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As Prepared for Delivery

It is an honor and privilege to be here at CSIS, one of our nation's preeminent foreign policy institutions. For almost half a century, CSIS and its scholars have provided valuable insights to our country's foreign policy discussions, bringing together government officials, academics, NGOs, business leaders and countless others to exchange ideas.

I want to offer special thanks to my good friend Juan Zarate for hosting today's event. As many of you know, when Juan served at the NSC, his innovative thinking and exceptional leadership were a driving force behind many of our government's critical national security strategies. But before that, he was the Treasury Department's first Assistant Secretary for Terrorist Financing and Financial Crimes and was my partner in creating a new organization in 2004, the Office of Terrorism and Financial Intelligence.

This audience is already well-versed in the history of U.S.-Iran relations and the challenges we continue to face as we try to prevent Iran from developing nuclear weapons and supporting terrorism. As we all know, Iran has failed to respond meaningfully to offers of engagement by the United States and others in the international community and has continued to defy multiple United Nations Security Council Resolutions (UNSCRs).

While the offer of engagement still stands, the United States and the international community have been forced to impose additional consequences on Iran. The objective of that pressure is to sharpen the choice for Iran's leaders between integration with the international community, predicated on fulfilling their international obligations, and the hardship of further isolation. The increased sanctions are also intended to make it harder for Iran to pursue international procurement for its nuclear and military programs.

When this Administration embarked on the policy of engagement, we recognized that Iran might well pursue the course that it has indeed chosen so far. As it became clear that Iran had chosen a path of defiance, we formulated our plan to pressure Iran. This involved developing a set of measures designed to create a dynamic that would isolate Iran – and especially its leadership and the institutions it controls – from the international financial and commercial systems.

As Secretary Clinton said earlier this month, "sanctions and pressure are not ends in themselves. They are the building blocks of leverage for a negotiated solution ..." By dramatically isolating Iran financially and commercially and by capitalizing on Iran's existing vulnerabilities, we can impact Iran's calculations. In this way, the strategy we have developed and are now implementing can and will create crucial leverage for our diplomacy.

There are three principal reasons why this is working. First, because the strategy we designed targets Iran's illicit conduct and the entities responsible for it, we have been able to attract the committed participation of the private sector around the world and build a broader coalition of governments than would otherwise have been possible. This conduct-based strategy also capitalizes on the deception and dishonesty Iran deploys to evade sanctions. This behavior increases the world's discomfort with Iran as a business partner, and thereby increases the pressure on Iran.

Second, this coalition now has the tools it needs to impose pressure on Iran – especially UNSCR 1929 and the new Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010 (CISADA). And the Administration worked diligently with our allies and partners during the negotiation of UNSCR 1929 to ensure that strong actions were taken to implement the Resolution.

Third, this all comes at a time when Iran is especially vulnerable because of its government's economic mismanagement and narrowed political flexibility.

It is not just my prediction that this strategy can have significant impact; it has already begun to do so. The financial measures the U.S. and others are implementing are imposing serious costs and constraints on Iran. We believe Iran's leadership was caught off guard by the speed, intensity, and scope of the new measures, misjudging the strength of the international community's will. The contrast between Iran's situation in 2005 and today is stark. Prior to Treasury's first action against an Iranian state-owned bank in 2006, Iran had access to financial services from the world's largest and most prestigious financial institutions, allowing it to conduct business in all corners of the globe. Today, Iran is effectively unable to access financial services from reputable banks and is increasingly unable to conduct major transactions in dollars or Euros.

This trend is no longer limited to the financial sector. Almost daily we receive reports of major firms around the world deciding to pull out of business dealings with Iran. Over the last several months alone, dozens of companies have announced publicly that they have curtailed or eliminated their business ties to Iran, including companies such as Toyota, Kia, Lukoil, Allianz, Lloyds, Royal Dutch Shell and many others. Iran is increasingly unable to secure needed foreign investment, financing and technology to modernize its aging energy infrastructure, threatening its oil and gas production and export capacity. Because of new sanctions legislation from Congress, Iran is having great difficulty importing refined petroleum. And Iran's shipping industry, a major conduit for its international trade, has found that international insurance companies are refusing to cover its ships and shipments.

Iran is now struggling to mitigate the effects of sanctions. Iran's leaders are turning increasingly to the Islamic Revolutionary Guard Corps (IRGC) – Iran's military vanguard that has long been involved in Iran's terrorism and missile programs– to prop up the economy. This is likely to exacerbate Iran's isolation, as companies around the world have begun to shun all business with the IRGC.

Perhaps most important of all, we are already receiving reports that the regime is quite worried about the impact of these measures, especially on their banking system and on the prospects for economic growth. And, as pressure increases, so has internal criticism of Ahmedinejad and others for failing to prepare adequately for international sanctions and for underestimating their effect.

