



THE ATLANTIC COUNCIL
OF THE UNITED STATES

**Thinking Beyond the Stalemate
in U.S.-Iranian Relations**
Volume II – Issues and Analysis

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Occasional Paper

July 2001



THE ATLANTIC COUNCIL

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The Atlantic Council is a nonpartisan network of leaders who are convinced of the critical importance of effective U.S. foreign policy and the cohesion of U.S. international relationships. The Council promotes constructive U.S. leadership and engagement in international affairs based on the central role of the Atlantic community in the contemporary world situation. To this end, the Council:

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Foreword

The Middle East presents more difficult choices for policy makers than any other region of the world. Different U.S. interests pull in different directions, misperceptions abound, and expectations are often unrealistic. In this environment, orchestrating policies to advance and protect U.S. interests is extraordinarily difficult. U.S. policy toward Iran exemplifies this situation well.

After more than twenty years of adversarial relations, the United States and Iran have both begun to demonstrate an interest in breaking out of this long stalemate. Broadly conceived, the benefits for both countries of an improved relationship would be significant. Time has soothed some past wounds and the rhetoric of hatred has subsided to a degree. However, serious differences remain.

Both countries believe that they have made clear the conditions that would have to be met before a policy change could even be considered. But attainment of these thresholds is unlikely in the near term. This report suggests a new approach for U.S. policy which would enable the United States to pursue more effectively its many interests vis-à-vis Iran, including its longstanding concerns about Iran's opposition to the Middle East peace process and its attempts to obtain weapons of mass destruction. The main aim of the report is to provide a reference guide for navigating successfully the obstacle-laden landscape of U.S.-Iranian relations when the time is ripe to embark on the journey.

This report represents three years of study and deliberation by a large and distinguished working group convened by the Atlantic Council. Acting as scouts, not advocates, the working group attempted to fit together the many complex issues in the U.S.-Iran relationship into a comprehensive approach. The report is published in two volumes. Volume I presents the conclusions and recommendations of the working group and summarizes the rationale for these judgments. Volume II is a comprehensive analysis of the current stalemate that provides the analytical basis on which the working group drew in reaching the conclusions in Volume I. While Volume II has been presented to the working group and has benefited from the inputs of its members, it does not represent a consensus report of the group.

This project is part of the Atlantic Council's multi-year program on reversing relations with former adversaries. The program began with a book of case studies and included an in-depth study of future U.S. relations with Cuba. In 1999 the Council published an analytic compendium of the policies, laws and regulations that govern U.S. relations with Iran.

The preparation of this report involved more than 100 persons. We are deeply indebted to the co-chairs who guided this effort: Lee Hamilton, James Schlesinger and Brent Scowcroft, all of whom gave generously of their time and wisdom in steering the project and its intellectual development. Cyrus Vance also served as a co-chair during the early stages of the study. I would especially like to acknowledge the major contributions of Roscoe Suddarth, the principal policy advisor; Elaine Morton, the rapporteur and author of this volume; Dick Nelson, the tireless and always creative project director; and David Saltiel, the assistant project director. This volume represents the views of the author and not necessarily those of all the members of the working group or the Atlantic Council.

Although they bear no responsibility for the content, this work would not have been possible without the generous support of the W. Alton Jones Foundation Fund of the Rockefeller Family Fund.

Christopher J. Makins
President, Atlantic Council of the United States

Thinking Beyond the Stalemate in U.S.-Iranian Relations

I. The Current Stalemate

Relations between the United States and Iran are currently frozen. In 1998, the Clinton administration invited Iran to engage in an official government-to-government dialogue in which issues of concern to both parties would be open to discussion. The goal was to develop a road map to normal relations. At the same time, the United States said that it would maintain its principal sanctions against Iran until Tehran changes its policies on issues of significant concern to the United States:

- support for terrorist groups such as HAMAS, the Palestinian Islamic Jihad (PIJ), and the Popular Front for the Liberation of Palestine-General Command (PFLP-GC) that have carried out violent acts against civilians in Israel. Also included among such groups are the Lebanese Hizbollah which used violence against Israel and allied forces during the eighteen year Israeli occupation of southern Lebanon, and is now cooperating with some Palestinian rejectionist groups in violence against Israeli forces in Palestine.
- opposition to the Middle East peace process in its refusal to recognize the legitimacy of Israel as a sovereign state having control over territory that was held by Palestinians before the state of Israel was created. Iran is also faulted for opposing the modalities of the peace agreements the United States is attempting to broker between Israel and the Palestinians and between Israel and Syria.
- efforts to acquire the technology, materials, and assistance necessary to develop nuclear weapons, chemical and biological weapons, and the missile capabilities to deliver them.

In contrast, Iranian officials have said that they will not engage in a government-to-government dialogue with the United States as long as sanctions remain in place; they consider the sanctions

a hostile act inconsistent with improving relations. The Iranians have stated that before a dialogue can take place, there must be parity and mutual respect between the parties. They argue that these conditions will not be met so long as Iran is subject to pressure in the form of the following actions by the United States:

- continuation of economic sanctions against trade and investment in Iran;
- sanctioning of foreign companies that invest in the development of Iran's petroleum resources;
- delay in returning frozen Iranian assets and properties;¹
- exertion of influence in international financial, monetary, and trade organizations to limit Iranian access to economic resources;
- impeding the transfer to Iran of advanced technology for peaceful nuclear energy purposes;
- efforts to exclude Iran from oil and gas projects in Caspian Sea states, prevent construction of pipelines through Iran to transport Caspian oil to international markets, and block market-based swaps of crude oil from the Caspian Sea countries for Iranian oil that could exit the Persian Gulf for shipment to global markets.

U.S. Approaches

A public U.S. attempt to initiate a dialogue with Iran was made on June 17, 1998 in a speech that Secretary of State Madeleine Albright gave before the Asia Society in New York. The speech was delivered slightly more than a year after Mohammad Khatami's surprise landslide victory as a reform candidate in the Iranian presidential elections of May 1997, and was, in effect, a response to a January 1998 CNN interview, in which Khatami praised the United States, indicated his opposition to terrorist attacks against civilians, regretted the 1979 hostage-taking incident, denied that Iran was seeking nuclear weapons, and called for a "dialogue between civilizations."

