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Iran and the Road Ahead

By Michael Jacobson
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Recently, two important developments have broken months of gridlock on the Iranian nuclear issue: a third round of UN sanctions and a new warning by the Financial Action Task Force (FATF). Although both measures are positive, their ultimate impact will depend on how aggressively and effectively key governments implement them.

Security Council Vote

The UN Security Council adopted Resolution 1803 on March 3, after nearly eight months of negotiations. The resolution will have an important symbolic impact, given that the December 2007 U.S. National Intelligence Estimate (NIE) seemed to halt international momentum to pressure Iran, making it unclear whether additional rounds of UN sanctions were even possible. The resolution's near-unanimous passage -- with fourteen members approving and Indonesia abstaining -- will send a strong message to Tehran. Those voting in favor included Russia, China, and South Africa -- all countries with longstanding economic ties to Iran.

The previous two unanimous resolutions (1737 and 1747) caught Iran by surprise, and the latest will undoubtedly do the same. President Mahmoud Ahmadinejad's recent statements indicate that he believed the UN would not sanction Iran further, especially in the post-NIE climate. The new resolution should show Iran that the Security Council is not paralyzed, and that future UN action is possible down the line.

Resolution 1803 builds on the two previous resolutions by expanding the blacklist of entities and individuals tied to Tehran's nuclear program; banning the sale of dual-use components to the regime; calling on member states to inspect cargo going to or coming from Iran; and urging countries to "exercise vigilance" in any trade incentives or guarantees they seek to broker with Iran. Perhaps most important, the resolution calls for similar vigilance over financial institutions regarding their dealings with Iranian banks -- particularly Banks Saderat and Melli.

FATF Warning

On February 28, FATF -- the international standard-setting body for efforts against illicit financing -- reiterated its October 2007 warning about Iran, calling on member financial institutions to use "enhanced due diligence" when dealing with the country. The FATF president also urged Tehran to address "shortcomings" in its anti-money laundering and terrorism financing regimes immediately.

In evaluating the significance of FATF's action, it is important to look at the organization's composition. China and Russia are members, as are a number of Iran's other key trading partners, including Italy, Japan, Germany, and the Gulf Cooperation Council. Since FATF works by consensus, both the February and October warnings were presumably issued without opposition from any of the thirty-four members.

Iran's recent behavior indicates that it is increasingly worried about FATF's actions, as it should be. Since the October warning, Iran has enacted legislation to combat money laundering, and government officials claim that a "supreme council" will be established to address such issues. In addition, even though Iran is not a FATF member, it sent a delegation to lobby FATF about its recent legislative changes. FATF dismissed the Iranian claims, however, calling the changes "skimpy" and noting their "big deficiencies."

Financial Impact

Although no additional Iranian financial institutions were formally blacklisted, the UN and FATF moves could nonetheless increase financial pressure on Tehran. Global financial institutions -- risk-averse by nature, particularly with regard to "reputational risk" -- are already leery about dealing with Iranian banks, and this new warning may reinforce their cautiousness.

In fact, according to U.S. Treasury undersecretary Stuart Levey, all of the global financial executives that departmental officials have met with over the past two years have either cut off or reduced their institutions' exposure to Iran. The number of foreign banks operating in Iran has sharply declined since 2006, dropping from forty-six to twenty. Surprisingly, even Chinese and United Arab Emirates banks seem to be exercising greater caution in their business dealings with Iran in recent months.

Reports that two British banks -- Lloyds TSB and Barclays -- are under investigation by the U.S. Justice Department and the Manhattan district attorney for possible violations of the Iran sanctions regime should only heighten the financial sector's concern. Financial institutions are particularly eager to avoid being the "next ABN Amro" -- the Dutch bank fined $80 million by the United States in 2005 for having an inadequate program in place to ensure compliance with U.S. sanctions against Iran and Libya. The *Financial Times* noted that the fine sent "seismic waves through the international banking system," and that the "reverberations are still being felt today."

How the Europeans respond to the new resolution will be crucial. Following the two previous resolutions, the European Union went further than the UN required, freezing the assets of not only the designated fifty individuals and entities, but also twenty others. The EU has also enacted a more comprehensive arms embargo and travel ban against Iran and its officials than required by the UN.

Now that the UN has spoken, perhaps it will free the EU to act further. While France and Britain have been urging expanded EU efforts for months, Germany and others have called for restraint while awaiting a UN decision. Given the extensive economic ties between various EU states and Iran, bold action by the union could have a significant effect. An especially powerful measure would be a European ban on Iran-related export credits -- a form of government insurance that has long underpinned European-Iranian business ties. Given that the UN resolution specifically calls on countries to exercise vigilance with this type of assistance, the Europeans would have ample justification for their own ban.

Challenges Ahead

A more difficult challenge for the United States and its allies will be to ensure that financial efforts against Iran are heeded by smaller banks and companies that do not conduct business in the United States or Europe. For example, as the larger, more established banks have scaled down their dealings with Iran, smaller, second-tier banks have stepped in. These types of institutions are unlikely to respond to the general warnings issued by the UN or FATF, or pay attention to veiled U.S. threats. They tend to be less concerned about reputational risk than the major players, and the possibility of being cut off from the U.S. market is irrelevant to them.

Fortunately, these entities might be convinced to reduce their ties to Iran if their own governments cautioned them, since they are far less inclined to ignore the proclamations of local regulatory agencies. The key then will be to ensure that all governments follow through on the UN and FATF actions and provide appropriate warnings to the financial institutions in their jurisdictions. This should be a focus not only for the United States and its allies, but also for international bodies such as the UN and FATF. For example, FATF has noted that while some member states sent alerts to their financial sectors in response to its October warning, many others did not. The United States should continue to track this issue closely, working with other key players to pressure countries that do not live up to their international responsibilities.

The bottom line is that there are still many steps the United States and its partners could take to raise the financial costs of Tehran's nuclear program. Although success is far from guaranteed, an approach that incorporates aggressive financial pressure remains the best means of persuading Iran to abandon its nuclear ambitions.

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