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US Sanctions Send Iran Into the Arms of Asia

China Hand

From a Western-centric point of view, the United States and its allies are pushing Iran into a corner.

A broader perspective would indicate that we might simply be driving Iran into the arms of Asia.

On March 24, Iran's official media reported that Iran will apply for full membership in the Shanghai Cooperation Organization (SCO), a would-be nascent EU-esque community headed by China and Russia and containing a fistful of continental Asian states.

Pres. Mahmud Ahmadinejad of Iran at SCO meeting, July 2007

Connoisseurs of irony, or at least sarcasm, will find fodder in Iran's reported appreciation of the SCO's goals of "anti-terror, anti-extremism, and anti-splittism" as well as its discovery of the deep cultural affinity between Iran and Asia.

But consider this:

- The two largest customers for Iranian oil are China and Japan.
- China has surpassed Germany as Iran's biggest trading partner.
- The main market for Iran's gasoline purchases has switched to Singapore.
- The main investors in Iran's energy industry—led by China—are all Asian.

In a development that may involve substance as well as symbolism, China will host the next round of G5+1 (UN Security Council members plus Germany) talks in Shanghai on April 16 concerning Iran's nuclear program.

China's Assistant Foreign Minister for the region, Zhai Jun, visited Tehran on April 9, presumably to give the Iranian government a heads up on China's position going into the G5+1 conference.

Iran's Foreign Minister Manuchehr Mottaki took the opportunity of Zhai's visit to lobby for "an Asian union" including Iran and China, presumably a step even beyond membership in the SCO.

If Iran's state media is reporting Zhai's remarks correctly, China is not spurning Iran's advances:

> Zhai said that China is prepared to cooperate with Iran in the area of key industries such as oil and gas.
>
> "Iran's growth of power in the region and the international arena is to Beijing's interest," he stated.

China-built oil tanker for Iran

Iran's rediscovery of its Asian side—and turn away from Europe, which has long served as a focus of Iranian aspirations, economics, and diplomacy—is the most important and perhaps least expected consequence of the network of national financial sanctions that the Bush administration has labored to pile atop the toothless UN sanctions against Iran.

American efforts to isolate Iran through the international financial system provide an object lesson in the iron law of unintended consequences. Instead of briskly destroying the Iranian Death Star with the help of our coalition of the willing, we appear to be engaged in global whack-a-mole, with a continuously expanding supply of holes and moles, and Uncle Sam demanding more and bigger hammers so he can win the game.

The United States has devoted immense efforts over the last two years to achieve international adoption of what is essentially a U.S. national sanction regime that goes beyond the global consensus reflected in the UN Security Council resolutions. The results have been, at best, mixed.

In its last year in office, the Bush administration has apparently embarked on a risky path to escalate its way out of the difficulties, contradictions, ambiguities—and perceived ineffectiveness-- that dog its Iran sanctions policy.

As the U.S. is well aware, the sanctions chain is only as strong as its weakest link. Aside from the United States, Israel, the UK, and France, it's weak links all the way across. One of the weakest links is, of course, China.

China is a major trade and energy partner of Iran, and has labored consistently to limit and dilute UN Security Council sanctions against Iran for its uranium-enrichment related activities.

As a result, to U.S. frustration, UNSC sanctions remain highly targeted, directly addressing individuals and organizations involved in enrichment activity, and specifically preclude military action.

There were attempts in the Western press to present the latest UNSC vote (14-0 with Indonesia abstaining) as a sign of united world resolve to pressure the Iranians for refusing to give the IAEA the answers it wants about its allegedly abandoned weapons program, or suspend uranium enrichment.

However, the Chinese quickly went on the record to counter the Western interpretation with its own.

Courtesy of Xinhua, here's what Chinese-language coverage had to say (translations by China Matters):

> [The resolution] emphasized diplomatic efforts, resumed dialogue and negotiations with Iran...balance between sanctions and encouragement of negotiations
>
> [There are] strict limits on targets of sanctions...sanctions are "reversible", temporarily or even permanently if Iran takes positive steps to implement the Security Council resolution...
>
> [D]ifferent countries have different interpretations of the resolution...roots [of deadlock] are in the severe lack of mutual trust between the United States and Iran. If this problem is not resolved, then there will be no breakthrough on the Iran nuclear question.

In other words, there is no support for meaningful international sanctions that would pressure the Iran regime.

In the wake of this less than decisive outcome at the United Nations, the US Treasury Department, exploiting a generalized call in the resolution for "vigilance" regarding financial dealings with Iran, announced a broadening of national measures against Iran on March 20.

From the Financial Times:

> The Treasury department has issued a warning of the risks of doing business with 51 state-owned and seven privately held Iranian banks – in effect the whole of Iran's banking sector. The list includes institutions specialising in export financing and foreign investment, as well as Iranian state-owned banks located as far away as Venezuela, Hong Kong and the UK.