A second attempt to improve U.S.-Iranian relations was made by Albright on March 17, 2000 in a speech that deliberately coincided with the Iranian New Year and presented a positive U.S. response to the impressive victory of reform candidates in the Iranian parliamentary elections one month earlier, on February 18, 2000. The speech was noteworthy for acknowledging Iranian grievances by listing several U.S. policies that had contributed to problems in the U.S.-Iranian relationship:

- involvement in the 1953 overthrow of the popularly elected government of Prime Minister Mohammad Mossadegh;
- backing the Shah when his government was brutally repressing political dissent;
- support of Iraq during its 1980-88 war with Iran.

¹ These are Iranian properties and assets that the United States blocked from being returned to Iran when it established a series of U.S. sanctions in response to the 1979 hostage-taking incident. The assets and properties have been under international arbitration by the Iran-United States Claims Tribunal that was established at The Hague as a result of the Algiers Accords that ended the hostage crisis. The Hague tribunal has the power to return these assets to Iran but the United States does not.

Albright's speech was also noteworthy in its announcing that U.S. economic sanctions would be lifted on the import of Iranian carpets and certain foodstuffs, notably pistachio nuts and caviar. At the same time, Albright made it clear that the principal U.S. economic sanctions would remain in place because the United States had not seen significant change in Iranian policy with respect to proliferation or in its support of terrorist groups, including those violently opposed to the Middle East peace process. Instead of attributing these activities to the government of Iran, however, Albright cited specific entities: the Iranian military and the Islamic Revolutionary Guard Corps (IRGC) for proliferation and the Ministry of Intelligence and Security (MOIS) for support of terrorist groups. Each of these institutions is under the control of Supreme Leader Ali Khamenei, not the control of President Khatami.

Albright concluded by calling for an official dialogue with Iran so that issues of common concern could be addressed through diplomacy including regional tensions in the Persian Gulf, instability and illegal narcotics trade in Afghanistan, relations between Armenia and Azerbaijan, regional economic development, and protection of the environment. In a press conference following the speech, Albright added that the kinds of things that the United States would talk about in a dialogue with Iran also included proliferation, terrorism, and the lack of Iranian support for the peace process.

The Iranian Response

Although the Iranian ambassador to the UN followed Albright's speech with remarks to the same audience that described Iran as "prepared to adopt proportionate and positive measures in return," any such measures have not been discernible. The Iranians continue to respond to this U.S. overture as they responded two years ago: they say they want to see "deeds as well as words" from the United States. For example, when President Khatami commented on U.S.-Iranian relations during a state visit to Germany on July 11, 2000, he praised the United States for taking a "new turn" in its relations with Iran, but he also said that the United States had not yet taken sufficient *concrete steps* to bring about improved relations. He went on to urge the United States to be more ambitious in its approach.

Another constant in the Iranian position was articulated in President Khatami's CNN interview of January 8, 1998 and reiterated on June 26, 2000 during a state visit to China.

[An] example of the sort of problem that exists between us and the United States is [that] they first level unfair and unsubstantiated accusations against you. And when they propose to hold talks they say that they want to have a dialogue with you about these very unfounded accusations.

Although large numbers of people in Iran recognized the positive intent of Albright's acknowledgment of U.S. policies that had harmed Iran, the initial official reaction was presented by Foreign Minister Kamal Kharrazi on April 5, 2000, when he referred to Albright's "confessions" and said that Washington must pay reparations for its past errors. He also noted that the United States was sending contradictory signals of friendship and hostility.

Perhaps the most discouraging Iranian reaction came on July 27, 2000 in a statement by Supreme Leader Khamenei when he said that any talk of rapprochement or negotiations with the United

States at this stage would be “an insult and treason to the Iranian people.” Khamenei argued that it would first be necessary for Iran to solidify its economic, cultural, scientific and military strengths. Otherwise Iran would be at a disadvantage in negotiations, and the United States would be able to dictate concessions.

Nevertheless, some analysts interpreted this statement as indicating a softening of Khamenei’s position. Instead of dismissing out of hand the possibility of a rapprochement, he seemed to be implying that relations could improve once Iran had placed itself in a stronger position.

The Broader Context

It is important to note that the context for evaluating the possibility of a U.S.-Iranian rapprochement is now one in which Iran has made steady progress in effecting rapprochement with other countries. During the Khatami presidency, Iran has taken significant steps to break out of its isolation.

- Iran has improved its relationship with its Arab neighbors in the Persian Gulf, most notably with Saudi Arabia, but also with other Gulf Cooperation Council (GCC) members, with the exception of the United Arab Emirates, with whom it has an unresolved territorial dispute.
- Iran has also improved relations with key European countries, as witnessed by high-profile visits Khatami made to Italy, France, and Germany, and the reestablishment of full diplomatic relations with the United Kingdom.
- Iran is engaged in significant military cooperation with Russia, so much so that some observers have begun to speak of a “strategic relationship” between the two countries.

These relationships – along with Khatami’s visits to China and Japan – give substance to Iran’s stated preference for an international balance of power that is multipolar in nature and challenges the “hegemonic” aspirations of the United States.

By reestablishing diplomatic relations with many countries, and by attracting European and Asian economic investment, Iran is increasingly in a position to defer the benefits that would come with a rapprochement with the United States. In fact, the current Iranian invitation welcoming the participation of U.S. firms in its economic development might prove to be a window of opportunity that could close unexpectedly at some future date.

In this situation, it may be useful to review the current U.S. approach to achieving improved relations with Iran. The U.S. government and many former U.S. officials and analysts subscribe to a model in which a series of modest parallel reciprocal steps are undertaken that have a confidence-building effect sufficient to bring Iran to the table. Government-to-government negotiations then ensue in which issues of concern to both parties are put on the agenda.

Policy analysts outside the government have devoted considerable effort to devising steps that the United States and Iran can each take to bring about rapprochement. The modest nature of the earlier steps envisioned is illustrated by Secretary Albright’s initial overture. In her June 17, 1998, Asia Society speech, Albright pointed to two steps that had already been taken by the United States: Iranians could obtain U.S. visas more easily than before, and the travel advisory to

U.S. citizens seeking to travel to Iran was modified. Albright invited Iran to engage in *parallel* steps, but it did not reciprocate.

Although Iranian policy may change in the future, it seems at present that *Iran has rejected a step-by-step process of small confidence-building measures that could help thaw relations* to a point at which real progress could be made in addressing major issues. Therefore, it may be that a different approach toward reformulating the U.S.-Iranian relationship needs to be developed.