Even at this early stage, as pressure is mounting, the strategy is beginning to give us the leverage we seek. It is already working.

U.S. STRATEGY

Conduct-Based Targets and the Public-Private Partnership

As we planned our strategy to pressure Iran, we decided to use conduct-based financial measures that target illicit actors because this has proven to be a better way to build a broad government and private sector coalition than trade embargoes that target an entire country. When we target specific bad actors – those that support terrorism or facilitate weapons of mass destruction (WMD) proliferation, for example – other governments are more inclined to take complementary action. It is difficult for any government, whether a close ally or not, to oppose such actions, especially since the reputation of their financial sectors often depends on such cooperation against illicit activity.

Even more significant, the private sector has great incentive to participate. They often act beyond the strict legal requirements in order to avoid the target's illicit conduct. Even though designations by Treasury's Office of Foreign Assets Control legally apply only to assets and transactions under U.S. jurisdiction, we have found that many banks and businesses around the world often cut off dealings with designated targets, giving our "unilateral" action a "multilateral" effect. This effect is self-perpetuating. As more banks cut off risky individuals and entities, the reputational risk increases for those that have not. Many follow suit, creating a ripple effect that amplifies the effect of sanctions. Once the private sector cuts of these bad actors, other governments find it easier to take formal action against the same targets. The result is a mutually-reinforcing cycle of governmental and private sector action that isolates the bad actors from the legitimate financial system. This puts tremendous pressure on our targets and, at the same time, promotes the integrity of the international financial system.

The Key Role of Financial Institutions and the Global Financial System in the Strategy

Banks are at the heart of our sanctions strategy for two reasons. First, they are the lifeline of international commerce – without access to financial services it becomes difficult to conduct commercial transactions, especially on a scale that a country like Iran needs. Therefore, by getting banks to cut off an illicit actor, that individual's or entity's access to the rest of the commercial sector is also affected.

Second, financial institutions have regulatory obligations and a cultural commitment to maintaining the integrity of the international financial system, with established concepts such as due diligence, knowing their customers, and understanding the nature of their transactions. While not all banks have unblemished records in this regard, they all ascribe to that credo. And since Treasury has responsibility for overseeing the integrity of the financial system, we have been able to develop a dialogue with financial institutions all over the world about the particular threats they face. Banks are eager to receive the type of information about illicit conduct that Treasury is able to provide and to engage with us about mitigating that risk. We are therefore able to make the private sector portion of the strategy work.

Making Evasion Work to Our Advantage

Prior experience with Iran taught us to expect that Iran would engage in deception and dishonesty to get around whatever sanctions were imposed. We therefore sought to create a sanctions program that becomes more effective the more the target tries to evade it.

It has been a common practice, for example, for Iranian banks and companies to conceal their involvement in transactions by removing or stripping their names from transaction documents. Non-sanctioned Iranian banks have also stepped in to further disguise the role of sanctioned banks. This was the case with Post Bank, for instance. Post Bank conducted transactions for Bank Sepah, which previously had been designated by both the U.S. and the UN. Bank Sepah would set up transactions and Post Bank would substitute itself for Bank Sepah to carry them out so that banks would not know that Bank Sepah was actually behind the transactions. As a result, the United States designated Post Bank for helping Bank Sepah evade sanctions.

Iran's deception is not limited to its banks. In the shipping industry, for example, Iran's national maritime carrier, Islamic Republic of Iran Shipping Lines (IRISL), which we designated in 2008, has employed front companies, renamed and repainted ships, and changed the nominal ownership of vessels – all to hide their connection to IRISL. This catalogue of deception by IRISL has now been exposed. To date we have designated 28 IRISL front companies and affiliates and identified more than 100 ships as being the property of IRISL and its fronts.

The more we have exposed Iran's evasion and deceptive practices, and taken enforcement action against those that have cooperated with Iran in those practices (including several major European banks that cooperated in stripping transactions), the more the private sector has become wary of conducting business with any Iranian entity or those acting on Iran's behalf. Because many in the private sector are simply unable to distinguish between Iran's legitimate and illicit transactions, they have opted to cut off Iran entirely. In this way, Iran's own evasion and deceptive conduct is further increasing its isolation.

BROADER COALITION AND NEW TOOLS

A major factor working in our favor is that more countries around the world are willing to take strong actions, and there are now better tools for those countries to use. The most important development, of course, is UNSCR 1929, which was enacted in June, following intensive diplomacy by the United States and our P5+1 partners. This Resolution sent a symbolic and powerful message of global unity to Iran and helps us rally states to respond decisively to the Iranian nuclear threat.