The prospect of the United States implicating the entire Iranian banking sector as an accessory in terrorist financing and proliferation, thereby cutting it off from the Western financial system, is a source of real anxiety for Iran.

However, the looming US sanction also looks like an attempt to deal with the unintended consequences of its financial campaign against Iran: Iran's abandonment of the dollar and total disconnection from the U.S.financial system in Iran's economy, coupled with the wholesale shift of Iranian trade and finance away from the United States, first to Europe and now to Asia.

The Asian trend is symbolized by the announcement of Iran's oil minister this January that, following successful negotiations with customers in China and Japan, the entirety of Iran's energy sales—over $50 billion per annum—are now conducted in Euros and Japanese yen, and none in US$ dollars.

Sometimes it looks as if the United States, and not Iran, is getting boxed into a corner. America's difficulties can best be illustrated by looking at the intertwined cases of Germany and China. Depending on how you look at it, Germany is either the keystone—or the weakest link—of the US campaign to isolate Iran, insofar as maintaining a European united front against Tehran is concerned.

Here's how Der Spiegel reported the situation in July 2007:

> But the US government is no longer content with United Nations economic sanctions on Tehran -- Washington wants more. ...American officials are irked that German companies are still doing business worth billions with Tehran. In particular, Washington has little understanding for the export guarantees Berlin still offers firms, effectively helping the mullah regime to buy new ships and power plant technologies.
>
> [The Treasury Department's Deputy Secretary for Terrorism and Financial Intelligence Stuart Levey] demanded Germany cut its so-called Hermes export credit insurance coverage when it came to deals with Iran....Levey told the officials that Washington wanted Germany to scale back all of its other economic ties with Iran as quickly as possible.

> But Levey ran into resistance from the Germans, who said his demands were understandable coming from a country that has no trade with Iran. Germany, however, exports more than €4 billion ($5.45 billion) in goods to the country each year, creating thousands of jobs. . .Besides, explained the Germans, the Hermes cover has been excluded from UN sanctions against Iran. In short, Levey could forget his request -- Germany would stick to the UN resolutions, but would do no more.

The United States did not take no for an answer.

The U.S. was also not shy about going around the Merkel government to go directly to Germany's financial institutions and lean on them to follow US policy regardless of what their government's official position was—something the Merkel government most certainly resented.

Again from Der Spiegel:

> And Levey hasn't just been knocking on the doors of government ministries while in Europe -- he's also been visiting the continent's captains of industry. While in Germany he went to the country's financial center Frankfurt to try to persuade the bankers there not to do business with Iran. German financial institutions feel the United States government has been engaging in "downright blackmail," according to one banker. Anti-terror officials from the US Treasury are constantly showing up to demand they cut their traditionally good relations with Iran. The underlying threat from the men from Washington is that they wouldn't want to support terrorism, would they?
>
> But there are no plans to stop financing German exports to Iran. "Of course our member institutions respect all sanctions set out in the UN resolutions," says a spokesman for the Association of German Banks. However, that didn't stop Deutsche Bank, along with German industrial heavyweights BASF and Siemens, from being put on a list by the US Securities and Exchange Commission (SEC) for having contacts with Iran.

German attitudes toward the sanction regime are clear from another Spiegel article:

> [T]he economics department of the German Foreign Ministry has collected revealing data which [German Foreign Minister] Steinmeier will use to back up his argument against EU sanctions.
>
> Several French companies in the automobile, energy and financial sectors -- including Peugeot, Renault, Total, BNP Paribas and Societé Générale -- have hardly reduced the level of business they do with Iran, according to the Foreign Ministry data. German exports to Iran, in contrast, have dramatically declined.
>
> Even more explosive is the data that reveals US hypocrisy over sanctions. The German Foreign Ministry accuses American firms of bypassing the boycott against Iran, which has been in place since 1979, by creating front companies in Dubai to carry out their business. German politicians have long internally accused the United States of knowingly tolerating the practice. Microsoft software is present in Iran, as is Caterpillar heavy equipment. And it's difficult to overlook the presence of brands like Pepsi and Coca-Cola in Tehran.

Despite this attitude, German defiance did not survive the summer.
In November 2007, Siemens announced it would sign no new contracts with Iran (while executing its existing agreements).

German banks took concrete actions to limit trade with Iran in Fall 2007, as this report from a Chinese exporter message board indicates:

> I have checked with Commerzbank AG and Dresdner Bank AG and it seems to be true that by order of their board of directors from the beginning of October 2007 only welfare operations would be supported by them and not even usual commercial businesses like deliveries of garments would be done.

The German government continued to wind down its Hermes export credit program.