Objectives and Analytic Approach

The purpose of this report is to stimulate thinking beyond the current U.S.-Iranian stalemate. It examines the full range of U.S. interests at stake in a broader strategic context and suggests approaches that could become part of a new strategic approach. This report identifies the major issues that will need to be addressed if U.S.-Iranian relations are to improve. In doing so it identifies areas in which cooperative endeavors might serve the interests of both countries as well as those in which competing interests necessitate that the two parties move toward compromise. The approach endorsed here is designed to develop a U.S.-Iranian relationship that is multifaceted in its strands. There are policy steps that can be taken immediately, but the focus of this report is on the longer term. In the future there will likely be opportunities for improvement that do not exist at present – sometimes because of the anxieties of key allies, like Israel, or because of sensitivities or important countries, like Russia, or because the Iranian government is not yet willing to move forward. It is worth noting that even modest steps often require Iranian permission.²

If the administration of George W. Bush decides that it wants to try to improve U.S.-Iranian relations, it will not meet with much success unless Iran indicates a similar interest. As a matter of practical politics, the executive branch will need to confirm a desire for reciprocity on the part of Iran. Congress and the public will expect this. Nevertheless, it may be necessary for the United States to take some initial unilateral steps to set events in motion. Such steps could include removing unnecessary irritants in the relationship, like the current practice of fingerprinting and photographing Iranian visitors to the United States. Although unilateral steps can be taken in an attempt to thaw the relationship, there will be a basic requirement for mutuality. The process of improving the relationship will require a spirit of give and take on the part of both countries.

Ideally, the U.S.-Iranian relationship could improve to the point where positive goals can be achieved by both sides and conflicts of national interest addressed in a practical manner. The United States should be patient, careful, and cautious. In particular, there should be a continuous evaluation of the degree of Iranian interest in an improved relationship and of Iran's willingness to respond to initiatives in a generally reciprocal manner.

The current political struggle in Iran, however, makes it *unrealistic to expect a calibrated quid-pro-quo interaction between the United States and Iran*. No element of the Iranian leadership can at this time

²A telling example is the fact that the Iranian government will not allow the United States a presence in Iran that would enable it to accept applications for visas to the United States. Iranian citizens must undertake an expensive and time-consuming effort that involves traveling to third countries (such as Turkey or the UAE) to obtain their visas from U.S. embassies or consulates there.

agree to develop a “road map” with the United States for improving the relationship without being vulnerable to attack from domestic political adversaries.

There are significant domestic constituencies in both Iran and the United States on high alert with respect to the national security threat that they believe the other country represents. These groups have sufficient political power to challenge even the most modest conciliatory steps by arguing that they are dangerous departures from past national policies.

The adversarial stance that the governments of Iran and the United States have taken toward one another has made it difficult to change course and move toward reconciliation, even in a different political environment. This is so partly because of the strident nature of the rhetoric that has come from some quarters in Tehran and Washington. It has been very effective in mobilizing domestic political opinion, but at the same time it has reinforced negative public attitudes which stand in the way of change. The standoff undermines the long-term interests of both countries.

In spite of these obstacles, this report suggests initiatives that could be implemented should there be a desire for improved relations on the part of both parties. It is cognizant of propitious changes that could occur in the geopolitical context in which future U.S.-Iranian relations might take place.

II. The Touchstone of U.S. Interests

The overarching goal of U.S. policy toward Iran should neither be to influence internal developments there, nor to focus on improved relations between the two countries as an end in itself. Instead, a reformulated relationship between the United States and Iran – one that is eventually characterized by normal diplomatic exchange and multiple forms of engagement – would be but a means toward an end. That end is the fullest possible achievement of U.S. interests.

To understand the role that Iran can play the achievement of the full array of important U.S. interests, it is necessary to take both a short- and a long-term view. Iran is most obviously relevant to the achievement of U.S. *geopolitical* interests, but its *energy* resources are important enough to merit separate consideration, especially as they relate to future U.S. and worldwide energy requirements. The recent tendency in U.S. foreign policy to use its economic power as a weapon has diverted attention from the fact that the United States has an *economic* interest in maintaining the international competitiveness of its companies. When these companies prosper, new jobs are created and, through taxes, the contribution of the companies to the domestic commonweal is expanded.

Geopolitical Interests

Iran is not only a primary player in Persian Gulf politics, but it is contiguous to independent states of the former Soviet Union. Many of these states are energy-rich, with elites that are unwilling to share power, and the prospect of future political instability cannot be ruled out. Some leaders are finding that the political practices that they inherited from the Soviet period and the extreme secularism of Soviet rule have provoked challenges to their regimes on the part of Islamic fundamentalists, including forces supported by the Taliban.³ Iran can contribute to the stability of the former Soviet states in the Caucasus and Central Asia by providing an economic hub for their exports and imports. This, in turn, would reduce the dependence of these states on Russia and would diversify their options for dealing with the outside world.

Iran is also contiguous with Afghanistan, where it opposes the Taliban, which has gained almost complete control over the country. Iran is engaged in military action on its eastern border with Afghanistan in an attempt to halt the entry of Afghan narcotics traffickers. This effort benefits other countries as well, stopping the flow of narcotics from Afghanistan to markets in Europe and other parts of the world.

Iran has a role to play with respect to the South Asian countries of Pakistan and India as a potential balance in the region and a transportation route for energy supplies. Most important, however, is the fact that as an energy-rich regional power with a key geostrategic location, Iran has attracted the interest of Russia and China.

³ In a presentation given at The Atlantic Council of the United States on May 1, 2000, General Anthony C. Zinni, USMC, Commander-In-Chief, U.S. Central Command, said that the Central Asian states are on the front lines of the fight against counter-terrorism, much of it emanating from the Taliban regime in Afghanistan.

Recent Approach

The array of U.S. geopolitical interests involving Iran is broader than those reflected in recent U.S. policies. In fact, it could be said that the Clinton administration's policy toward Iran was driven almost solely by emphasis on global issues, such as international terrorism and the proliferation of weapons of mass destruction, and by concern about threats to the security of Israel. The sum of the geopolitical factors that motivated U.S. policy toward Iran under the Clinton administration is reached when U.S. Caspian policy is added to these other issues.

