

Back to the Future

Europe, the United States, and Iran Sanctions after the Nuclear Deal

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Transatlantic unity on sanctions played a key role in achieving the Joint Comprehensive Plan of Action (JCPOA) with Iran over its nuclear program. As well as the sanctions relief it entails, the deal will progressively bring both sides of the Atlantic back to a status quo ante—a misalignment of the United States and Europe's respective legal constraints with regard to their relations with Iran. This situation is creating concerns on both sides of the Atlantic, particularly Europe's negative view of both the overreach and extraterritoriality of U.S. sanctions and the United States' concern that Europe is uninterested in enforcing the deal because of revitalized economic interests in Iran.

Maintaining transatlantic unity will be critical both to enforce and to deliver the obligations as prescribed by the agreement in the future. Even more importantly, it will be necessary to respond swiftly and strongly to Iran's potential violations of the agreement or perhaps even renew sanctions on Iran after the deal ends if Iran's nuclear ambitions continue to be problematic. Beyond Iran, making sure that the United States and Europe continue to see eye-to-eye on sanctions policy writ large will also be required to preserve the efficiency and sustainability of an increasingly important tool of statecraft to alter behavior that violates international legal norms, short of the use of military force.

The United States and Europe therefore need to craft a coordinated approach toward Iran sanctions to ensure smooth navigation through upcoming legal dissimilarities and to avoid returning completely to unilateral strategies.

U.S.-EU Alignment on Iran Sanctions, an Exception Rather Than a Norm since 1979

The closer EU-U.S. legal and political alignment on Iran sanctions since the late 2000s has been an exception rather than the norm during the past three decades. This exception was only made possible in the past decade by the common perception that Iran's nuclear ambitions represented a threat to international security and stability in the Middle East and to forestall potential U.S. or Israeli military action. Many forget that the European Union did not place economic sanctions against Iran until 2006. At the time, the European Union was Iran's largest trading partner, with

EU-Iran two-way trade reaching up to \$30 billion annually in the late 1990s and through the 2000s. In contrast, the United States had put in place several layers of bilateral sanctions against Iran beginning in 1979 and significantly enhanced during the Clinton administration's first term through the 1996 Iran Sanctions Act. Clearly, Europe and the United States were very much misaligned in their economic relations with Iran.

From a transatlantic standpoint, Iran sanctions proved more controversial than consensual until the first UN Security Council (UNSC) sanctions against Iran's nuclear ambitions were passed in 2006. Europeans challenged early U.S. sanctions attempts in 1996, through the bipartisan Iran Sanctions "D'Amato-Kennedy" Act, to expand the scope of their own sanctions by imposing secondary—or extraterritorial—sanctions on European companies investing in Iran's oil and gas production infrastructure. Europeans strenuously opposed Washington's restrictions on their companies. And while recognizing increasing Iranian support for international terrorism, which was Washington's justification for those sanctions, European leaders did not believe economic sanctions were the best way to address the challenge. As a result of Europe's vocal negative reaction, the U.S. government decided to use its waiver authority and did not impose any sanctions against European companies.

Closer EU and U.S. political and legal alignment on sanctions only began to emerge following the disclosure in 2002 of Iran's clandestine nuclear activities and accelerated with Iran's continued refusal to negotiate limits to its nuclear ambitions. The Iranian nuclear threat played a critical role in convincing Europeans, and the EU-3 (France, the United Kingdom, and Germany) of the need to sanction Iran, as did the fear that, in the absence of some European action, the United States and/or Israel might be more likely to conduct military strikes against Iran's nuclear facilities. Europeans saw sanctions against Iran as a way to prevent another military conflict in the Middle East after the transatlantic divide over the 2003 U.S.-led invasion of Iraq, rather than punishing Iran for its behavior.

