Economic sanctions in a smaller world: Is globalization increasing the precision and efficacy of foreign policy tools?

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Introduction

As a longstanding foreign policy tool of the United States, financial and economic sanctions have played a vital role historically, as both an independent measure and a complement to military action. However, their use and intended effects are often far more complicated and, subsequently, more difficult to control. The objective of this paper is to investigate how a more interconnected and co-dependent global system affects the ability of such tools to produce predictable, effective, and desirable results.

In light of recent geopolitical developments in Iran and North Korea, such as the pursuit of nuclear capability and heightened confrontational rhetoric, a debate over the efficacy of such measures continues to be both timely and relevant. Present-day sanctions imposed by the United States appear to be directed predominantly towards states considered to be nuclear threats. However, The U.S. Department of Treasury currently oversees sanctions programs for 15 countries, as well as specialized programs for narcotics, terrorism, the rough diamond trade, and transnational criminal organizations.\(^1\) Above all, it is necessary to view these programs and other foreign policy tools as a collaborative venture contributing to the advancement of state goals.

The theoretical mechanisms behind economic sanctions are as follows: sanctions are used to coerce and constrain the actions of, or signal to, a target country. Notably, this can only be determined within the context of both countries, but it is likely to be a mix. Additionally, the effect of such measures is also determined largely by an actor’s ability to control the narrative surrounding an imposed sanction.

For instance, a sanction-imposing, or enforcing country, may take steps to produce a negative effect on a target country’s economy with the aim of changing certain behavior.

However, a behavioral shift is rarely produced through economic sanctions directed at state actors alone, but frequently constrains a target country’s ability to pursue deviant or objectionable behaviors. At the very least such measures express the view of an enforcing country while attempting to shape dialogue over specific objectionable behaviors domestically and abroad.

Creating a beneficial incentive structure and maintaining credibility are also highly important for an enforcing country. While a sanction does not have to impose a cost, without proper incentive, it is unlikely a sanction will lead towards a desired change in a target country’s behavior. Furthermore, the threat of sanctions must be deemed credible to avoid objectionable behaviors. It would be unlikely for an enforcing country to take measures against a target country if the cost of implementation were deemed to be too great. Recently, the Obama administration considered more assertive action towards Beijing due to the number of cyber-attacks on U.S. companies that have originated in China.² Sterner rhetoric aside, China accounted for 14 percent, or $535.2 billion, in U.S. trade in 2012, so it is unlikely the U.S. would take action that could threaten its relationship with its second largest trading partner.³

Historically, economic sanctions have been viewed as blunt instruments that inevitably harm the general public in a target country.⁴ While amplified domestic pressure could lead to behavior shifts or constrained action, non-state actors have become increasingly relevant. Transnational corporate entities and large firms presently have a more profound effect on target economies. Logistically, the domestic population of a target country is at a disadvantage to

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provide large sums of capital, advanced technologies, or military goods to their home country as compared to foreign firms or governments. Academic opinion is split as some argue that the newfound prominence of private sector actors adds complications due to differing goals.\(^5\) However, the distinction between state and non-state actors’ goals seem to favor enforcing countries with sufficiently large economies via the ability to manipulate incentives. Not only is a firm’s primary objective to maximize profit, but in many cases it is also their fiduciary duty.\(^6\) Therefore, the threat from a sufficiently large economy or unified bloc of economies to secondary actors, such as construction or technology firms, for the discontinuation of government contracts or activity in an enforcing economy acts as a disincentive for investment in a target country.

The current economic conditions in Iran are not wholly the result of imposed sanctions, which adds another level of complexity to any evaluation. A discussion on domestic economic challenges will be provided to clarify to what extent the U.S action has produced desirable effects. However, and as mentioned previously, this also empowers Iranian officials to leverage their narrative against the U.S. using the imposed sanctions as a scapegoat for domestic policy shortcomings or failures.

The findings of this paper will show that a more economically, financially, socially, and politically integrated international global system allows for more direct targeted financial sanctions, but the increased complexity of the system as a whole also enables evasion. Additionally, this paper will show that imposing sanctions in a more complex environment

increases the chance for negative externalities and sometimes leads to results that are counterproductive to the sanctions’ intended effect.