Current U.S. policy toward the Caspian Sea area serves, in part, to help Turkey develop a role of regional influence vis-à-vis the Turkic-speaking Caucasus and Central Asian countries, but it has been described primarily as preserving the political and economic autonomy of the independent states of the former Soviet Union. The achievement of this goal remains dependent on the ability of the states to forge transportation links with the outside world. Nevertheless, U.S. Caspian policy has sought to discourage these states from utilizing routes that transit Iran. The political support that the Clinton administration gave to the Baku-Ceyhan pipeline should be examined in this context: It helped Turkey, penalized Iran, and could reduce Russian influence in the Caspian region.

Expanding the Context***U.S. Relationships with Russia and China***

The most important geopolitical developments for the United States are those that involve Russia and China. Both of these countries have the size, geographic position, economic potential, and military strength that, in combination, can have a profound effect on U.S. interests and on the prospects for international peace and stability.

Although Russia could cooperate with the United States on foreign policy matters and play a relatively benign role on the world stage, there are elements within the Russian leadership that keenly feel the loss of Russian great power status and have lingering Cold War attitudes. Consequently, the possibility of a future resurgent Russia with an impulse to dominate its neighbors in the Caspian and Central Asian regions and to play a significant role in Persian Gulf politics cannot be ruled out.

Meanwhile, China is likely to cooperate with the United States in some areas, while also being a geopolitical competitor in East Asia. China is already making economic inroads into Central Asia that may result in the enhancement of its political power there. Beijing is currently following a relatively conservative foreign policy and focusing its attention on internal economic issues, but with the passage of time it will want to play a larger role, reflecting its geopolitical weight. If it does so, there may well be points at which Chinese policy poses a significant threat to the achievement of U.S. interests.

Russia and China have described themselves as forming a strategic relationship. If oil and gas pipelines are built to connect China's population centers with energy supplies originating in eastern Russia, their ties are likely to be reinforced.

In an increasingly multipolar world, the geopolitical positions of China and Russia will be enhanced to the extent that they can forge strategic relationships with regional powers like Iran.

There are already elements of a strategic relationship between Russia and Iran. In December 2000, the two countries signed an arms sales agreement reported to be valued at \$2 billion and to include Iranian purchases of S-300 antiaircraft weapons, MI-17 helicopters, and SU-25 aircraft.⁴ Russia is Iran's primary arms supplier and its only supplier of civilian nuclear technology. Part of the reason for this circumstance is the U.S. policy of trying to isolate Iran. The United States has effectively withdrawn from engaging Iran, leaving the field to Russia. In addition, the current U.S. policy of trying to curtail natural economic and political relationships between Iran and the countries in the Caucasus and Central Asia has prevented Iran from playing a countervailing role against increased Russian power in the Caspian region.

Meanwhile, China has expressed an interest in Iran by investing in its energy sector. In fact, China is helping Iran to engage in swaps of Caspian and Persian Gulf oil. Iran has plans to reconfigure its northern refineries so it can become a major consumer of crude oil produced in neighboring Caspian states.⁵ The oil would be transported to the northern refineries through a pipeline originating at the Iranian port of Neka, on the edge of the Caspian Sea. The United States has discouraged foreign companies from assisting Iran in this plan, but a Chinese consortium is contributing to the pipeline's eventual construction.

China's future energy requirements will motivate it to continue to strengthen the Chinese-Iranian relationship.⁶ Iran has found that China, like Russia, can help it compensate for the absence of a relationship with the United States. In addition, because of its regional power aspirations, Iran seeks to reduce U.S. dominance in the Persian Gulf. Strengthened relationships with China and Russia can help Iran achieve this goal.

U.S. Relations with Its Allies

The U.S. approach to Iran is based on assumptions that are not shared by its European allies. Many major West European countries have resumed diplomatic relations with Iran, engaged in high-level visits, and actively pursued Iranian commercial opportunities. In general, the allies believe that the best way to alter Iranian policies is through engagement. Although the Europeans' approach enables their companies to pursue investment and trade opportunities without U.S. competition, the policy differences sometimes cause strain in U.S.-European relations.

The reaction of the European Union (EU) to the passage of the Iran and Libya Sanctions Act of 1996 (ILSA) is a case in point. Had the May 18, 1998 waiver for the Total-Gazprom-Petronas contract not been issued, the European Union probably would have filed a World Trade Organization (WTO) complaint against the secondary sanctions that the United States had

⁴ See "Moscow and Tehran Sign Military Pact," *Financial Times*, December 29, 2000. In discussing the deal, Iran's minister of defense, Rear Admiral Ali Shamkhani, pointed out that Russia and Iran have common interests in Central Asia, the Caucasus, and Afghanistan, as well as a common viewpoint concerning the expansion of NATO "and its allies, particularly Israel."

⁵ Foreign Minister Kharrazi has stated that Iran's refineries could absorb 800,000 barrels per day of Caspian oil, thereby making it unnecessary to construct export pipelines for Caspian oil production at this stage. Speech delivered at a meeting sponsored by the Eurasia Group, September 19, 2000. U.S. analysts consider this claim exaggerated.

⁶ China's sole Iranian crude purchaser, Zhuhai Zhenrong Co., has agreed to buy 240,000 barrels a day from the National Iranian Oil Company in 2001, an increase of 71 percent from 2000. See Dow Jones Energy Service "China Strengthens Oil Ties with Iran through Major Deals," January 29, 2001.

imposed on EU companies. If the WTO had ruled in favor of the EU position, punitive retaliatory sanctions against the United States would have been authorized. Some EU countries expressed their opposition to the U.S. attempt at extraterritorial law-making by enacting domestic legislation blocking their companies from acceding to the ILSA requirements.

If the same domestic political forces in the United States that acted to bring ILSA about in 1996 succeed in obtaining enactment of a similar bill once ILSA expires in August 2001, the conflict between the United States and the European Union over the issue will be revived. Meanwhile, the ILSA restrictions have been honored in the breach by several European companies and, now, by Japanese and Chinese firms as well. In fall 2000, Japan received negotiating rights over part of Iran's Azadegan oilfield, a prized opportunity in view of the size of the field, which is also of great interest to U.S. companies.⁷ Some analysts believe that Iran chose Japan to put pressure on the United States regarding the sanctions and to introduce Asian competition to counteract potential European dominance in its oil and gas sector. Meanwhile, the China Petroleum and Chemical Corporation has made a \$150 million-plus investment in Iran that has activated an ILSA review to determine whether the United States will apply sanctions against China.⁸

There is a multitude of issues that need to be addressed by the United States and its allies in a spirit of cooperation. Removing tensions caused by the differences in policy toward Iran would reinforce the alliance relationship and possibly make other issues easier to resolve. Moreover, by coordinating its approach toward Iran with its European allies, the United States could strengthen its policy's effect on Iran while being able to shape joint initiatives.