As a result, and beyond the imposition of early European sanctions following the first UNSC resolution in 2006, European governments also became more tolerant of U.S. efforts to exercise due diligence related directly to European banks that conducted financial transactions with the Iranian regime utilizing the U.S. financial systems, even when those entities were in compliance with EU sanctions. The recent \$258 million fines imposed on Deutsche Bank, and other penalties against European banks in past few years, for evading U.S. sanctions in Iran, Syria, Myanmar, and elsewhere, demonstrate that the U.S. financial system is indeed a powerful tool to achieve U.S. sanction compliance.

To European leaders, EU sanctions were solely linked to Iran's ambitions to acquire a nuclear military capability. The European Union did adopt limited human rights-related sanctions after the 2009 so-called Green Revolution (interestingly, the United States did not), but those sanctions mostly targeted individual Iranians and never constrained economic relations between Europe and Iran. These individual sanctions remain in force under the JCPOA. Likewise, sanctioning the Iranian Revolutionary Guard Corps (IRGC), the al-Qods Force, and several of their related

subsidiaries, was justified in European minds by the obvious role played by these institutions in Iran's nuclear program.

However, these sanctions did not respond to Iran's increasing support of European and American declared foreign terrorist organizations in the Middle East, such as the military branch of Hezbollah in Lebanon or Hamas in the Palestinian territories or Iran's growing power projection capabilities in the region. These larger regional considerations were largely absent from subsequent UNSC resolutions imposing international sanctions against Iran. These structural European assumptions about Iran sanctions have not changed much since then, even though the European Union took additional steps such as adding, in 2013, the military branch of Hezbollah to its list of foreign entities excluded from European financial markets.

Potential U.S.-EU Friction after the Nuclear Deal

Since reaching the comprehensive agreement on July 14, both the United States and the European Union have started to take steps to prepare for its implementation. Washington and Brussels both published draft U.S. waivers and EU decisions on October 18, the so-called Adoption Day on which the agreement entered into force. The actual suspension of sanctions however is not precisely scheduled. This will not occur until the International Atomic Energy Agency (IAEA) confirms that Iran has implemented all the nuclear steps it has committed to take. Considering all that still needs to be done, "Implementation Day" should not take place before the first half of 2016, despite optimistic Iranian statements that it could happen before the end of 2015. It is worth noting that while the United States appointed an envoy for implementation of the agreement, the European Union has not yet done so. Officials from the European External Action Service (EEAS), who participated in the negotiation of the deal with the P5+1, are likely to bear this responsibility for the European side, along with French, British, and German officials.

Different transatlantic interpretations of the implementation of the agreement and particularly the suspension and reimposition of sanctions could increase transatlantic frictions.

U.S. Concerns

Is the snapback credible in Europe?

On one hand, high-level visits by European governments and business delegations to Iran since the conclusion of the deal are fueling concerns in the United States that European governments are in a hurry to return to economic business as usual and will not be willing to punish Iranian violations of the deal by reinstating suspended sanctions. EU companies' investments in Iran's markets are expected to grow in the years ahead and may deter European governments from suspending or reimposing economic sanctions against Iran in times of crisis. In particular, it is feared that Europeans may be reluctant to raise cases of Iranian noncompliance with the agreement that could result in the snapback of all sanctions. According to that argument, a more cautious and prudent EU approach to increasing economic relations with Iran would ensure some leverage over Tehran should there be noncompliance with the agreement, while also

maintaining European focus on the agreement's implementation vice the prioritization of economic relations over the agreement.

U.S. concerns here are understandable, but only up to a point. The United States will not develop economic relations with Iran after the deal because of the continuation (if not accentuation) of its unilateral embargo. Washington has very few economic interests at stake and remains focused on security consideration, which makes policymakers at times indifferent to Europeans economic sacrifices in opposing Iran's nuclear ambitions. This indifference is fueled by the perception that European banks and firms in the past have actively worked to circumvent sanctions policy. Despite this returning misalignment on Iranian economic relations, it is not inconceivable that the current U.S. administration (and possibly future ones) also wishes to avoid the collapse of an agreement considered to be one of its most important foreign policy legacy issues and would also not be keen to publicly declare that Iran has violated the agreement (should it become publicly known).

Are Europeans going to make the IRGC richer?