**Execution and implementation**

The execution of United States sanctions is handled by the Office of Foreign Assets Control, commonly referred to as OFAC. The Treasury Department’s involvement in administering sanctions is not a new occurrence. OFAC was created in December of 1950 after China’s entry into the Korean War. President Truman declared a national emergency and proceeded to block Chinese and North Korean assets. Additionally, the Treasury Department began implementing sanctions as far back as the War of 1812 and the Civil War.

OFAC replaced the Office of Foreign Funds Control, or FFC, which was created at the onset of the Second World War in response to the German invasion of Norway. At that time, the FFC’s principal purpose was to make sure the securities and foreign exchanges of occupied countries were not used and to prevent unwilling repatriation of funds from citizens of occupied countries. When the United States entered the war on December 8, 1941, the FFC administered all foreign trade and financial sanctions against the Axis.

Additionally, there is a large degree of latitude concerning the enforcement of sanctions imposed by the United States. As stated by the Treasury Department, OFAC has the ability to alter any statements, stances, or interpretations, published or non-published, without notice. The

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Treasury Department also uses the current Iranian financial sanction regulations outlined by the Comprehensive Iran Sanctions, Accountability, and Divestment Act, which states that they are given the responsibility to determine what is considered a significant prohibited transaction on a case by case basis. Finally, the Secretary of the Treasury holds the ability to sign a waiver to the current Iranian financial sanctions if it is determined to be in the interest of national security by the president.  

**Sanctions leading up to and related to the Iranian hostage crisis**

On November 4, 1979, relations between the United States and Iran rapidly disintegrated when 52 Americans were taken hostage by a group of militants and Islamic students. While this was not the beginning of what is now considered to be a decidedly tenuous relationship between both countries, the events which unfolded that day have proven to be a turning point in U.S-Iran relations.  

On November 12, 1979, under the advisement of the secretaries of the departments of defense, state, energy, and treasury, President Carter issued presidential proclamation 4702 discontinuing all U.S purchases of Iranian oil. Additionally, on November 14, 1979, Carter issued executive order 12170 freezing all Iranian assets held by the United States. Through this action, $12 billion worth of assets were seized, including $1.418 billion in Federal Reserve holdings partially made up of 1,632,917 ounces of gold bullion, $5.579 billion in overseas

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branches of U.S banks, $2.050 billion in U.S. banks, and roughly $2 billion from other persons in the United States.\textsuperscript{15} These measures were reinforced on April 7 and 17 of 1980 respectively, with the passage of executive orders 12205 and 12211, which restricted interaction with Iran’s central bank, disallowed private business interaction between persons of the United States and Iran, imposed a trade embargo with the exception of medical supplies and food, and forbid travel to Iran by United States citizens.\textsuperscript{16}

International efforts were promoted by the United States in a letter sent to the Secretary General of the United Nations on November 9, 1979. Thereafter, the United Nations issued a statement calling for the release of all hostages on November 27, 1979. However, when the United States approached the United Nations Security Council on January 10, 1980 calls for sanctions were not expedited as quickly as a statement for the immediate release of the hostages. The Soviet Union proceeded to vote against such measures, citing that the issue was bilateral in nature.\textsuperscript{17}

Notably, even harsh economic sanctions on Iranian oil and highly effective targeted financial sanctions were unable to produce the desired outcome of the Carter administration. President Carter would go on to leave office without a resolution to one of the largest challenges of his presidency. The hostages would be released on January 20, 1981, after a total of 444 days.\textsuperscript{18} This period overlapped the Iran-Iraq war, which took place between September of 1980 and August of 1988. Following the revolution and the conclusion of the Iran-Iraq war, Iran entered a reconstruction period from 1989 to 1992.\textsuperscript{19} During this timeframe, Iran began

