PUNISH MISBEHAVIOR

How Economic Sanctions Affect American Business

By Troy Anderson

As the drumbeat for war grows louder, the most burning questions for Israeli Prime Minister Benjamin Netanyahu—and U.S. President Barack Obama—are whether and at what point to launch preemptive strikes on Iran's suspected nuclear weapons facilities.

While both Obama and Netanyahu hope economic sanctions will convince Iranian leaders to abandon their nuclear ambitions, experts say the window of opportunity for sanctions to work is narrowing.

Iran, whose leaders have called for the "annihilation" of Israel and the "disappearance of the West," is making headway in developing a range of ballistic missiles and accelerating its nuclear weapons program. Experts say it now has enough low-grade enriched uranium to make several nuclear weapons.

Former CIA Director Michael Hayden recently told the Israeli newspaper *Haaretz* that the Iranians will be able to begin work on a nuclear weapon in 2013 or 2014.

Oddly, this intensifying international conflict could have the unintended effect of moving the U.S. toward greater energy independence. As a result of the Iranian nuclear crisis, U.S. policymakers are considering ramping up domestic oil production and searching for alternative energy sources.

This phenomenon comes amid "a new energy boom" in North America, which over the last five years has become the fastest-growing oil- and natural-gas-producing area in the world.

"To some extent, the sanctions are driving up oil prices," says Phillip Swagel, a professor of public policy at the University of Maryland and a nonresident scholar at the American Enterprise Institute, a Washington, D.C.-based think tank. "Iran is producing less oil and is having a more difficult time exporting oil. This, to some extent, creates more scarcity in the rest of the world and drives up oil prices—and that generally helps Texas. That's not good for the economy as a whole, but it's good for Texas, where there is a lot of oil and natural gas. The negative, of course, is that Texas companies are not able to sell their products to Iran."

Amid the tightening economic sanctions, Iran's oil revenues dropped in July to $2.9 billion from $9.8 billion in July 2011, according to the Rhodium Group. This drop in oil revenues comes as the U.S. has deepened economic sanctions against Iran.

Signing of the Iran Threat Reduction and Syria Human Rights Act

In August, President Obama signed the Iran Threat Reduction and Syria Human Rights Act of 2012 into law. Coupled with existing sanctions, the act represents the strongest set of sanctions to isolate any country in the world during peacetime, according to the American Israel Public Affairs Committee.

As a result, virtually all of Iran's energy, financial, and transportation sectors will be subject to U.S. sanctions. Companies conducting business in these industries face the possibility of losing access to U.S. markets. But most importantly, the law prohibits the repatriation to Iran of any revenue it receives from the sale of its oil, "robbing Iran of 80 percent of its hard currency earnings and 50 percent of the funding for its national budget," according to AIPAC.

Iran's energy sector is responsible for more than a quarter of the country's gross domestic product, and revenue from oil exports makes up more than half of the government's annual budget. U.S. sanctions have already deprived the nation of tens of billions of dollars in investments and reduced its oil exports by 60 percent, or about $40 billion a year.

U.S. Rep. Ileana Ros-Lehtinen (R-FL), chair of the House Foreign Affairs Committee and co-author of the act, told fellow members of Congress that the bill "blacklists virtually all of Iran's energy, financial, and transportation sectors, and cuts off companies that keep doing business with Iran from access" to U.S. markets.

"It will undermine Iran's ability to repatriate the revenue it receives from the sale of its crude oil, depriving Iran of hard currency and funds needed to sustain its government," says Ros-Lehtinen. "It prevents the purchasing of Iranian sovereign debt, thereby further limiting the regime's ability to finance its illicit activities.

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"We should be under no illusions that this legislation is a magic wand that we wave and will resolve this problem overnight. Sanctions have helped to knock the regime off balance, but unless the Executive Branch fully implements these measures immediately, the regime is likely to regain its footing and further speed up its nuclear march. We must act now to stop that march."

Jeanne Archibald, a partner and head of the Global Government Regulatory Practice at the Hogan Lovells legal firm and a former general counsel of the U.S. Treasury Department, says the bill also makes non-U.S. entities owned or controlled by U.S. companies subject to U.S. sanctions against Iran. Further, it requires companies that trade on the U.S. Stock Exchange to disclose certain details about Iran-related business to the Securities and Exchange Commission.