On the other hand, critics of the deal fear that Europe's business with Iran, notably with Iran's public institutions, could provide additional financial resources to the Islamic Republic, which will only increase its ability to project destabilizing influence and power in the Middle East, to support international terrorism, or to violate human rights domestically. In particular, concerns focus on European business that may be conducted with the IRGC, or with the "galaxy" of affiliated subsidiaries controlled by it, bringing additional resources to the IRGC's malignant activities in Iran's neighborhood. One solution to this problem could be, as the idea is already being actively discussed in Congress, to formally designate the IRGC as a foreign terrorist organization (FTO) under U.S. law. The move could have significant legal implications for European companies. At a minimum, it would introduce ambiguities about the applicability of U.S. primary sanctions to a large number of EU-Iran transactions. This initiative would therefore likely have an impact on European companies, further deterring them—especially European banks—from doing business in Iran.

There are legitimate concerns that the JCPOA will lead to increased availability of financial resources for proxy organizations throughout the Middle East. However, it would be problematic for the European Union to designate the IRGC as a foreign terrorist organization. The European Union will point to the fact that it will keep most of its nuclear nonproliferation sanctions in place for the next eight years, which include a freeze on all economic relations with the IRGC, the al-Qods Force, the construction consortium Khatam-al-Ambia (associated with the IRGC), and dozens of other entities and individuals associated with Iran's nuclear and ballistic programs. Moreover, no financial or physical transactions under EU jurisdiction can be possible with these entities until 2024. European governments will be capable of prosecuting—and they should do so—any entities or individuals under their jurisdiction that engage in such transactions. A problem may materialize in 2024 when the European Union lifts restrictions imposed on the IRGC, but this does not pose an immediate issue to resolve.

EU Concerns

Nonnuclear U.S. sanctions would threaten the JCPOA

Europeans are growing increasingly uncomfortable with ongoing U.S. debates about the post-deal use of sanctions to address nonnuclear concerns created by Iran's domestic and regional behavior. Leaders fear that new sanctions, especially additional trade and financial restrictions that were used on the nuclear program, would deny Iran the economic benefits it is supposed to receive from the JCPOA implementation. Such new sanctions would offer Tehran an easy excuse to reject the restrictions it reluctantly agreed to in Vienna, and it could blame Washington and the P5+1 for violating the agreement. European recriminations against Washington would follow, challenging any effort to snap back old sanctions, respond to Iran's refusal to implement the restrictions agreed in Vienna, or go beyond them if Iran advances its program further.

As Europeans would likely refuse to align EU sanctions with new, U.S. sanctions targeting nonnuclear Iranian behavior, the transatlantic misalignment could grow even larger and put European companies under legal threat even while their activities would be in full compliance with the JCPOA. From a European standpoint, all governments included in P5+1 talks since 2003 were absolutely clear that the conclusion of a comprehensive agreement with Iran over its nuclear program was always going to bring a large amount of additional financial resources to Iran's government. None of the governments involved, even previous U.S. administrations, attempted to broaden the issue set beyond the nuclear issues (to which the ballistic missile question was only one dimension). The merits of a narrowly defined agreement related only to Iran's nuclear activities can be debated. But even a perfect deal covering all Iranian enrichment activities and nuclear weapons, as well as deliverable ballistic capabilities, was going to bring substantial economic relief to the Iranian regime without addressing Iran's regional ambitions or human rights violations at home.

Is the United States willing to be more transparent related to sanctions in order to make the JCPOA work?

The JCPOA will hardly work, from an Iranian standpoint, if companies and banks refuse to take advantage of the legal lifting of sanctions or if new U.S. sanctions are put in place in response to Iran's alarming regional behavior. There are concerns in Europe regarding the way the United States will implement its own obligations to suspend U.S. nuclear-related sanctions, in particular the extent to which the U.S. Treasury and its Office of Foreign Assets Control (OFAC) will provide sufficient guidance and transparency to international banks and trading companies seeking to renew business ties with Iran. The efficiency and efficacy of U.S. sanctions have relied on Washington's ability to create an environment of ambiguity and risk for any business undertaken with Iran, beyond what legal restrictions explicitly prohibit, whether in the United States or in Europe.