\textsuperscript{16} \textit{Ibid}, 87
\textsuperscript{17} Hossein Alikhani, Sanctioning Iran: Anatomy of a Failed Policy (London: I.B. Tauris, 2000), 76.
\textsuperscript{18} \textit{Ibid}, 95
initiatives to reestablish production capabilities lost during the war. Iran also made attempts to
gain investments in technology and develop foreign partnerships as a means to create and
improve domestic infrastructure. These partnerships, some of which included former Soviet
states, allowed Iran to counteract a great deal of negative repercussions intended by previously
implemented sanctions.20 The United States’ trade sanctions were also relaxed during this
period.21

Iran and Libya Sanctions

Sanctions again began to tighten in the early 1990s under the Clinton administration.
Iran’s nuclear program and support of terrorist organizations prompted the passage of two
executive orders. Executive order 12957, passed on March 15, 1995, banned all trade in Iran’s
energy sector. Executive order 12959, passed on May 6, 1995, banned all trade and investment
with Iran.22 A renewed interest in exerting economic pressure on Iran peaked shortly thereafter
when the 104th Congress passed the Iranian and Libyan Sanctions Act, or ILSA, on March 19,
1996.23 The main components of this act are as follows: immediate cessation of assistance from
the Export-Import Bank of the United States; the denial of export licenses to any company found
in violation of trade and business restrictions; a cap on loans or lines of credit from United States
institutions of $10 million within a 12 month period; the immediate cessation of Iran’s ability to
act as a primary dealer of United States debt instruments; and a ban on imports for violating
domestic companies.

20 “A Study of Iran’s Responses to U.S. Economic Sanctions,” GLORIA Center, Overview, accessed March 2,
21 “A Study of Iran’s Responses to U.S. Economic Sanctions,” GLORIA Center, accessed March 2, 2013,
22 “1995 Executive Orders Disposition TablesWilliam J. Clinton - 1995,” 1995 Executive Orders Disposition Tables,
http://www.govtrack.us/congress/bills/104/hr3107.
Targeting Iran’s energy sector and actors seeking to invest in it was, and is presently, a logical strategy for the United States’ economic sanctions. Currently, oil exports account for 70 percent of Iran’s government revenues.\(^{24}\) The provisions above were enacted with a 5 year expiration clause. This act expired in 2001 and again in 2006, when it was retitled the Iranian Sanctions Act, or ISA. This marked a policy transition for the United States, which began to focus more specifically on Iran. New policies sought to restrict Iran’s ability to avoid negative impacts from sanctions during the reconstruction period by targeting foreign firms in violation of the ISLA.

**The rial and the Comprehensive Iran Sanctions, Accountability, and Divestment Act**

The Comprehensive Iran Sanctions, Accountability, and Divestment Act, or CISADA, was signed into law on July 1, 2010, by President Barack Obama. This supplemented the ISA of 1996 with slight shift of focus. CISADA takes steps to target Iran’s petroleum sector, and more specifically, companies who seek to aid it with their business. The act states that, “a state or local government can enforce measures to divest its assets from or prohibit the investment of assets it controls in any person that has an investment of $20 million or more in Iran's energy sector, including in a person that provides oil or liquefied natural gas tankers, or products used to construct or maintain pipelines used to transport oil or liquefied natural gas, for Iran's energy sector; or is a financial institution that extends $20 million or more in credit to another person for at least 45 days if that person will use the credit for investment in Iran's energy sector.”\(^{25}\)

Importantly, these measures create a financial incentive structure such that companies risk more from investment in Iran than they stand to gain.

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The debate leading up to the implementation of CISADA centered on the sanctions’ speculated effect. While many politicians viewed these measures as a firm message to Iran opposing their nuclear ambitions, others viewed them as a blunt policy tool that would inevitably harm the Iranian people.  

Inflationary environments are often harmful to the general population within an economy. While slight inflation is often a sign of a growing economy and can be beneficial to balance sheet repair on the part of debtors, a large increase in the price level can be harmful to the general population, since a decrease in the purchasing power of the domestic currency can also occur. When this happens, individuals will get less goods and services for their money. This creates problems for both individual consumers and firms. Individuals on a fixed income may find it increasingly difficult to meet their needs, while firms are less likely to spend or make investments due to market uncertainty. This can lead to an overall decline in spending, which can result in a decline in output and employment.