According to the February 28 International Herald Tribune, the consequences of German participation, no matter how grudging, in US-led pressure on Iran on Germany's bottom line was unmistakable:

> German exports to Iran have dropped drastically in the past two years amid increasing concern over Tehran's nuclear ambitions, according to a new report from the German Economy Ministry.
>
> The report shows a drop in German exports to Euro 3.2 billion, or $4.7 billion, in 2007 from Euro 4.3 billion in 2005. Meanwhile, government guarantees that exporters will be paid for their goods sold to Iran have more than halved, to Euro 503.4 million in 2007 from Euro 1.16 billion in 2006.

No doubt an occasion for triumphant high-fives at the US Treasury Department. The mood in Germany, however, was assuredly less joyful.

The Summer 2007 Der Spiegel article pointed out:

> Were Germany to end its Hermes export guarantees, German locomotives might no longer be delivered to Iran, but Chinese and Russian companies would gladly step into the breach. The Americans would end up gaining nothing, while the German economy would stand to lose a lot.

Over in Asia, China was undoubtedly pleased to see Germany surrender the Iranian market under US duress. Chinese exports to Iran have skyrocketed at exactly the same time that Germany's sagged.

In fact, China has displaced Germany as Iran's biggest trading partner, with trade of about $20 billion, not including the significant sanction-evading trade through Dubai (many, many billions more).

In a development that Germany undoubtedly noted, on March 26, two weeks after Tehran announced it was making a Euro 90 million progress payment toward a 2006 contract it signed with Siemens for 150 locomotives, Tehran Urban & Suburban Railway Co. signed a new €360m contract with China Northern Locomotive & Rolling Stock Industry Group for 455 metro cars and 160 double-deck coaches. Another 455 coaches are currently under tender.

Trends like these create new problems and responsibilities for the United States.

Now the onus is on the Bush administration to show Berlin that it is able to live up to its self-elected role of global sanctions cop, and prevent others from profiting by Germany's participation in the network of national, US-led sanctions against Iran.

The US-led sanctions regime certainly won't flourish if the Europeans see it as nothing more than an invitation for China to eat their lunch.

Treasury Deputy Secretary Robert Kimmitt acknowledged the issue in October 2007:

> "We hear from the business community that it's a concern of theirs - to act responsibly, only to see someone else act irresponsibly," Mr Kimmitt said in Brussels after talks with four EU commissioners. "The Russians and Chinese have been signatories to each of the UN Security Council resolutions and I would think, whether it be in the financial sector or other sectors, someone else stepping in would be very inappropriate and very counter to what the Security Council has called on the world community to do.

The trouble has always been, of course, that China and Russia have always insisted on following the UN sanctions to the letter and no further—heeding annexes listing a few dozen companies and individuals and hundreds of items of equipment and materials-- but declining to endorse the open-ended statement of principles and broad call to action that the US is trying to read into the resolutions.

The headline of a June 2007 report in the Wall Street Journal—which noted a 70% surge in Chinese exports to Iran over the previous year—says it all

China-Iran Trade Surge Vexes U.S.

What to do?

More specifically—and awkwardly—how could the United States extend its reach beyond its own borders and perform the apparently sovereignty-affronting task of interfering in Iran's third country trade with China without the legal cover of UN Security Council sanctions?

Beyond pressure on allied governments to restrict their export credit facilities to Iran, apparently, the solution chosen by the Treasury Department was to attack Iran's ability to use the most common financial instrument in international trade—the Letter of Credit or LC—in its import and export dealings with China and other business partners.

The Letter of Credit system relies on a network of cross-border banking relationships that offer payment guarantees and financing to importers and exporters.

To a significant extent, the LC is the underpinning of the Asian export miracle since the 1950s and, until recently, it was the backbone of billions of dollars of non-oil trade between China and Iran.

The United States has labored mightily to disrupt this system as far as Iran and Asia are concerned, and create the risk that both Iranian and export-country banks would be unable to meet their payment obligations because of US harassment.

Typically, a bank will have ties with less than one hundred international banks—and the names are published in a directory that no doubt saved the officers at Treasury's Office of Terrorism and Financial Intelligence a good amount of heavy lifting. Since dollar-denominated Letters of Credit largely clear through New York, the Treasury Department was able to convince Iran's correspondent banks worldwide that handling an Iranian LC made them liable to penalties for violation of US national sanctions.

The US government has in the past imposed sizable penalties for violation of US sanctions—ABN-Amro was hit with an $80 million fine in 2005—so the risk was genuine and significant. The US also made it clear that U-turn transactions—by which intermediary banks in third countries could strip out references to Iran in dollar-denominated LCs—would be grounds for enforcement actions.

The compliance departments of international banks—responsible for controlling the risk when the bank puts its own assets and reputation on the line in an LC transaction—inserted boilerplate clauses in their LC undertakings not to pay or process Iran-related credits.