U.S. Interests in the Persian Gulf

One of the key tenets of U.S. foreign policy over the last quarter of a century has been the commitment to protect the free flow of energy resources in the Persian Gulf. The United States has devoted annual sums in the tens of billions of dollars to achieve this goal. It has deployed troops and equipment in forward positions in Saudi Arabia and Kuwait, headquartered the navy's Fifth Fleet in Bahrain, and prepositioned military equipment in Oman, Qatar, and the United Arab Emirates.

Iraq is now, and will continue to be, an important factor in the development of U.S. foreign policy. Iran has benefited greatly from the U.S. policy of trying to contain Iraq through the UN sanctions regime. Iran has had the luxury of attempting to improve relations with Iraq to the point of stating that it wants a normalization of ties. Although Iran will always consider Iraq a threat, an improved relationship with Iraq would reduce Iran's fear of an imminent military attack from the west. Conversely, Saddam Hussein would not have to fear a military attack from Iran. This means that Iraq would not have to divert attention and resources to protect itself on that front. It would also eliminate any concern that Iran might decide to aid insurrection by

⁷ Conoco has assessed the field using seismic data. The U.S. government is examining it as a potential violation of ILSA. Conoco, which carried out the study through a European subsidiary, believes that it was acting within the confines of the U.S. legislation.

⁸ See Campion Walsh, Dow Jones Newswires "China Firm's Oil Deal May Revive U.S. Sanctions on Iran," January 16, 2001. See Kenneth Katzman, "The Iran-Libya Sanctions Act (ILSA)," Congressional Research Service report RS20871, April 2, 2001, for a listing of the other contracts in possible violation of ILSA. The companies and countries being examined are: TotalFina of France, Royal Dutch Shell of the UK and the Netherlands, ENI of Italy, Norsk Hydro of Norway, and Bow Valley of Canada. Foreign investors engaged in exploratory studies in Iran will also be subjected to ILSA scrutiny when contracts are consummated.

Iraq's Shia majority in the south. If the United States and Iran established a working relationship, Iranian policy toward Iraq could change.

A regime change in Iraq will probably result in significant internal turmoil in Iraq. Over the longer term, U.S. policy makers could be confronted with other situations of internal turmoil in the countries bordering the Persian Gulf. There is potential for turbulent political change in Iran, as well, but, in contrast with other states in the region, Iran's political system has the safety valves of democratically electing its president, parliament, and local councils. Iran also has an economy that is much more diversified than those of its neighbors, even though it is still skewed toward dependence on its energy sector.

In the short term, Iran's relevance to U.S. interests in the Persian Gulf derives primarily from its potential relationship with Iraq. In a longer-term perspective, given the potential for political turmoil in Iraq and other states, the United States would benefit from Iran's continued political stability, which is dependent on the degree to which it can lessen economic deprivation and achieve economic growth sufficient to meet annual demands for employment for close to one million youthful entrants into its job market each year. U.S. and other foreign investment in employment-generating industries could help encourage stability and positive change in Iran.

A longer-term perspective is also required to prepare for the contingency that Saddam Hussein or a similar Iraqi leader will be in power when UN sanctions are lifted. The sanctions regime is already eroding. Moreover, the sanctions did not address the conventional weapons and trained military forces that Iraq possessed after the Persian Gulf War. After sanctions are lifted, Iraq can be expected to be more successful in its attempts to refurbish and expand its military equipment. The commercial incentives that Iraq will be able to present to potential arms suppliers by virtue of its oil income will make it relatively easy to accomplish this task, even in the face of existing multilateral export controls on various arms and dual-use items. Thus, the future conventional military threat that Iraq may pose to its neighbors cannot be dismissed. Both the 1980 invasion of Iran and the 1990 invasion of Kuwait are evidence that Saddam Hussein considers military invasion of his neighbors an acceptable instrument of foreign policy. Iraq has not moved away from its contention that Kuwait is an Iraqi province.

In the past, the U.S. commitment to Persian Gulf security has involved facilitating a balance of power between Iran and Iraq.⁹ During the Clinton administration, however, attention was focused almost exclusively on preventing the acquisition of WMD by both states. While nonproliferation is an important global issue, and while possession of WMD is an important component of any balance of power equation, the United States would benefit from a renewed focus on *geopolitical* considerations. With a broader perspective, an improved U.S.-Iranian relationship would allow the two countries to work together to counter dangers emanating from Iraq.

The U.S. commitment to defend its allies in the Persian Gulf and guarantee the free flow of oil is well established and should be continued for the foreseeable future. If the United States were able to rely on the countries of the region to a greater extent, however, it would be able to reduce the visibility of U.S. forces in the area. A key reason for doing so is self-protection: not only

⁹ See Zbigniew Brzezinski, Brent Scowcroft, and Richard Murphy, "Differentiated Containment," *Foreign Affairs* 76, no. 3 (May/June 1997), 22.

would a reduced military presence limit the number of U.S. targets for terrorist attacks, but it would also diminish the motivation of the terrorists to strike in the first place, abroad and in the United States.

U.S. Relations with the Muslim World

The United States' relationship with the Muslim world is burdened by both a lack of understanding of Islam by Americans and an anti-U.S. and anti-Western worldview that is held by many individual Muslims. These attitudes are encouraged and exploited by dissident leaders bent on changing the internal status quo of various regimes with large Muslim populations. These attitudes are also often a generalized reaction to economic deprivation. In addition, many Muslims "in the street" see the difficulties confronted by Palestinians as a result of the Arab-Israeli conflict as representative of the persecution of Muslims generally. Because of the United States' strong support of Israel, and its key role in trying to broker a Middle East peace agreement that many believe is unfair to the Palestinians, the United States is viewed as complicit in the constraint exercised by Israel over the physical movements and economic activities of Palestinians and when Palestinian casualties occur.

The role of these perceptions in terrorism is obvious. Consequently, one of the strongest motivations of the United States in trying to reach a Middle East peace agreement is to remove the Israeli-Palestinian issue as incitement. Against this backdrop, there would be symbolic benefits if the United States could be seen as having a normal diplomatic relationship with the *Islamic Republic of Iran*.