The strong deterrent effect of U.S. sanctions has been reinforced over the years by a series of financial penalties imposed on major European banks for violations of U.S. primary sanctions. In

most cases, European banks, purposefully or not, misinterpreted the scope of their legal obligations and the extent to which their activities involving the U.S. financial system came under the jurisdiction of those sanctions. Those penalties had a strong effect—likely intended—on the European banking sector: they convinced many banks to decline all incoming transactions with Iran, even when some of them might have been legal from both a U.S. and EU legal standpoint. Separating legal transactions from illegal ones became more costly than stopping all transactions altogether.

Clarifying this sanctions ambiguity will be key for banks to finance legal trade with Iran, in Europe but also in Japan. The inability, or unwillingness, of U.S. authorities to provide more clarity and transparency—if not formal assurances (which may be a stretch too far) to foreign financial institutions—could create tensions with Europe if these positions were to endanger the JCPOA. Again, it would provide Iran with easy arguments to blame the West. Many foreign firms are already wary of engaging in significant investments in Iran before the next U.S. presidential election in November 2016, lest there be a change in U.S. policy. This particularly impacts long-term investment in the Iranian energy sector.

Most Republican presidential candidates have committed themselves to “renegotiating” the JCPOA, which reflects public opinion in that a majority of Americans (56 percent) supported a rejection of the deal in an August CNN poll. Whether this objective is realistic or not, Europeans will strongly resist abandoning the current deal if a better alternative isn’t realistically negotiable. At the end of the day, there is little the Obama administration can do to address this political uncertainty, even if it is detrimental to the deal’s early stages of implementation. But there is much it can do to address the legal uncertainty in the first place.

Why and How to Preserve Transatlantic Unity over Iran Sanctions

Why?

On one hand, avoiding tensions will put Europeans and the United States in a better position to address potential Iranian violations of the deal, whether minimal, significant, or deal breaking. European governments will be more inclined and may have more political flexibility to put nuclear nonproliferation over their trade interests once again when necessary if European companies have been treated fairly in the course of the deal’s implementation, were Iran to violate the conditions of the agreement.

On the other hand, transatlantic tensions would reduce the West’s ability to ensure that Iran’s nuclear program will remain exclusively peaceful over the long term, especially when the restrictions the JCPOA imposes on Iran’s fuel cycle activities lapse in the next 10 to 15 years. Even if the deal puts Iran a year away from a nuclear breakout capability during that time, it does not reduce Iran’s technical ability to break out of its obligations or to manufacture a nuclear weapon at a later stage. Renewed sanctions could still play a role in addressing an Iranian breakout at that time.

Finally, preserving consensus on Iran sanctions will matter to ensure the sustainability of economic sanctions themselves. Sanctions have become a very valuable nonmilitary coercive tool for international security. This success in the past decade has mostly relied on a unified transatlantic approach made possible by Europe's positive mindset toward sanctions beginning in 2006, even as these sanctions threatened its economic interests at a precarious economic moment for Europe. European collaboration on sanctions is important for the effectiveness of the sanctions themselves, as well as for the United States' interests and national security. Hence, the European frustration with Washington's extensive reach via the U.S. financial system should not be underestimated and could weaken support for future sanctions in Europe.

Europeans need to have greater awareness and understanding of U.S. concerns vis-à-vis Iran, and Americans must also do their part in showing more understanding and solidarity for the economic pain that has been principally absorbed by their European partners. It is in both Europe's and the United States' utmost interest to retain the ability to use economic sanctions in future crises.

How?

What can be done to avoid tensions? Likely a little bit of give and take on both sides of the Atlantic.

First, the European Union will need to demonstrate its determination to enforce the sanctions that will remain in force.