On the supply side, Stuart Levey and the Office of Terrorism and Financial Intelligence (OTFI) jawboned the PRC and, in a reprise of the German end-around, also bypassed the Chinese government to pressure Chinese banks directly with the threat of legal proceedings against their US operations if they were caught handling Iranian L/Cs.

The result was a significant dent in L/C based business between the PRC and Iran as many Chinese banks reportedly decided the risk of US penalties outweighed the benefits of handling Iranian LCs.

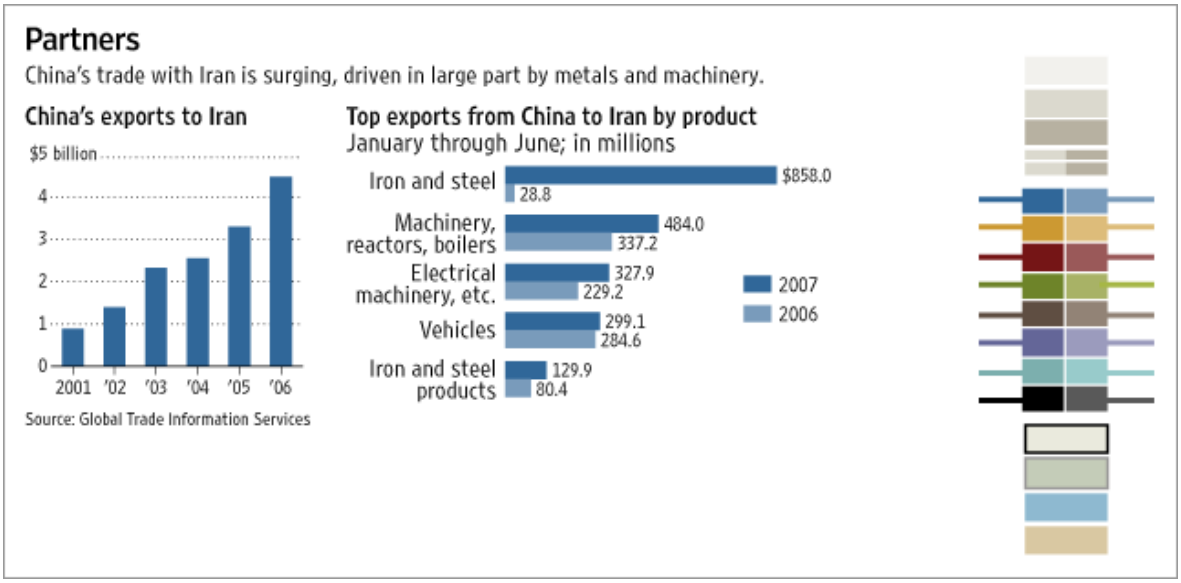
Iran sent five delegations to China to try to achieve a workout—and even proposed establishment of a China-Iran bank that would presumably clear all transactions internally without going through New York—but the Chinese demurred. China's attitude toward the US sanctions campaign against Iran could be characterized as one of grudging outward compliance combined with energetic evasion.

The lesson of Iran sanctions appears to be Trade Will Find a Way—to China—and, if not directly to China, then through Dubai.

The Financial Times reported:

> "Chinese banks have become very nervous and are reluctant to deal with Iran directly," said a second businessman. "They prefer to work with Iranians who import goods to Iran through Dubai to pretend they export goods to UAE rather than Iran."

Chinese exporter message boards for the last three years make interesting reading. One finds detailed and impassioned accounts of Chinese exporters—and their equally anxious Iranian customers—laboring to work around sanctions, embargoes, and blocked LCs, and deal with the problem of Iranian banks that want to pay them but are unable to move US$.



Chinese exports to Iran

Advice on the message boards was virtually unanimous. Go Dubai. Go Euro. And go T/T. Go Dubai, as in route Iran business through the Middle East entrepot located across the
Straits of Hormuz in the United Arab Emirates.

In response to the US sanctions against Iran, there has been a rush of thousands of Iranian businesses and hundreds of billions of dollars of Iranian capital to incorporate in Dubai, which plays the role of free-wheeling Hong Kong to Iran's socialist PRC, and transact Iran's business under UAE cover through the banks there.

Dubai's non-oil trade with China—99% of it from China to the UAE and ultimately destined for Iran and other countries in the Persian Gulf—had soared an astounding 47% in 2007, to a value of US$19 billion, virtually equal to the announced direct non-oil trade between China and Iran.

As for the other elements of the evolving China-Iran trade regime:

Go Euro as in switch to the Euro, as there are fewer national sanctions that would prevent foreign banks from processing Euro transactions.

Go T/T as in Telegraphic Transfer i.e. wire transfer of funds executed confidentially through the Belgium-based Society for Worldwide International Financial Telecommunication (SWIFT) as an alternative to LCs.

