelihood of getting us to a successful outcome with Iran. Who here believes that the reason that China and Russia have been reluctant to support tougher sanctions is because they doubt America's good faith?

This week, Secretary Gates suggested that «if the engagement process is not successful, the United States is prepared to press for significant additional sanctions that would be non-incremental." The Secretary is absolutely right that the drip drip of incremental sanctions will not answer the mail. But he posits a false choice for the administration and our allies. In truth, the choice is not between engagement and sanctions. Rather, it is only by applying the toughest possible sanctions that we stand any chance of persuading Iran's leaders to consider serious negotiations with the international community.

It's time to give the President the tools he needs to do what is necessary to force a choice inside the halls of power in Tehran. Right now there is no choice to be made; the status quo with the rest of the world is working out nicely for the regime.

I would like to say that we can rely on the Iranian people to deliver a better government, and one that serves their needs as much as the needs of the international community. But I don't think such a change is on the cards in the timeframe we need. That should be the topic of another hearing, and other legislative efforts. The courageous people of Iran deserve our support. In the meantime, however, the United States needs to do more to defend its own national security and that of our allies. I believe this committee can provide much needed help, and that S. 908 is an important and useful way to move forward.

Thank you.