To the extent that Iran is able to incorporate democratic and liberal values into an Islamic political system,¹⁰ it provides an alternative example for the more dictatorial regimes in Muslim countries. This is particularly important at a time when autocratic regimes in some Muslim countries are confronting pressure for greater political participation. It is also important because competing models such as that of the Taliban in Afghanistan and doctrines promoted by various Islamic fundamentalist groups are much more authoritarian.

The United States has made it clear that it favors the Turkish model of a secular Muslim state, but it is also important to U.S. interests for Iran's Islamic republic to provide a democratic model for Muslim countries that seek to incorporate religion into their systems of governance. The acceptance of the model will be contingent, in part, on the ultimate success of the Iranian reform movement's attempts to promote real democracy and rule of law. Conversely, a hard-line reaction in Iran that results in the suppression of the democracy movement will represent the failure of democracy in a society committed to Islamic principles.

There is an *economic* element as well. The basic purpose of President Khatami's call for a "dialogue between civilizations" was articulated in an address to the Organization of the Islamic Conference (OIC)¹¹ which was held one month prior to his CNN interview. The concept of a dialogue of civilizations was promoted there as a means of enabling Muslims throughout the world to *overcome the "passivity and backwardness of Muslim countries"* through contact with Western civilization and a willingness to learn from Western accomplishments in science, technology, and

¹⁰ For a description of some of these attempts, see Robin Wright, "Iran Now a Hotbed of Islamic Reforms," *Los Angeles Times*, December 29, 2000.

¹¹ <<http://www.persia.org/khatami/khatami03.html>>

political and social organization. This is the context in which Khatami made his January 1998 overture to the United States.

Resolution of Regional Conflicts

Iran is already a member of the UN "6 plus 2" committee established to address the civil war in Afghanistan. The United States and Iran could work more effectively in this context if they had a better relationship. There also might be reasons to have direct U.S.-Iranian bilateral consultations in view of the similarity of interests that the two countries have regarding Afghanistan's current situation and the dangers posed by the Taliban.

Although a cease-fire has been in place since 1994, the conflict between Armenia and Azerbaijan over Nagorno-Karabakh has not been resolved. The enclave's future status and collateral issues remain at issue. Iran has good relations with Armenia and may be affected by the outcome of negotiations because its population includes a significant number of ethnic Azeris. Iran tried to participate in mediation efforts but was rebuffed by the United States. With a better U.S.-Iranian relationship, the United States could come to accept Iranian efforts to help mediate in such instances and benefit from the results. Iran already has participated in diplomatic efforts to bring about peace during the five-year civil war in Tajikistan.

Energy Interests

The economic well-being of the United States and the rest of the world is dependent on a continued, sufficient and steady supply of energy. Technological breakthroughs that might reduce international energy dependence on fossil fuels like crude oil and natural gas may be on the horizon, but they are unlikely to become cost competitive for some time. It will take even more time to achieve sufficient market penetration to begin to replace fossil fuels. Therefore, the industrialized and developing worlds will for the foreseeable future find themselves dependent on the relatively few countries whose natural endowment of crude oil and natural gas make them key international energy suppliers. Iran is one of these countries, with a worldwide share of almost 9 percent of oil reserves and 16 percent of natural gas reserves. Iran's natural gas reserves are second only to those of Russia.

The United States is heavily dependent on fossil fuels, in 1999 consuming 25.5 percent of the world's oil and 26.9 percent of its natural gas.¹² Worldwide, future demand for oil and natural gas will grow significantly, in part because of continued population growth in the developing world, but also because most of the developing countries will be engaged in a process of industrialization, which will require more energy. There will be vast expansion in the use of automobiles and other motorized forms of transportation, along with dramatically increased demands for the provision of electricity. The transportation sector already accounts for close to half of the world's consumption of oil, while natural gas is the most efficient and environmentally benign fossil fuel for the generation of electrical power. Over 2 billion people in the world do not yet have access to electricity. Meeting demand for electricity is high on the political and economic agendas of developing countries.

Because of global economic interdependence, the United States must be concerned not only about its own energy requirements but also about the access to energy resources enjoyed by its

¹² U.S. Department of Energy, *International Energy Outlook 2000*.

major trading partners. These countries need adequate energy to produce imports that are required by the United States, and they need sufficient energy-related economic health to be able to buy U.S. exports. Japan, for example, must import virtually all of its energy; it relies on Iran for much of its oil. Other highly industrialized Asian countries are similarly affected. Close to 40 percent of Iran's oil exports are to Asia.

The amount of energy available is an important determinant of future worldwide development and economic prosperity, but so is uninterrupted delivery. The downturn in the availability of oil for export caused by the Iranian Revolution of 1978-79 helped trigger a worldwide economic recession. The shortfall of crude oil on the international market caused by Iraq's August 1990 invasion of Kuwait caused oil prices to increase by 40 percent before new oil became available. The shortfall was caused by Iraq's destruction of Kuwaiti oil production facilities and by retaliatory sanctions imposed by the United Nations that had the effect of curtailing Iraq's oil market access.

Each of these events would have had much more severe international economic repercussions if Saudi Arabia and the UAE had not been able to draw upon their spare production capacity to compensate for supplies of oil that did not reach the market. Under normal circumstances, only Saudi Arabia, the UAE and Kuwait have enough spare capacity to intervene in this way – and Saudi participation is crucial. In a tight oil market, the full burden essentially falls on Saudi Arabia. During 2000, when the Organization of Petroleum Exporting Countries (OPEC) increased its production levels in response to urgent requests by the United States and other key oil consumers, it did so in increments ranging between 500,000 to 1.7 million barrels per day. At the height of the increase, Saudi Arabia was said to have only 2 million barrels per day of spare production capacity remaining. It is estimated that there would be an additional 1.5 to 2 million barrels a day without the sanctions against Iran, Libya, and Iraq.¹³ Together the petroleum reserves of these three countries almost equal those of Saudi Arabia.

The importance of being able to increase production capacity can be appreciated by the fact that the world currently relies on only 13 countries for more than 80 percent of all crude oil exports traded on international markets. A glance at the list¹⁴ reveals that many of these countries could suffer an interruption in their oil exports due to political instability; some are grouped contiguously making them vulnerable to cross-border conflict.