To further examine these arguments, the following section will track prominent events and fluctuations in the rial occurring after the passage of CISADA. A baseline for this examination will be established using the period right after the passage of CISADA. At this time, the official exchange rate stood at 1 U.S. dollar for 10,000 Iranian rials. On October 4, 2010, four of Europe’s largest oil companies, (Total, Statoil, Eni, and Royal Dutch Shell) willingly complied with U.S. sanction guidelines and committed to ceasing any further investment in Iran. The rial depreciated 2.4 percent in four days arriving at 1 U.S. dollar for 10,258 rial.

Between June 7 and August 24, 2011, a subsidiary of Bobcat and Swiss-German

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construction equipment supplier Liebherr divest from Iran.\textsuperscript{28-29} In light of these and other events the rial depreciated another 3.1 percent from October, to 1 U.S. dollar for 10,589 rial.

On December 9, 2011, Chinese based Huawei Technologies agreed not to pursue new business with Iran. This statement issued from the world’s second largest telecom infrastructure vendor expressing intent to restrict business involvement again pressured the rial.\textsuperscript{30}

On December 27, 2011, David Cohen, Undersecretary of the Treasury Department, stated that the Iranian Revolutionary Guard Corps, or IRGC were profiting off the plight of the Iranian people by taking advantage of the gap between the rial’s official and market rate. At this time the demand for foreign currency by Iranians led to the IRGC, seeking arbitrage profit by obtaining foreign currency at the official rate and selling it to citizens at a much higher market rate. The official rate stood at 1 U.S dollar for 11,088 rial. However, the market value of the rial had declined 35 percent from March of 2011 and the gap between the official and market rate stood at 40 percent.\textsuperscript{31}

Between January 3 and 6 of 2012, the Obama administration took action against Iran’s Central Bank, the main clearing house for oil and gas payment to Iran. This legislation targeted foreign firms that purchase Iranian oil. Since Iran’s monetary policy is achieved through the purchase and sale of currency, limiting foreign currency from oil sales reduces Iran’s foreign

exchange reserves and thus their ability to defend the rial.\textsuperscript{32} After the announcement by the Obama administration on the 3\textsuperscript{rd}, the market value of the rial plummeted to 1 U.S. dollar for 17,800 rial. By the 6\textsuperscript{th}, the Iranian Central Bank provided foreign currency to the market. The market value rose to 1 U.S. dollar for 14,000 rial, while the official rate depreciated to 1 U.S. dollar for 11,194 rial.\textsuperscript{33} Then, on January 17, in an effort to support the rial, Iranian police were sent into the streets of the capital with the goal of cracking down on unsanctioned currency exchange.\textsuperscript{34}

On January 23, 2012, all 27 nations of the European Union agreed upon and announced an oil embargo with Iran.\textsuperscript{35} This further pressured Iran’s Central Bank by limiting foreign exchange reserves. Shortly thereafter, on January 25, the official exchange rate stood at 1 U.S. dollar for 11,306 rial, while the market value greatly depreciated to roughly 1 U.S. dollar for 20,000 rial. This then led to a decision by Iranian economic minister Shamseddin Hosseini and President Ahmadinejad to increase the interest rate from 12.5 percent to 21 percent. The consensus view was that Iranian interest rates would have to be increased to a level above Iran’s 20.6 percent inflation rate to promote confidence domestically and reduce sales of the rial.\textsuperscript{36}

On April 3, 2012, it became internationally known that Iran had banned importation of roughly 600 goods. Essential items remained on a list of acceptable imports; however, this move


by the Iranian government was an attempt to support their domestic currency by promoting the purchase of domestic goods, thereby reducing depletion of foreign currency, and allowing the central bank to continue to defend the rial. At that time, the official rate stood at 1 U.S. dollar for 11,808 rial, while the market value continued to hover around 1 U.S. dollar for 20,000 rial.\(^{37}\)