"With respect to U.S. companies, one very important provision will make a U.S. company potentially liable—and by that I mean civil penalties that can be applied if the non-U.S. subsidiary of that U.S. company engages in activity vis-á-vis Iran," Archibald says.

Prior to the passage of this law, the wholly owned subsidiary of a U.S. company could conduct business with Iran. But now the parent company can be subject to fines, says Archibald, who describes this as a "major shift."

But Archibald doesn't expect this to have a major impact on Texas businesses—most of which presumably haven't been doing business with Iran. "I suppose the interesting question is, as other countries decide not to do business with Iran, does this change world oil prices for petroleum products and does it increase demand for U.S. petroleum products because the supply on the world market decreases? As world demand requires more oil products and there is a smaller supply, Economics 101 tells you people will look to increase the supply. Whether it's reasonable to assume that will come from offshore drilling in the U.S. I think is a little bit speculative, simply because the U.S. has not typically been a large exporter of petroleum products."

The Strait of Hormuz

On the other hand, while the Iranian nuclear crisis may create more demand for U.S. oil and benefit the Texas economy, experts say Iran's threats to close the Strait of Hormuz if attacked could cause the price of oil to spike dramatically, with serious repercussions for the global economy.

The shipping lane, located between the Gulf of Oman and the Persian Gulf, is the only route from the Persian Gulf to the open ocean. About 35 percent of the world's sea-traded petroleum passes through the strait. In September, an armada of aircraft carriers, battleships, minesweepers, and submarines from 25 nations converged on the strait to help protect the oil tankers.

"Clearly, if the Strait of Hormuz were closed, that would be very expensive for the U.S. at a time when our economy is not doing very well," says Steven Craig, a professor of economics at the University of Houston. "That's true, whether we buy Middle East oil directly or not. There is really an international market for petroleum. If the price goes up for other countries, the price will go up for us also. So, it's clearly in our economic interest to not have a war or for the strait to be closed."

At this point, the debate over the potential fallout from the Iranian nuclear crisis centers on whether the economic sanctions will persuade Iran's leaders to give up their suspected nuclear weapons program.

Sanction History

The U.S. and other nations have long used economic sanctions as part of the response to foreign misdeeds by nations such as Iran, North Korea, Sudan, Cuba, and others, according to the authors of a 2007 report, "Economic Sanctions Reconsidered," by the Peterson Institute for International Economics. In contrast to conventional wisdom, these tools of international diplomacy succeeded in achieving foreign-policy objectives in only about a third of 200 cases studied over a 25-year period, the authors found. As defined in the report, economic sanctions involve the "deliberate, government-inspired withdrawal, or threat of withdrawal, of customary trade or financial relations."

The history of such sanctions actually dates to ancient Greece. The most celebrated occasion involved Pericles' Megarian decree, enacted in 432 BCE in response to the kidnapping of three women. U.S. President Woodrow Wilson used economic sanctions in modern times in response to the horrors of World War I, launching the Allied blockade of Germany. During World War II, sanctions were usually imposed to disrupt military adventures or to complement a broader war effort. More recent cases include sanctions against China in the wake of the Tiananmen Square massacre, the Helms-Burton sanctions against Cuba, the Iran and Libya Sanctions Act, and the sanctions against Iraq prior to the onset of a full-scale war in 2003.

The annual cost imposed by sanctions on target countries has risen from $2 billion in the post-1965 period to $27 billion in 2000, the authors wrote. "Although sanctions activity has grown, particularly in recent decades, it has expanded much more slowly than world merchandise trade, which grew more than 400-fold (in nominal terms) between 1915 and 2000. Compared with total world trade flows, the cost imposed by sanctions on target countries represents barely a ripple in the world economy."

Mixed Discussions On Impact of Sanctions

In terms of the sanctions on Iran, Swagel says, the biggest impact has been on Iran, not the U.S. "It's increasingly difficult for Iranian companies to have economic transactions with the rest of the world, just because the U.S. tells banks, 'If you deal with Iran, you can't deal with anyone in the U.S.,'" Swagel says. "That's a pretty potent tool."

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David Mahmood, chairman and founder of the Dallas-based Allegiance Capital Corp., a middle-market investment banking firm, says the economic sanctions can be quite damaging for companies that have been exporting goods to Iran. Mahmood says he's in the process of selling an oil field services company that exported products around the world, including to Iran. The company was sanctioned for sending products to Iran.