The same logic that leads the United States to seek diverse supplies of oil would seem to suggest that a similar policy of promoting diversity in sources of spare capacity would be prudent, easing the burden on Saudi Arabia, Kuwait, and the UAE. Iran, like most other major oil exporting countries, is already producing at capacity. Lack of capital and Western technology are calling into question Iran's ability to maintain its share of OPEC production at current levels. Iran would like to maintain its share of OPEC production for the next twenty-year period, when the worldwide demand for OPEC oil is expected to increase significantly.

¹³ Petroleum Finance Company estimate cited by Vahan Zanoian at a meeting of the Council on Foreign Relations, October 10, 2000.

¹⁴ In rank order, Saudi Arabia, Russia, Norway, Venezuela, Iran, the UAE, Kuwait, Nigeria, Iraq, Mexico, Libya, Algeria, and the United Kingdom.

Iran wants increase its production capacity to 4.7 million barrels a day by 2005 and 7 million barrels a day by 2020.¹⁵ If these goals are achieved, Iran would be in a position to contribute to the U.S. goal of ensuring that oil markets are buttressed by an array of exporters. It would therefore be in the U.S. national interest to facilitate U.S. investment participation in Iran's efforts to increase its production capabilities, instead of imposing sanctions against U.S. (and foreign) participation in the Iranian hydrocarbon sector.

Iran also has a significant role to play in future worldwide production of natural gas. As in the oil sector, the ability of Iran to exploit its natural gas reserves is dependent on its ability to make capital investments to produce and process the gas, while also creating the infrastructure necessary to transport it for export. The dimensions of Iran's investment requirements can be seen by pointing to the fact that Iran now produces slightly more than 2 percent of all natural gas supplies, but possesses 16 percent of all reserves. For Iran to increase its profile in the natural gas sector, will require major investments in infrastructure for transport. It is more difficult to ship natural gas than it is to ship oil. Pipelines have to be constructed for land shipment, while shipment by sea requires facilities to liquefy the natural gas at the point of departure and regassify it when it reaches its destination.

The United States almost produces enough natural gas to satisfy its own needs, but it is also dependent on other countries importing and transporting enough natural gas to meet their own requirements. Natural gas will be the most rapidly increasing source of worldwide energy consumption during the next two decades, predominantly because it has become the fuel of choice for the production of electrical power. There are economic and environmental reasons for this. The most cost-competitive current design for new power plant construction is a "combined-cycle" plant fired by natural gas.¹⁶ These plants produce power efficiently and have comparatively low initial construction costs. Moreover, natural gas plants emit far lower levels of pollutants than traditional coal-fired plants. This is important in controlling local pollution, as well as limiting carbon emissions associated with global warming.

There will also have to be huge investments in the infrastructure necessary to transport natural gas to the points at which it will be used. Countries like China and the other rapidly industrializing countries of East Asia will be heavily involved in these endeavors. Their degree of success will determine progress in their broader economic development. They will find it hard to attract foreign investment if they are unable to guarantee a steady supply of electricity, because it is essential for computer-based information and production systems.

There are political implications as well. When the urban areas of a country are susceptible to brownouts and blackouts, the regime that is currently in office suffers from public perceptions of incompetence. Dissatisfaction with the absence of electrical power altogether can be a contributor to political unrest in areas of the hinterland. In either instance, the United States is indirectly affected because of its interest in seeing political stability and relatively smooth economic development in the rest of the world.

¹⁵ Reuters, "Iran Targets 4.7 Million BPD Capacity by 2005," August 24, 2000.

¹⁶ In some locations in the developing world, however, the availability of plentiful coal resources in areas contiguous to electrical power plants serves to make coal-fired electricity generation cost competitive.

Economic Interests

By 1999, the United States, enjoyed a \$10 trillion economy, \$33,900 per capita GDP, and exports valued at close to \$700 billion per year. In contrast, Iran – with a population one-fourth as large – had an economy of only \$63 billion, \$1000 per capita GDP, and imports valued at \$13.8 billion per year.¹⁷ In spite of this basic disparity, Iran presents significant trade and investment opportunities for U.S. businesses, especially those in the agricultural sector, manufacturers of heavy machinery and aircraft and electrical power plant components, and investors in hydrocarbon and mineral resources.

In 1995, when the comprehensive U.S. sanctions against Iran were imposed, U.S. exports to Iran were relatively minimal at less than \$500 million per year. Before the revolution, however, 15 to 20 percent of Iranian imports came from the United States.¹⁸ France and Germany together have an economy that is less than 40 percent that of the United States, yet they currently export approximately \$2.2 billion worth of goods to Iran.¹⁹

Although there are barriers to foreign trade and investment that will have to be removed before Iran can gain its full potential as a trading partner, it already enjoys several advantages:

- a market of 65 million people, many of whom are young and eager to emulate Western patterns of consumption;
- a literate and professionally trained workforce;
- local access to an abundance of raw materials and cheap, subsidized energy;
- an economy that is in need of further diversification but is already much more diversified than others in the Middle East;
- a location that will enable it to become a market hub for the Middle East and Central Asia; and
- vast hydrocarbon and mineral resources that have barely begun to be exploited, including gold, lead, magnesium, mercury, phosphate, silver, sulfur, and zinc.

Most important, however, is the fact that the government of Iran has embarked on a series of programs designed to move the country toward economic development at a rapid pace. There will be domestic barriers²⁰ to overcome in order to achieve these goals, and Iran is keenly aware that it will also need substantial foreign investment. The Ministry of Economics estimates that \$10 billion a year in foreign investment is required.²¹

¹⁷ “The United States: Major Economic Indicators,” January 1, 2001 <<http://www.tdctrade/cp/mktprof/america/mpusa.htm>>. GDP statistics for Iran are estimates for the year 2000. In 1999 Iranian GDP was \$53 billion, a drop from \$60 billion in 1998. Economist Intelligence Unit Country Report, December 2000.

¹⁸ Ernest H. Preeg, “Feeling Good or Doing Good? A Critique of Unilateral Economic Sanctions,” Center for Strategic and International Studies, Washington, DC, November 1998.

¹⁹ For the year ending March 19, 1999, Germany exported goods worth \$1.66 billion to Iran, and France exported goods worth \$556 million. *Atieh Bahar Investment Guide to Iran, 2000*.

²⁰ A primary barrier will be resistance from the economically powerful religious foundations that have a role in much of the country’s commercial activities.

²¹ Dow Jones Newswires, “Iran Needs \$10 Billion Foreign Investment Annually – Paper.” May 22, 2000.