These efforts to remove the burgeoning China-Iran trade beyond the jurisdictional reach of the United States—to the detriment of America's European allies—are eliciting a variety of US responses.

President Bush, Vice President Cheney, and Stuart Levey have all visited the UAE in recent months to call for a cutback in the UAE's economic activity with and on behalf of Iran. As a result, Dubai has apparently halted incorporation of new Iran-related companies and discouraged letter of credit Iran business by its local banks (the UAE branches of international banks had already discontinued the practice).

As an apparent shot across the bow, the Treasury Department also deployed an official sanction (not just a warning) against Future Bank, an enterprise in the neighboring emirate of Bahrain, a bank co-owned by the blacklisted Melli Bank of Iran.

For those of us who recall Treasury's role in the North Korea affair, Future Bank looks a lot like Banco Delta Asia in Macau: a small bank in a secondary jurisdiction, blacklisted as a demonstration project and a warning that the United States is ready to take extreme destructive measures against bigger recalcitrant money center banks and territories.

It remains to be seen whether Dubai—which is keen to develop the China-Iran connection and less than enthusiastic about U.S. anti-Iran initiatives that can only cut into its growth and profits—will take Treasury's admonition to heart.

As for the shift toward telegraphic transfers denominated in Euros, America's threat to designate the entire Iranian banking system, including its state bank, as participants in terrorism financing and proliferation may be an attempt to deal with this offshoring option.

Telegraphic transfers involve shifting of private funds from an account in one bank to an account in another bank based on a simple instruction to pay by a depositor at a member bank. European banks handle billions of dollars of these routine transfers every day through SWIFT. The US Treasury's March 20 advisory may be part of a strategy to shut down the TT/SWIFT channel for Iranian transactions by tainting the entire Iranian banking system.

In its March 20 advisory, the Treasury Department urged "all financial institutions to take into account the risk arising from the deficiencies in Iran's AML/CFT [anti-money laundering/combating the financing of terrorism]regime, as well as all applicable U.S. and international sanctions programs, with regard to any possible transactions with the following Iranian institutions".

"The following Iranian institutions" was a list of virtually the entire Iranian domestic and overseas banking system, including Iran's central bank, Bank Markazi.

As a justification, the advisory cited a passage of the most recent UNSC resolution calling for "vigilance" and a statement dated February 29 calling for "enhanced due diligence" on Iranian business by the Financial Action Task Force (FATF), a multi-national anti-money laundering organization based on the G-7 nations in which the US hopes to forge an institutionalized "coalition of the financial willing" reside.

Then the advisory goes well beyond the circumspect UNSC and FATF language to present Iran's terrorist and proliferation activities and

the evasive actions of Iranian banks in service of these activities as established fact:

> *Iran's AML/CFT deficiencies are exacerbated by the Government of Iran's continued attempts to conduct prohibited proliferation related activity and terrorist financing.* ***Through state-owned banks, the Government of Iran disguises its involvement in proliferation and terrorism*** *activities through an array of deceptive practices specifically designed to evade detection. The Central Bank of Iran and Iranian commercial banks have requested that their names be removed from global transactions in order to make it more difficult for intermediary financial institutions to determine the true parties in the transaction. They have also continued to provide financial services to Iranian entities designated by the UN Security Council in its Resolutions 1737 and 1747. The U.S. Department of the Treasury is particularly concerned that the Central Bank of Iran may be facilitating transactions for sanctioned Iranian banks.* [emphasis added]

Presumably, Treasury's wish is that risk averse compliance departments of international banks will instruct their operating departments to refuse all Iranian transactions and avoid the potential regulatory and legal jeopardy that might arise from disregarding the possibility of imminent US sanctions. A further, formal US designation of the Iranian banking system as a terror finance facilitator could provide the US Treasury Department with an additional weapon—the prospect of subpoenaing SWIFT records on telegraphic transfers.

SWIFT's relations with the U.S. government are currently awkward and extremely fraught. SWIFT's reputation for banking confidentiality—a legal obligation under EU privacy laws—was rocked by a New York Times exposé in 2006 reporting on SWIFT's cooperation with the US government on subpoenas pertaining to terrorist financing. In response, SWIFT categorically stated it could only comply with US subpoenas related to terrorism, and specifically precluded cooperating on investigations related to lesser crimes such as money laundering.

If the United States goes to the next level and designates Iran's banking system as engaging in terrorist financing, it would presumably have the standing to subpoena SWIFT records to identify banks handling money transfers in and out of the Iranian banking system, and threaten them with draconian sanctions and financial penalties.

Currently, such a sanction is hypothetical, as is the willingness of the United States to impose it—and the European Union to accept it.

It remains to be seen how much genuine international support the U.S. can muster for such a broad-brush approach to sanctioning Iran, one which is long on assertions, short on evidence or due process, and goes far beyond the stated UN consensus.