Building on three previous sanctions resolutions, UNSCR 1929 contains a range of strong provisions, including: a ban on certain ballistic missile activity; a ban on Iran's investment in nuclear industries abroad; a ban on the export to Iran of certain heavy weapons; mechanisms for inspecting Iranian cargo and seizing contraband; and a requirement to exercise vigilance when conducting business with any Iranian entity including the IRGC and IRISL. The Resolution's financial provisions call upon member states to prevent *all* financial services (including banking, insurance and reinsurance) if there are reasonable grounds to believe that such services *could* contribute to Iran's nuclear or missile programs. Significantly, the language of these provisions provides a legal basis for member states to take strong steps. And given the strong public record regarding Iran's illicit and deceptive activities, the operating presumption should be that virtually all transactions or financial services involving Iran could contribute to its nuclear or missile programs. We pushed hard for these provisions because they feed directly into the broader strategy I described.

We also worked extensively with our allies before and after the negotiation of UNSCR 1929 to set up follow-on actions robustly implementing the Resolution. And what we have seen so far is exactly that. The sanctions imposed by the European Union (EU), for example, include considerable restrictions on Iran's energy, financial, insurance, trade, and transportation sectors.

The financial measures adopted by the EU are particularly forceful. Transactions of more than 40,000 Euros generally cannot occur without prior governmental authorization. The opening of new outlets of Iranian banks within the EU is prohibited. The EU even prohibited the establishment of any new correspondent accounts by Iranian banks. The EU has also banned the provision of insurance or re-insurance to the Government of Iran or any Iranian entity.

The EU also froze the assets of more than 100 entities and individuals including, most importantly, most major state-owned Iranian banks as well as the IRGC and IRISL. Australia, Canada, Norway, Japan, and South Korea have taken a similarly robust approach. The leadership of these countries is crucial, as others that now follow will look to the precedent they have established. And their actions have demonstrated a strong and growing international consensus to hold Iran accountable for its actions.

U.S. Actions to Sustain Momentum

The United States has taken several of our own actions this summer, adding substantially to an Iran sanctions program that was already the most rigorous in the world. Since the adoption of UNSCR 1929, we have targeted more than 50 additional entities, ships and individuals supporting Iran's proliferation and terrorism activities including Iranian state-owned banks, IRISL ships and companies, and IRGC officers. We have also formally identified dozens of banks, investment companies, and technology firms owned or controlled by the Government of Iran, including several with names that obscure that affiliation, thus aiding companies around the world seeking to avoid transactions with the Iranian government.

Congress took a key step to augment the force of existing measures by passing CISADA, which President Obama signed on July 1. CISADA forces a stark choice: if you conduct certain business with Iran, you can't do business with the United States. CISADA contains significant restrictions on government contracting and sanctions for companies that assist Iranian acquisition of refined petroleum products or that invest in Iran's energy sector.

CISADA also requires Treasury to prohibit or impose strict conditions on access to the U.S. financial system by any foreign financial institution that facilitates a significant transaction or provides significant financial services for: the IRGC or any of its affiliates; or any bank sanctioned by the U.S. because of its involvement in Iran's WMD proliferation activities or its support for international terrorism. As of this month, there are now 17 such banks as we recently designated for proliferation an Iranian-owned bank in Germany, Europäisch-Iranische Handelsbank, which was one of Iran's few remaining access points to the European financial system. This provision of CISADA is already proving to be very powerful. The possibility of being shut out of the U.S. financial system has compelled financial institutions that had not already cut off business with these 17 banks of their own accord to re-think their decisions.

Shortly after CISADA became law, I received an urgent message from a bank executive I had spoken with on several occasions about his bank's significant business dealings with Iran. He told me that he wanted to make sure I knew that the bank's board had just met and, in light of CISADA and other sanctions on Iran, had resolved to cease all further business with Iranian institutions immediately. His bank is not alone.

IRAN'S VULNERABILITIES

The new tools and the increased leverage made possible by our broad coalition come at a time when Iran is vulnerable to pressure.

In the economic sphere, Iran is having difficulty attracting the foreign investment – particularly Western investment – needed to develop the keystone of its economy: the oil and gas industry. Despite the fact that Iran sits atop one of the world's largest oil and gas reserves, its oil production has stagnated of late and, as the IMF has noted, Iran's medium-term production capacity depends on its ability to attract investment. Iran's oil minister stated publicly, in late 2009, that Iran was not attracting the investment it needed to prevent a decline in production. Even before the recent round of sanctions, Iran's investment environment was grim and now, because of the new measures, and the unwillingness of financial institutions, insurance companies and major energy companies to undertake projects in Iran, the investment landscape for Iran today is even more bleak.

