Ratcheting Up Economic Pressure on Iran I

Jeffrey J. Schott says a new law calling for sanctions on Iran's central bank and new European curbs on oil purchases are raising the stakes in the West's confrontation with Tehran.

Steve Weisman: Iran's economy is going through turmoil because of sanctions being imposed by the United States, Europe, and others. Jeffrey Schott, senior fellow at the Peterson Institute for International Economics, has been looking at the impact of these sanctions on Iran, and on the world oil What sanctions are being imposed?

Jeffrey Schott: A law that was signed by President Obama at the end of last year ratchets up the sanctions against Iran by targeting relations with the Central Bank of Iran. That complicates the ability of the Iranian Government to sell oil in world oil markets. The idea is to put a squeeze and to reduce the ability of Iran to sell oil in the world markets and therefore dramatically reduce their government revenues.

Steve Weisman: How does it complicate the sale of oil?

Jeffrey Schott: It basically limits the ability of non-US financial institutions to deal with the Central Bank of Iran. It basically made most of those relations with the Central Bank of Iran radioactive in that, you touch it and you become radioactive and have difficulty in having access to dealings in the US financial market. It devolves very quickly into border-type arrangements that try to circumvent the financial system.

Steve Weisman: Of course sanctions have been tightened for many years. Why are these sanctions biting?

Jeffrey Schott: The sanctions haven't been implemented yet. It's a concern because there is basically a six-month window under which this big threat is looming. It could be imposed by a certification by the President probably by the middle of this year. The reason why there is this flexibility is that the problems with cutting off supplies or sales from Iran affect a number of important countries. China, India, Japan, and Korea together account for about 60 percent of Iran's oil exports. Those exports are about 2.4 million barrels a day. So not a large share of the world oil market, but because global supply and demand balances are so tight, any significant reduction in shipments to the world oil market could have an immediate impact on world oil prices.

Steve Wesiman: What's the effect of the European intention to halt purchases of oil from Iran?

Jeffrey Schott: That would affect another 15 or 20 percent of Iranian sales. And the question is whether there's a substitution effect and other markets pick it up. What the US sanctions are trying to do is limit the ability of this diversion of shipments to third markets.

Steve Weisman: What's being done to assure the Chinese and others that they can have access to oil?

Jeffrey Schott: That gets to be a complicated situation, because if we go forward and implement these sanctions, we run up not only into an immediate conflict with Iran, but with a number of our important allies that need to cooperate with us to ensure that the oil embargo or oil sanctions work, but also that other foreign policy measures against in the region. Those countries also work with us on Iran, on North Korea, and others. So there needs to be a way of compensating for the effects on world oil markets and for the reduction in supplies to key markets.

Steve Weisman: One way to compensate is to get other exporters to pump more oil. Is that being done?

Jeffrey Schott: Unlike the situation that we had when Libyan oil went off the market, where there was an immediately good substitute for that high quality oil, there is a good substitute for Iranian crude and that's Saudi crude. And the Saudis have an ability to increase production a bit. There has to be some incentive to ensure that other countries divert at least some of their shipments of purchases of oil away from Iran.

And indeed, the sanctions don't require a total embargo. It just means the sanctions can be waived if countries demonstrate that they are significantly reducing their purchases from Iran. So we're not talking about cutting off entirely, but really tightening the squeeze on Iran without making it so difficult on our allies that they won't cooperate with us.

Steve Wesiman: Is the Obama administration nervous about this? It's a little hard to tell, but they didn't necessarily welcome the legislation in the first place.

Jeffrey Schott: They didn't welcome the legislation when there was very limited presidential discretion. During December, the terms of implementing the sanctions were modified to give the President a great deal more discretion. The sanctions do not automatically enter into force unless the President declares that the world oil market can accommodate some reduction in Iranian supplies. It seems a bit vague. But I think the President has the discretion if he thinks that the sanctions would cause a major spike in world oil prices because of tight supply-demand balances, that he wouldn't do it.

This type of discretion is a little different from the National Waiver Authority that exists in other sanction's laws with regard to Iran, which have been used very actively to shield foreign oil companies from US sanctions. That got a bad name in Congress. This compromise gives the President a little more discretion in when to pull the trigger on implementing the sanctions. The sanctions don't necessarily require the total cut-off of purchases from Iran.

Steve Weisman: If the purpose of sanctions and economic pressure is to get Iran to be more accommodating on its nuclear program, it doesn't seem to have had that effect. We're headed toward a possible political or military confrontation.

Jeffrey Schott: Part of the objective of imposing these sanctions is to make it more difficult and more costly for Iran to pursue its nuclear ambitions. And by reducing revenues and causing economic distress, it will make it harder for the regime to continue to accelerate the development of its program. Will it lead them to say, "We give up and we're abandoning everything"? That's a big political issue and sanctions over the course of history have been less effective in getting a country to back down on a major policy goal.

Steve Weisman: This is something you have studied. But you've also said that financial sanctions have a bigger bite than some trade sanctions. What do you think is the outlook of this latest set of steps?

Jeffrey Schott: Financial sanctions in the past have been more effective than trade sanctions in general. And in recent years, advances in technology have made financial sanctions even more effective than they were in the past.

Steve Wesiman: Because flows of funds can be tracked?

Jeffrey Schott: Yes. This really is a big ratcheting up in the pressure on Iran. It could lead to a political backlash from Iran trying to use military or covert operations. Not necessarily blocking the Straits of Hormuz, but funneling material and funds to Hezbollah and others as they've done in the past, to try to create mischief and diversions in the region. I think we have to be quite prepared for that type of the reaction. It is a big ratcheting up and to do so and to create the potential frictions with major allies in East Asia, taking that risk, I think, means that the security folk are getting increasingly concerned about the pace of development of Iran's industry.

Steve Weisman: Jeff, thank you very much.

Jeffrey Schott: Thank you.