As the United States tries to stand, King Canut like, between the Iran's ocean of cash and the shores of the international trading system, Iran's volume of direct and indirect trade does not appear to have declined. Despite relentless jawboning by the United States and professed unity on the importance of pressuring Iran, execution of the US-led financial blockade has reportedly been spotty, especially among smaller, second-tier banks outside of Europe for whom the reputational and business risks of offending the Treasury Department are less than dire.

There are indications that the big European banks are currently honoring the US call for cutting ties with Iran in the breach, cutting LC ties and eschewing dollar transactions while letting Euro-denominated transactions bubble along. Certainly, Iran's ability to export oil—and get paid for it in Euros—has not suffered.

Beyond the failure to disrupt Iran's oil exports, the United States has yet to put an end to Iran's most strategic—and vulnerable—import: gasoline.

The US had great hopes for fostering domestic dissatisfaction with the Iranian regime by disrupting its large gasoline imports (only the United States imports more gasoline than Iran). At US behest, the French government pressured banks BNP Paribas and Calyon (a subsidiary of Credit Agricole) to cut off letters of credit for Iran's gasoline trade. The Reliance refinery in India announced it was stopping gasoline and diesel sales to Iran. An apparent major victory was claimed when Swiss trader Vitol, supplier of most of Iran's gasoline, announced in December 2008 that it was not renewing its contract.

But guess what?

Iran switched its gasoline purchases to Singapore on a Euro basis, paying in cash and, according to Reuters, even through LCs.

> Some Asian traders said that some Singapore banks are willing to handle Iranian LCs, but not in dollars. Singapore's biggest banks are DBS, UOB and OCBC.

As for Vitol, Reuters reported in a separate article:

> [Iran] has purchased 12 cargoes of gasoline of around 35,000 tonnes each for January delivery, another industry source said. **Of those, Swiss-based trader Vitol will deliver five cargoes**, he added.

Emphasis, as they say, added.

So it looks as if Vitol's withdrawal from the Iran gasoline business was just another piece of sanctions kabuki and the inconvenience surrounding Iran's gasoline imports has been limited.

On non-oil trade, Iran is awash in oil revenues and can afford to pay a premium for the aggravation of evading American sanctions to import Chinese reinforcing bar, underwear, machinery, and cheap electronics.

Judging from anecdotal references on a Chinese bulletin board, it looks like the financial costs of Iran transactions for a Chinese exporter had increased 10% as a result of the LC crackdown—an unpleasant but manageable number.

The picture of unenthusiastic compliance and vigorous evasion is similar in matters of strategic investments. European energy companies have largely desisted from Iran investments, preferring not to expose their extensive US business interests to possible sanctions.

While BP, Royal Dutch Shell, Total, and GDF are holding back, China and others are pushing forward. The China National Offshore Oil Corporation (CNOOC) reportedly concluded a deal for a $16 billion investment in Iran's North Pars natural gas field in December—in the midst of negotiations on the third round of UN sanctions.

CNOOC in Beijing

Developments like this create an atmosphere of anxiety, impatience, and unslaked greed—elements not conducive to an effective sanctions regime—among Western oil companies.
The BBC provided a taste of oil industry opinion on Iran:

> Iran's huge energy reserves are hugely significant for the oil industry.
>
> Mr Kirsch [previously of the U.S. State Department] says many oil firms would take the risk of upsetting the US if others were doing the same.
>
> "What you're seeing is a strange sort of dance with some of these energy companies and they're all hoping that another company will be the first one in to become the lightning rod for the US reaction," he explains.
>
> "The first company that does break ranks and makes a major investment will lead to an opening of the floodgates," he says, meaning that if one oil company does a deal with Iran, lots of others may follow.

The U.S. is working to stem the tide by deploying diplomatic and regulatory pressure against Asian oil companies and others willing to test the blockade. It has threatened sanctions against CNOOC, on the basis that CNOOC, by virtue of its listing on the New York Stock Exchange, is subject to the Iran Sanctions Act.

India's Essar Group pulled out of a deal to construct a refinery in Iran after the United States—and the governor of Minnesota—threatened retaliation against its interests in the U.S.

As an intimidating step, the US has also requested a copy of a multi-year gas deal between Switzerland's EGL and Iran valued at $28 billion+, to determine if the Swiss partners would be subject to sanctions.

The US government also suggested that this apparent violation of Swiss "neutrality"—Switzerland's foreign minister participated in the signing ceremony in Tehran on March 17—might dictate the termination of the arrangement by which the Swiss embassy in Tehran handles U.S. interests.

Reviewing America's Iran-related activities over the last few years, a disturbing pattern emerges. We are not sanctioning Iran so much as we are sanctioning our unwilling allies, especially those in Europe, for continuing to do business with Iran. This is not a trend conducive to an effective sanctions regime. The U.S. campaign of sanctions has not only yielded resentment and grudging enforcement by many of our allies. It has also elicited open rancor and even defiance.