In April of 2012, Hyundai Motor Company and Porsche start to end business ties with Iran. Although both companies account for a very small amount of Iranian business, this event showed a shift in international consensus. The exit decision was made even after the Iranian parliament approved a bill to reduce car import duties by 20 percentage points to 70 percent in March of 2010.\(^{38}\)

By June 21, 2012, the price of a liter of milk had risen to 8,000 rial and the price of a kilogram of meat had risen to 5,000 rial. This put a burden on producers selling to the government at the official prices of 6,300 and 4,200, rial respectively. The Jomhouri Eslami newspaper stated that producer costs had increased between 34 percent and 37 percent within Iran in their last fiscal year. Additionally, Omid Karimien, a member of the Iranian Parliament Economic Committee, stated that the fluctuations in the rial, “[were] a testimony to the lack of solidarity in our economy.”\(^{39}\)

The Iranian Central Bank then made the decision to let the official rate depreciate to 1 U.S. dollar for 12,249 rial while the market value slightly strengthened to 1 U.S dollar to 18,300 rial. Central Bank efforts alone have not been able to close the gap between


the two rates.⁴⁰

On July 9, 2012, Italian firm Edison International S.P.A ceased interaction with Iran’s energy sector. This included a contract with Edison to explore Iran’s Dayyer natural gas field. The U.S. State Department issued a press release stating that, although Edison’s activity had been in violation of CISADA up until their withdrawal from Iran’s energy sector under a special provision of the ISA, as long as Edision continues to function within the guidelines of CISADA no action will be taken against them. At that time both the official rate and market value of the rial depreciated: the official rate stood at 1 U.S dollar for 12,271 rial, and the market value stood at 1 U.S dollar for 19,600 rial.⁴¹

On July 20, 2012, in a tacit admission that the Iranian government’s store of foreign currency was under pressure, Iran implemented a three-tiered exchange rate system for different classes of imports. The Iranian Students’ News Agency issued a statement indicating that the official rate would be offered for basic goods at 1 U.S. dollar for 12,260 rial. A rate of 1 U.S. dollar for 15,000 rial would be offered for capital and intermediate goods, and a rate of 1 U.S. dollar for 19,000 rial would be used for luxury goods.⁴²

On August 6, 2012, an event that would become known as the Iranian chicken crisis began. Authorities across Iran discovered 60 tons of stolen live and processed chicken throughout the country over a 15 day period. The escalating pressures on the rial and citizens’ contempt for the Central Bank’s inability to stop an increase in the price level of one of Iran’s dietary staples lead to this event. At that time, the official rate of the rial stood at 1 U.S. dollar for

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12,253 rial, and the market value stood at 1 U.S. dollar for 21,510 rial.43

On August 17, 2012, a New York Times article highlighted the increased pressure on Iran’s domestic currency. Reports showed a growing number of Iranians were filling trucks with domestic rial and heading to currency markets in Afghanistan.44 Then on August 18, The Economist published an article showing that basic food, clothes, and electronics were increasingly being considered luxury goods. The macroeconomic implications of this more subjective classification led to market, but generally less favorable, exchange rates on items not previously considered luxury goods, such as chicken or fruit. The disconcerting fluidity of the three tier import system weighed heavily on the public opinion resulting in few viewing Iran’s stated inflation rate of 24 percent a year as probable. At this time the official rate had strengthened to 1 U.S. dollar for 12,288 rial.45

On September 11, 2012, the official rate for the rial remained largely unchanged, but the market value eroded to 1 U.S. dollar for 25,650 rial.46 This event spurred legislators critical of President Ahmadinejad to pressure the Iranian Central Bank to take action. Then on September, 16, The Washington Times commented on the increased frequency of unsanctioned currency exchanges taking place in neighboring countries.47

On September 24 and 25 of 2012, the Iranian government implemented an initiative to

offer government-subsidized dollars to import certain goods. These exchange rate centers, designed to counteract the negative effects of informal currency centers drew on the three trier system. Priority goods such as meat and grain were given dollar accessibility at the official rate. Construction equipment, tires, and synthetic fibers were given access at 2 percent cheaper than market rate. By September 29, the rial had fallen to an all-time low as measured by the market value of 1 U.S. dollar to 28,400 rial.