Europeans should not buy in to Tehran's argument that sanctioning illegal behavior is tantamount to a provocation. It may be presented as such in Tehran, but Western governments should care less about that and more about continued compliance with international legal norms through existing sanctions. European governments, as well as European institutions themselves, need to reach out to the private sector, both the banking industry and trade industries, and make it clear that there will be consequences to sanctions violations, in the form of freezing assets in Europe for instance, even if larger economic sectoral sanctions are suspended. The more Europe appears committed and serious in its implementation of remaining EU sanctions, in particular those related to the IRGC and its subsidiaries, the more the United States may find the flexibility required to show more transparency on the implementation of its own sanctions.

Second, the United States, for its part, will need to show increased transparency on U.S. sanctions implementation.

The United States should be willing to publish detailed and extensive guidance on: (a) what the U.S. Treasury will consider legal transactions with Iran; (b) what exact criteria it will take into account to determine whether a transaction made outside of the United States falls under U.S. primary and/or secondary sanctions (a key point to assess the potential legal consequences for violations of U.S. sanctions committed by non-U.S. companies); and (c) what steps or assurances it may be ready to take in order to reassure international financial institutions to finance legal

trade with Iran. There will surely be skepticism in Washington about, and likely political pressure against, more transparency. No one should expect U.S. authorities to suddenly turn into strong supporters of increased trade with Iran. And European governments themselves should be careful about their messaging to business in the early stages of the JCPOA. But it will be in the Obama administration's interests, and hopefully those of its successor, to make the JCPOA successful. At the very least, its potential failure should not be attributed to the P5+1 not fulfilling their sanctions relief commitments.

Third, the United States and European powers need to do more thinking about what future role sanctions could play in ensuring that Iran is deterred from violating the JCPOA.

For now, this role is limited to the scenario of a full snapback of UN Security Council sanctions in response to a case of "significant noncompliance." The October 18 EU decision preparing for the suspension of sanctions accordingly states that EU sanctions would be reintroduced in case of "significant nonperformance by Iran of its commitments under the JCPOA." Europeans and Americans have made it clear this threat is credible. Whether they share a game plan to address Iranian actions that fall below the threshold of snapback "nonperformance" is another thing.

To start with, it should not be in our interests to define precisely what we do or don't consider as a significant case of nonperformance. All cases of nonperformance should bear consequences for Iran. Ambiguity can be useful if Iran is unsure about what exact consequences a specific noncompliance action could bear, especially if a full snapback—which would in essence end the deal—is a realistic scenario. Ambiguity is the best way to ensure that Iran does not miscalculate its real margin of "nonperformance." But Iran will surely want to test that margin at some point, and it may well be that the EU-3 concludes that such a test—be it granting IAEA access to a site with some delay, for instance—falls under the threshold of "significant nonperformance."

It is for this reason that limited sanctions could perhaps play a role, for instance through the use of a targeted freeze of financial assets or retaining Iranian oil-related resources under escrow. Sanctions-related answers could also include creating new restrictive measures, not necessarily reintroducing sanctions now suspended. What Americans and Europeans could signal to Iran is that violations falling under the threshold of full snapback may receive nonsanctions-related answers that would still create costs. Sanctions were never the only tool used by the West to deal with Iran's nuclear ambitions, so there's no reason why we should now limit ourselves only to the use of sanctions to ensure Iran complies with the deal. Initial talks should be launched about these options, even if it necessary for the United States and Europe to avoid declaratory public statements at this stage. The extent to which such discussions have already taken place is unclear, but they would likely strengthen the deal.

Finally, the United States and the European Union should engage in a dialogue about the potential added value of sanctions in addressing Iran's problematic nonnuclear behavior in the region.

Even if Europeans are unlikely to favor such action, they might consider limited sanctions, such as individual designations or restrictive measures addressing Iran's exports of lethal weaponry in its neighborhood. If these types of measures are actively considered, the Obama administration could begin to frame the possibility of more ambitious sanctions that Europe could potentially support should they be needed in the future. This clearly would not be an easy discussion for Europeans, but the discussion on U.S. transparency won't be an easy one for the Americans either.

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