India's aggrieved tea exporters, looking to expand exports to Iran, responded to the State Bank of India's suspension of Iranian LCs by proposing that the Asian Clearing Union—through which South Asia negotiates some of its international payments—add the Euro to the dollar as an approved clearing currency.

Turkey, a linchpin of US diplomacy in the Islamic world, was surprisingly blunt in its response to US calls to join its financial embargo. When Stuart Levey visited Ankara in January 2008 to request that Turkey halt dealings with Iran's Bank Mellat, the Turkish Daily News reported:

> Turkey says it cannot simply suspend Iran's Bank Mellat operations in the country upon a U.S. request. 'What binds Turkey are the resolutions of the United Nations and not U.S. presidential decrees or congress decisions,' a diplomat says...

Even within Europe, support for the US regime is less than universal. France has been the most aggressive and wholehearted, reining in its energy and industrial sector and reportedly cutting off all Iran banking transactions except Euro payments under existing contracts—and only with prior government approval. France's President Sarkozy also showed his support for the U.S. strategy by lobbying aggressively but unsuccessfully for additional Iran sanctions at the EU level during the negotiations over the third UNSC resolution.

At the other end of the spectrum are Austria and Switzerland, which have openly and adamantly insisted on enforcing the letter of UN sanctions and no more . Each has defiantly concluded gas deals with Iran.

> Austria's Foreign Minister went on record in October 2007 to state: "The basis of sanctions against Iran are the resolutions of the United Nations Security Council...France is free to slip in changes [in its national sanctions but not try to expand EU sanctions]. We stick to our positions."

As for Switzerland, despite a barrage of full-page advertisements placed by the Anti-Defamation League in the International Herald Tribune, Wall Street Journal, and New York Times on April 8 to support the US position that the EGL gas deal violated the "spirit" of the UN sanctions--headed "Guess who is the world's newest financier of terrorism? Switzerland,"--AFP reported that the Swiss government and industry groups are not backing away from the transaction.

> [A Swiss government spokesman stated] the contract "is in full conformity with the existing UN sanctions against Iran", as well as the US Iran Sanctions Act.
> He also pointed out that there are at least 10 other countries with major energy deals with Iran, including Japan, France and Italy.
> ...
>
> Swiss industry leaders too, were unfazed by the criticism.

> EGL spokesman Bogdan Preda said Wednesday he had no further comment on the issue, other than to reiterate that the deal "respected all national and international agreements".
>
> The president of Swiss energy group Axpo, of which EGL is a member, Heinz Karrer, told tabloid Blick that it is "incomprehensible" that Switzerland is seen to be financing terrorism, pointing out that "many other countries" also obtain energy from Iran.
>
> Head of the Economie Suisse business umbrella group Gerold Buehrer also told the newspaper that he "stood behind the deal at the beginning", and that he "still stands behind it".

With this mix of support, resistance, and non-compliance, the question is this: if the United States designates Iran's entire banking sector as a facilitator of terrorism and proliferation, will the European banks and governments go along with this draconian step, in a combination of conviction and self-interested calculation that Europe's competition in Asia will get cut off at the knees?

The answer may have a lot to do with whether Europe believes that Iran can provide vindication of the sanctions regime that has eluded the United States so far on Cuba, Libya, and North Korea—and justify the costs to America's allies.

The answer may not be one that the US administration is prepared to hear.

In December, the General Accounting Office titled its review of the US government's anti-Iran activities under the gloomy title Iran Sanctions: Impact in Furthering US Objectives Is Unclear and Should be Reviewed.

The Guardian summed up the apparent futility of Washington's sanctions approach in its report on Iran's recent parliamentary elections:

> The election has strengthened the hand of Iran's Revolutionary Guard, a militantly conservative force with growing control over the economy. At least 120 of the 290 members of the new parliament will be former guardsmen like President Mahmoud Ahmadinejad.
>
> **The election results are a blow to advocates of sanctions as a means to pressure Tehran into suspending uranium enrichment**, which the country's critics allege is a cover for a secret arms programme. Iran insists it is for energy generation.
>
> **A year ago US and British diplomats were pointing to criticism of Ahmadinejad's combative style on the world stage as evidence that economic pressure was working. "It's hard to see that now," a western diplomat in Tehran admitted.**
>
> Even reformists say sanctions do more harm than good, by making Iranians close ranks around the leadership.
> ...
>
> The elections took place in the wake of a third wave of sanctions imposed by the UN security council, and as the US attempted to tighten the ring around Tehran by imposing sanctions on a Bahraini bank partly owned by Iranian state-run financial institutions.
>
> Saeed Leylaz, a liberal political analyst in Tehran, said the election outcome demonstrated the bankruptcy of western policy. "[Radical conservatives] like it. They like isolation to cover and hide their mismanagement behind sanctions and to have more control internally."[emphasis added]

Bear in mind, people like Saeed Leylaz are the people we are supposed to be helping with sanctions.