Late 2012 was a cacophony of political, economic, and currency concerns in Iran. On October 2 and 3 President Ahmadinejad publically admitted that sanctions were partially to blame for the depreciation of the rial. He commented on the crisis, saying, “I ask you, dear people, do not change your money into foreign currency.” The rial fell to a new all-time market value low of 1 U.S. dollar to 37,000 rial. Riots began to break out in Tehran over the weakening currency. Police even fired tear gas on demonstrators.

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Global Competitiveness and Sanctions

Starting in the early 2000s, Iran liberalized investment regulations, likely in an effort to attract foreign direct investment, and to expand an alternative means to foreign exchange accumulation outside of oil sales. The World Economic Forum publishes the Global Competitiveness report, or GCI annually. I will use GCI, along with foreign direct investment, current account, and oil purchases as evidence of Iran’s policy focus to support the hypothesis above as well as any sanction effects.

The report is made up of 110 variables; two-thirds come from an executive opinion survey, and one-third from publically available data. The data is then organized into 12 sections, each of which is considered an important component of competitiveness. Competitiveness should translate into notable economic changes, such as an increase in wage or more international investment. The GCI argues that to sustain higher income, labor productivity must increase. Another distinction is made between how this is achieved. It can be broken down into three routes, factor driven, efficiency driven, and innovation driven development.

The first stage is factor-driven. Countries compete based on their factor endowments, primarily unskilled labor and natural resources. Companies compete on the basis of prices and sell basic products or commodities, with their low productivity reflected in low wages. At this stage of development, competitiveness relies mainly on well-functioning public and private institutions, infrastructure, a stable economy, health, and education.

The second stage is efficiency driven. This is required to maintain increasing wages. Efficiency is primarily accomplished through higher education and training, efficient goods

51 Ibid
markets, efficient labor markets, developed financial markets, the ability to harness the benefits of existing technologies, and market size.

In the final stage, innovation is the driving force behind development and sustainable higher wages. Companies must compete by producing new goods using the most sophisticated production processes and through innovation.

<table>
<thead>
<tr>
<th>Year</th>
<th>Rank</th>
<th>Index score</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010-2011</td>
<td>69</td>
<td>4.14</td>
</tr>
<tr>
<td>2011-2012</td>
<td>62</td>
<td>4.26</td>
</tr>
<tr>
<td>2012-2013</td>
<td>66</td>
<td>4.22</td>
</tr>
</tbody>
</table>

Notable progress in the ranking of 142 countries was made from the 2010-2011 period to the 2011-2012 period; however this partially eroded in the 2012-2013 period. It is important to highlight that Iran was ranked sixth globally in attracting foreign investments in 2010. It is quite possible the effects of CISADA started to counteract Iran’s efforts to limit the effect of sanctions. Looking at foreign direct investment should help to clarify some of the movement in GCI.

FDI alone does not completely clarify the economic landscape. Turning to current accounts, we see the following. Iran’s balance of payments is positive and increased dramatically after 2010. This can be explained by policy outlined in previous sections relating to the three-tiered exchange rate system for different classes of imports. Again, this was likely done in an effort to reduce the outflow of foreign currency.

Data on oil purchases paints a dramatic picture. As previously mentioned, the E.U. oil embargo reduced international purchases of Iranian oil by roughly 600,000 barrels a day, but this represented only part of the decline. China decreased their purchases by 30 percent, while other major buyers, including Japan, India, South Korea, and Turkey, have also taken steps to reduce dependence on Iranian Oil. Geopolitical tensions play a huge role in international relations but

harsh economic realities often take center stage. For China, India and Japan, Iranian oil accounts to close to 10 percent of their total crude supply while demand from Asia is only growing.\textsuperscript{57}