As a result, Iran's energy sector is losing access to much-needed technology and will only face continued stagnation – which could have long-term political as well as economic consequences as Iran struggles to create jobs for its disproportionately young population. Unemployment is currently over 14 percent, even according to unreliable official estimates; Iran's parliament has claimed that it is as high as 22 percent. High unemployment poses a particular political challenge for Iran's leadership since people under age 30 account for three out of four unemployed Iranians.

The Iranian leadership's inability to develop its most important industry or create sufficient jobs is an example of the economic mismanagement that is undermining public confidence. As is well known, Iran also continues to suffer from high inflation. Reliable numbers are hard to come by, but we believe that the current rate is much higher than the official Iranian government claim of about 9 percent.

In addition, the Iranian banking system is unhealthy, even aside from the devastating effect of sanctions. Just a couple of years ago, the leadership forced Iranian banks to make loans at interest rates significantly lower than the inflation rate, prompting the resignation of two central bank governors. State-owned banks have also made excessive credit available to politically-connected elites who have often failed to repay such loans with impunity. As a result of such poor lending decisions, the Iranian banking sector has a very high rate of nonperforming loans– approximately 20 percent of the banking sector's total assets. In an apparent effort to address the problem, recent Iranian media reports suggest that Iranian banks are increasingly willing to lend only at high rates, making credit difficult to obtain for average business owners at a time when external credit is tight. In addition to undermining confidence in Iran's banks, such practices also feed into the perception that Iran's banking system is rife with official corruption and cronyism.

Because of the leadership's economic mismanagement, Iran is poorly positioned to respond to sanctions. And, as the leadership tries to formulate a response, it is faced with unappealing choices. For example, because it is encountering difficulties in acquiring gasoline because of sanctions, the government is seeking ways to reduce demand for gasoline. One obvious step would be to reduce the heavy subsidies on gasoline that now make the price at the pump about 42 cents per gallon. Iran recently announced that it would reduce subsidies on gasoline and other items by $20 billion. These subsidy cuts were delayed last week once again, most likely because of concern about popular backlash. Iran's main audit body warned that such subsidy cuts might result in severe political disputes. When Iran raised gasoline prices and instituted monthly gasoline rations in 2007, riots broke out across the country. Thus, because of concern about angering the populace, Iran's leadership is unable to take steps to mitigate the effects of sanctions, making our measures even more effective.

IRGC

Because of all of the pressures it faces, the Iranian government is increasingly turning to the IRGC to maintain its hold on political power and for key economic projects. This trend meshes perfectly with our conduct-based strategy, since it is hard to imagine a better sanctions target than the IRGC. We have sanctioned the IRGC since 2007 because it actively supports terrorism and has long been involved in Iran's proliferation activities. Of course, it also led the crackdown on legitimate protesters after the June 2009 elections.

Unable to attract foreign sources of investment, Iran has turned over to the IRGC major projects, often through sole-source contracts. These include major metro contracts, international airports, and other infrastructure projects. Indeed, the IRGC has extended its reach deep into Iran's economic life, taking increasing control over significant portions of the Iranian economy. Iran has even turned to the IRGC to develop oil and gas fields. For example, because Iran could not attract a suitable foreign energy firm to develop phases of the South Pars gas field, Iran gave the opportunity to Khatam al-Anbiya, an IRGC-affiliate. Khatam al-Anbiya lacked the capability to develop the project itself and thus sought suitable foreign partners. However, after it was designated by the U.S., then the EU, and finally by the UN, Khatam al-Anbiya was forced to withdraw from the project.

Using the IRGC to fill the investment gap, thus, will only make matters worse for Iran. As we have seen time and again – including in the Khatam al-Anbiya example – responsible international businesses are unwilling to deal with any entity affiliated with the IRGC. The UN

Security Council has now designated most of the major companies controlled by the IRGC and many of its senior officers for proliferation. The EU, and of course the United States, have also designated the IRGC in its entirety. In addition, the IRGC's growing control over large segments of the Iranian economy deprives Iranian businesses not connected to the regime of economic opportunities. Iran's reliance on the IRGC will thus accentuate the impact of sanctions and exacerbate the already-existing tensions between the government and the people of Iran.

CONCLUSION

For all of those reasons: because of the way we designed our strategy, because we have a broad coalition with powerful tools to use, and because Iran is vulnerable, the strategy we have in place today is working to create the leverage we need to enhance our diplomatic options. But, in the end, you don't have to take my word for it. Last week, former Iranian President Rafsanjani publicly warned leaders in Iran "to take the sanctions seriously and not as a joke." He said that, "we have never had such intensified sanctions and they are getting more intensified every day. Whenever we find a loophole, they [the Western powers] block it." The goal of sanctions is not to harm the people of Iran. It is to influence the calculations of Iran's leaders. And until Iran agrees to abide by its international obligations, what Rafsanjani is observing will only continue and the pressure on Iran will increase.

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