While the effectiveness of sanctions is questionable, the costs to Europe of the US sanctions regime are unmistakable.

The pressure that the United States is exerting on Iran's economy through the financial system is genuine and significant...but so is Iran's shift away from the dollar and the reorientation of its trade and strategic relationships toward Asia. These tectonic shifts may dictate that Europe decides to co-exist with the reality of the Asian-Iranian relationship, instead of futilely attempting to strangle it in its cradle. The open question is whether these new realities will be addressed –or even acknowledged—in the United States as America's Iran policy evolves.

Ambiguity—and the threat of drastic unilateral American action—are at the heart of our Iran diplomatic strategy. So far, U.S. tough talk and stern measures have all occurred within the moderating context of the G5+1 process. The next G5+1 meeting on Iran scheduled for Shanghai on April 16, could provide China the opportunity to burnish its currently tarnished international image by taking the lead on the Iran issue.

Russia, a good indicator of China's stance on Iran, apparently feels that more inducements rather than more sanctions is what the situation demands.

> [Russian Foreign Minister] Lavrov in an interview with Ekho Moskvy radio on Tuesday said that offering new incentives to Iran is aimed at persuading Tehran to freeze its uranium enrichment program.
>
> The Russian foreign minister also voiced his country's opposition to new sanctions against Iran over its nuclear program.
>
> "We must focus on drafting new positive proposals now," AP quoted Lavrov as saying.
>
> The Russian top diplomat declared that the proposals drafted by diplomats from the US, Russia, China, Britain and France, along with Germany, **would offer Iran new economic, energy and security incentives to Iran**. [emphasis added]

The iron law of U.S. diplomacy at present seems to dictate that it can only enter into Iran-related discussions with a coercive unilateral instrument close at hand to deploy if discussions don't go our way. At this time, the most readily available weapon is the threat to escalate the March 20 warning concerning the Iranian banking network to a full-fledged sanction.

It may turn out that the sanction threat will serve primarily as America's latest bargaining chip in the endless game of high stakes poker

between Iran, Europe, China, and the United States, and not the harbinger of total financial warfare against our less-than-enthusiastic allies or an imminent US attack against Iran.

Another indicator of Washington's intentions and militancy on Iran will be what happens to the CNOOC deal.

Despite its growing economic and strategic embrace of Iran, China is not eager to seek open conflict with the United States. China's former ambassador to Iran commented in the Chinese media that China would hesitate to openly welcome a sworn enemy of the United States into the Shanghai Cooperation Organization.

China, obviously aware of the diplomatic and regulatory pressures that the U.S. brought to bear on the Swiss gas deal and Indian refinery project, has circumspectly declined to officially announce the conclusion of the CNOOC deal and give the United States an opening to demand a copy of the agreement. Nevertheless, the Chinese Ministry of Foreign Affairs went on record to draw a line in the sand on the CNOOC contract, an indication that it isn't ready to pull the plug on the deal in response to US pressure:

> [T]he energy cooperation between CNOOC and Iran is nothing beyond a business deal between relevant enterprises. ... UN Security Council's resolutions and actions should contribute to the peaceful solution of the issue through dialogue and consultation. Actions against Iran should not affect or impair normal economic and energy cooperation with Iran.

The possibility that CNOOC may simply delist from the already beleaguered New York Stock Exchange in response to sanctions and seek a more hospitable home elsewhere could figure in Washington's calculations as to the advisability of sanctioning CNOOC.

In the last year of President Bush's term, with the world looking beyond him to a new president and more flexible policies, the result of additional sanctions may not be as dramatic as the United States desires and Iran fears. However, the unanimous desire of American political parties and candidates to be tough on Iran in an election year, and the geo-political ambitions of pro-American leaders Nicholas Sarkozy and Silvio Berlusconi—expected to return as Italy's president—could tilt the global balance in favor of escalating the confrontation with Iran and lock the next US administration into a hard-line anti-Iran posture.

Nevertheless, even if President Bush claims a short-term victory for his legacy of U.S.-orchestrated national sanctions and zero-sum confrontation with Iran, circumstances lead one to believe that Iran, an oil exporting nation with significant foreign exchange reserves, powerful friends and a significant number of unenthusiastic enemies, can survive even formal, across-the-board financial ostracization.

The long term result will probably be the rise of the Euro, and the loss of America's post-World War II dollar-based world financial hegemony—accelerated by a significant shift in the Middle East's political and economic center of gravity toward Asia, led by Iran.

China Hand is the author of the Asian affairs website China Matters.
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See also John McGlynn, The US Declaration of War on Iran.

China Hand follows up on this article at China Matters.

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