\begin{table}[h]
\centering
\caption{Top Energy Buyers From Iran and Reductions (amounts in barrels per day, bpd)}
\begin{tabular}{lcc}
\hline
Country/Bloc & 2011 & Current \\
\hline
European Union (particularly Italy, Spain, and Greece) & 600,000 & Negligible \\
China & 550,000 & 380,000 \\
Japan & 325,000 & 180,000 \\
India & 320,000 & 260,000 \\
South Korea & 230,000 & 180,000 \\
Turkey & 200,000 & 140,000 \\
South Africa & 80,000 & 0 \\
Malaysia & 55,000 & 30,000 \\
Sri Lanka & 35,000 & 20,000 \\
Taiwan & 35,000 & 20,000 \\
Singapore & 20,000 & 15,000 \\
Other & 55,000 & 25,000 \\
Total & 2.5 mbd & 1.25 mbd \\
\hline
\end{tabular}
\end{table}

In summary, Iran took measures to increase competitiveness and boost foreign investment, while limiting the outflow of foreign currency holdings, thereby growing its current account balance. The IMF provides future estimates as seen in the graph above. The consensus view shows a rapidly declining current account balance as the graph approaches 2017. The GCI highlights development strategies and is helpful in determining how to classify Iran’s economy. While Iran certainly does not fit into the third stage of development, a mixture of stage one and two seems probable. We see this through attempts to increase technological presence, stabilize


their currency, and develop and diversify their energy sector. Consequently, this also maps sanction strategy.

The actions of the U.S. and E.U. to limit oil purchases from Iran reduced foreign exchange reserves and put Iran’s Central Bank at a disadvantage to act in defense of the rial. Additionally, with the passage of CISADA, individual firms and technology companies were targeted in an effort to further impact Iran’s energy sector. However, this was not a panacea, since FDI has remained strong.

**Evasion**

Iran has continually sought to evade sanctions. For example, on January 10, 2013, OFAC issued an advisory for Iran’s use of a traditional informal banking and money exchanges called the hawalas network in the Middle East and South Asia, to circumvent the sanctions against financial transactions.\(^5^9\) This network allows firms to conceal any Iranian involvement in business deals. Estimates suggest that as much as several billion dollars move in this informal manner every year.\(^6^0\) Although, most of these transactions occur in Asia, such a discrete mechanism of transfer has become very useful in the Middle East, specifically to Iran for the purpose of evading sanctions.

A typical network operates as follows. An individual or entity in the U.S. may want to conduct business with Iran but is unable to do so due to financial restrictions. However, this can be achieved through the use of intermediaries, out of sight of the traditional banking system. A


simple transfer could involve a contact in the U.S, generally a business, a middleman in an
unrestricted country, and a business in Iran. The individual or entity seeking to move money to
Iran would approach a U.S. business with ties into the hawalas network. Money would then be
given to this business and transferred to a middleman in an unrestricted country. In many cases
this would also be a business. The method of transfer could be a practice known as under
invoicing, during which more merchandise is sent than is paid for. The discrepancy represents
the money the individual or firm in the U.S. wishes to transfer. Once this is completed, the
middleman would arrange through a standard payment system, or under invoicing, for the funds
to reach the target destination in Iran.\(^6\)

Additionally, many countries are setting up payment for oil through barter. This is the
case for China and India, while Russia and Pakistan have also attempted to set up such
arrangements. India has set up a state owned bank to settle up to 45 percent of its oil debt in
rupees. Iran is also using yuan paid to Asian accounts to buy Chinese cosmetics, clothes, toys,
electronics, and household appliances. Russia and Pakistan have attempted to secure oil in return
for wheat. Iranian officials have also made it known that payment will be accepted in any foreign
currency including gold.\(^6\) Kenneth Katzman, of Congressional Research Services stated, “Iran
cannot stabilize the value of its currency with such unorthodox payment methods, and that is
why its economy is collapsing” \(^6\)

\(^6\) Patrick M. Jost, "Money Laundering - The Hawala Alternative Remittance System," Money Laundering - The
Hawala Alternative Remittance System, accessed April 23, 2013,
https://secure.interpol.int/Public/FinancialCrime/MoneyLaundering/hawala/default.asp.
\(^6\) Pratish Narayanan, "India and China Skirt Iran Sanctions With 'Junk for Oil'" Bloomberg, March 30, 2012,
junk-for-oil-.html.
Major Indicators

On the following graphs, note that the IMF estimates figures where none are available and provides forecasts for several years beyond 2013.