"That almost put the company under," Mahmood says. "The people who run it are Iranian, they had many business contacts in Iran, and I can tell you they were very supportive of the (Obama administration) and good, loyal Americans. But businesses get hurt when products are blacklisted and sanctions are put in place. These folks made many trips to Iran to generate business contacts and create business that generated American jobs. They did what good business dictates and what the American government promoted—developed exports, grew the economy and created jobs."

Like Swagel, though, Mahmood agrees that the sanctions keep oil prices high. In that sense, the sanctions are probably helpful to energy producers in Texas and the Southwest and to those companies that supply oil-field services companies, Mahmood says. "There are positive and negative aspects on both sides," Mahmood says. "I think for the oil companies it's probably beneficial. For the people buying gas at the pump, the typical American, it's not beneficial. I think crude prices will stay at $80 to $95 a barrel for some time, and if armed conflict breaks out in the Strait of Hormuz, I think you would see a significant jump in the price of oil."

Brian P. Amidei, a partner and managing director at High Tower Advisors, a national partnership of wealth-management advisors from large Wall Street firms, says the Iranian nuclear crisis offers a good opportunity for the U.S. to reduce its reliance on foreign oil.

"I think if we drilled more in the U.S., opened up the Keystone Pipeline and the Bakken field in North Dakota—if they allowed this to be explored the way we'd like it to—I think we could save a lot of manufacturing jobs and put people to work in different industries," Amidei says. "I think that would have a tremendous impact on the economy. I don't want oil spills like we had in the Gulf a couple of years ago, but the fact is, oil exploration and fracking technologies have come a long way. I think we should look to loosen the restrictions on what prevents us from increasing our oil output."

For years, U.S. policymakers have debated whether the country should encourage more domestic oil production or keep relying on Middle Eastern oil, Craig says. "There has been a raging debate over a long period of time whether we should encourage domestic production or encourage Middle East production because who knows when some calamity will happen and that Middle East petroleum will not be available at all," Craig says. "The Middle East still, by far, has the least expensive oil, absent the security concerns in the world. And so it is still most beneficial for the world to have access to Middle Eastern oil."

Ivan Eland, a senior fellow and director of the Center on Peace & Liberty at The Independent Institute, a nonpartisan public-policy think tank in Washington, D.C., says economic sanctions have a mixed history of success. The use of economic sanctions in Panama in the late 1980s and in Iraq in the early 1990s weren't successful and eventually led to war, Eland says. In the case of Iran, Eland says Iran can evade the sanctions because oil tankers can leave with one destination on their manifest and simply show up somewhere else with a different manifest location.

"The sanctions are very leaky, and they leak more over time as the target country finds ways around them," Eland says. "Oil sanctions are one of the easiest things to avoid. The main effect of the sanctions is to raise costs on the sanctioned country. There are some economic impacts on Iran from the oil embargo, but over time you'll see that dissipating. The economic effects dissipate either through legal or illegal reordering of markets."

Given the volatile situation in the Persian Gulf, Mahmood says, now is a good time for the U.S. to move toward more energy independence, drilling more domestically and opening up the Keystone Pipeline. "The U.S. is becoming less dependent on foreign oil," Mahmood says. "We import 1 million barrels a year less than we did previously, and with cheap natural gas we are building energy independence in this country."

In the short run, diplomacy and economic sanctions are probably the best hope of resolving the nuclear showdown in the Middle East, Mahmood says. Certainly, Israel is not going to sit on the sidelines and let Iran develop nuclear weapons. "It will probably be easier to move forward on this once the election is over," Mahmood notes. "It's become highly politicized. Regardless of which side you are on, there will be more certainty once we know who is going to be in control in the White House and Congress over the next four years."

At that point, Mahmood expects that the nation will have a more settled foreign diplomacy strategy and be able to "deliver a message in a clearer voice" after the presidential election.

"In political seasons, it gets a little bit like the Tower of Babel," Mahmood says. "I think the important thing is for the American people to keep separate in their minds the power structures in Iran, the fundamentalists who run the country, and the Iranian people, because a large number of Iranian people have struggled against their own leaders and paid a dear price for it." **N**

An award-winning journalist at the Los Angeles Daily News, *the* Press-Enterprise *and other newspapers for 20 years, Troy Anderson writes for Reuters, Newsmax,* Christianity Today, Bankrate Insurance *and many other magazines and online publications. He lives in southern California. For more information, visit www.troyandersonwriter.com.*