As the data indicates, the rate of growth increased from a low of 3.67 percent a year to 8.16 percent a year following measures to liberalize regulation in the early 2000s. During the final renewal of the ISA sanctions in 2006, growth increased from 6.21 percent a year in 2006 to 6.37 percent a year in 2007 before the end of the bull market in 2007-2008. The data shows that the financial crisis negatively impacted growth in Iran. Growth declined from 6.37 percent in 2007 to 0.58 percent in 2008. Growth in Iran then continued to recover through 2010, again approaching 6 percent. However, after the passage of CISADA, growth started to decline and after increased scrutiny for the Iranian central bank to take action and the E.U. oil embargo turned negative as the economy contracted by 0.94 percent in 2012.

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As the data indicates, the unemployment rate declined sharply following measures to liberalize regulation in the early 2000s. The unemployment rate dropped from a peak of 16.6 percent in 2001 to a trough of 10.3 percent in 2004. During the final renewal of the ISA sanctions in 2006, unemployment actually began to decrease through the financial crisis to a trough of 10.4 percent in 2008, before increasing to 13.5 percent the year CISADA was enacted. The data shows that the unemployment rate in Iran then decreased to 12.3 percent in 2011 before steadily increasing through the scrutiny for the Iranian central bank to take action and the E.U. oil embargo. Long term estimates from the IMF expect an unemployment rate of roughly 18 percent by 2018.

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As the data indicates, growth in average consumer prices increased following measures to liberalize regulation in the early 2000s. Growth in average consumer prices remained relatively steady from 2002 to 2004, and then growth declined from 15.34 percent to 10.40 percent in 2005. Growth in average consumer prices increased sharply from the final renewal of ISA in 2006, from 11.87 percent to a peak of 25.4 percent in 2008. The data shows that growth in average consumer prices then decreased back to 10.8 percent in 2009. After the enactment of CISADA growth in consumer prices grew to 25.2 percent annually. Long term estimates from the IMF expect growth in annual consumer prices to decline moving towards 2017, however this seems unlikely due to the E.U. oil embargo and increasing pressure on the Iranian central bank.

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Conclusion

When raising the question of whether globalization is increasing the efficacy and precession of foreign policy tools, it is not surprising that the answer is mixed. If we think about economic globalization as the increasing economic interdependence of national economies across the world through rapid cross-border movement of goods, service, technology, and capital, then more interdependence results in several outcomes.

One, countries are more likely to have the ability to cooperate on an international economic stage. This can allow the largest economies, if there is the political will, to leverage their influence over target countries. This was seen in the case of U.S. sanctions and the E.U.’s oil embargo. However, a more complex system also allows for evasion, as discussed with the hawalas network and barter agreements between Iran, China, India, Russia, and Pakistan. Essentially, economic globalization increases the possibility of greater policy efficacy, but at the same time, produces a more nuanced system that can be exploited through nontraditional banking systems and other measures.

When thinking about precision, the outcomes are equally mixed. Through depreciation of the rial, the domestic population of Iran is negatively affected through an increase in the price level. This was shown quite explicitly through movements in annual average consumer prices after the passage of the ISA sanctions and the enactment of CISADA. Additionally, high unemployment rates generally disproportionately negatively affect unskilled workers, and in this case the domestic population of Iran, as seen through consistently higher unemployment rates. In this sense sanctions are still blunt tools. However, The Comprehensive Iran Sanctions, Accountability, and Divestment Act has proved successful in targeting Iran's energy sector by implementing an incentive structure for domestic and international firms: a task made easier
through the development of the modern international financial system. Through these policies, growth rates have slowed, oil sales have decreased, attempts to increase competitiveness have been curtailed, current account balances are in decline, and foreign exchange reserves are likely to be evermore scarce. Therefore, sanctions have been effective in precisely targeting the drivers of Iran’s continued nuclear ambition.
Works Cited