Investment Opportunities in the Oil and Gas Sector

Given the current tight U.S. energy situation, obtaining access to energy resources now being forgone is a high priority. Iran has had 43 oil and gas exploration and production projects out for tender since May 1998.²² Ten foreign companies have signed contracts for projects: Bow Valley, ENI/Agip, Enterprise, Gazprom, Norsk Hydro, Petronas, Saga, Shell, Sinopec, and TotalFinaElf. In addition, Shell, Lasmo, and Veba are studying an offshore area in Iran's section of the Caspian Sea. Lasmo, BP, Shell, Gaz de France, BG, BHP, Petronas, ENI/Agip and TotalFinaElf are studying Iran's natural gas reserves and are competing to develop a Master Gas Plan for Iran.

Total, Gazprom, and Petronas received an ILSA waiver in May 1998 for a contract to produce from the South Pars gas field. The other companies are in potential violation of ILSA, and the contracts they have entered into are currently being evaluated by the United States to determine whether they violate ILSA and whether ILSA sanctions will be applied. The existence of ILSA has not prevented foreign investment commitments in Iran. They reached \$4.5 billion in 2000 alone. Other investment commitments are to come. The dimensions of the investments currently underway can be appreciated by realizing that each phase of the eight-phase South Pars project will require an estimated \$1 billion.

All of the development projects awarded so far are offshore. The only onshore project is at the Anaran Block, where Norsk Hydro is exploring. There is keen competition among foreign companies for onshore fields, although no other onshore projects have been awarded.²³

Iran is also seeking a significant expansion in its ability to produce and transport natural gas for domestic consumption and for export. It has embarked on a program for switching from oil to natural gas domestically to free up more oil for export. It also wants to obtain full value for its natural gas, one-tenth of which is still flared during the process of extracting oil. Iran plans to begin exporting natural gas to Europe by 2005, as well as to India and Pakistan. The gas for India and Pakistan will be transported by pipeline (providing current plans come to fruition) and by tanker in liquefied form. Iran has one liquefied natural gas (LNG) facility and is planning to build two more plants. Potential foreign investors include BP Amoco, British Gas, Gaz de France, Royal Dutch Shell, and TotalFinaElf.²⁴ Meanwhile, Shell has offered to build a gas-to-liquid plant.

Iran also plans to expand its petrochemical industry, with the objective of doubling its production capacity. Iran is second only to Saudi Arabia in petrochemical production in the Middle East. Petrochemical contracts signed with foreign firms reached \$2 billion in 1999, and Iran's oil minister predicted that new contracts amounting to another \$2 billion would be signed in 2000.²⁵

²² "Iran," Energy Information Administration of the U.S. Department of Energy, Washington, DC, February 2000 <<http://www.eia.doe.gov/emeu/cabs/iran.html>>.

²³ Iran is reluctant to allow foreign investment in its onshore fields because of a constitutional prohibition that first must be overcome. See note 26.

²⁴ Dow Jones Energy Service, "Iran NIOC Seeks to Develop Second LNG Export Project – MEES." October 16, 2000.

²⁵ "Iran: Investors Wanted," *Economist Intelligence Unit*, September 1, 2000.

In addition to these ambitious plans, Iran also must address inadequacies in its methods of exploiting its hydrocarbon resources. In June 2000, Iran estimated that it currently needs \$10 billion to maintain its position as the second largest producer in OPEC.²⁶ Outside observers have commented that the lack of modern gas injection technology and the use of old drilling machinery and methods have held down potential production and damaged wells. Iran has acknowledged that a lack of skilled and experienced manpower in the oil industry has retarded the progress of ongoing development projects.

Finally, Iran is hampered in attracting foreign investment in its oil and gas sectors by its constitutional prohibition against granting foreign concessions.²⁷ Instead of production sharing agreements, which would be preferred by foreign investors, Iran currently only permits “buy-back” contracts. Under the terms of such contracts, the company provides the investment capital to construct a particular facility and is then reimbursed for costs plus a rate of return on its investment of 15 to 18 percent. The buy-back period usually lasts 5 to 7 years, during which the reimbursement and profit premium for the investors are derived from the initial production of the facility; once satisfied, all future production belongs to Iran. This procedure hastens the exit of the company. Under the terms of the buy-back contracts, however, Iran is allotted only 40 percent of the production that occurs once the project comes on-stream. The remaining 60 percent is used to re-pay investors.²⁸

Buy-back contracts have the perhaps-unintended effect of benefiting the foreign company by protecting it from the adverse effects of oil market price volatility. The company’s costs and profits are paid out of forthcoming production at a rate independent of the amount of oil or gas necessary to reach the agreed upon sum. The buy-back arrangement also has a negative short-term effect on the country because it must defer more than one half of any financial gain from the sale of the oil or gas produced during the period it takes to pay off the investor.

Dissatisfaction with the buy-back arrangement on both sides will probably give rise to new arrangements that will enable foreign investors to continue to participate in projects that they have developed. Eventually, joint ventures with Iranian partners involving production-sharing agreements may be allowed.²⁹ It has even been suggested that the terms of the buy-back arrangements for new contracts will change by mid-2001.³⁰ The buy backs are expected to retain the same name, but in spirit they will edge closer to production sharing agreements (PSAs). For example, Iran is beginning to think in terms of risk and reward sharing.³¹ If Iran refuses to move toward production-sharing agreements, it will not remain competitive in the world market for foreign investment.

²⁶ Iran Press Service, “Iran Says It Lacks Modern Oil Technology and Experts,” June 2, 2000.

²⁷ Article 81 of the constitution states, “The granting of concessions to foreigners for the formation of companies or institutions dealing with commerce, industry, agriculture, services or mineral extraction, is absolutely forbidden.”

²⁸ Siamak Namazi, Atieh Bahar Consulting, private communication, April 14, 2001.

²⁹ Dow Jones International News, “Iran Energy Investment Changes Encouraging Says Norsk Hydro,” February 5, 2001.

³⁰ Siamak Namazi, Atieh Bahar Consulting, private communication, January 7, 2001.

³¹ “Iran: Oil and Gas Issues: The Buy-Back,” *MEED Quarterly Report*, January 19, 2001.

Investment for Infrastructure Construction and Replacement

Population increase and urbanization have created substantial demands for new infrastructure in Iran. For example, in October 2000, Iranian officials announced that they are seeking to attract \$7.8 billion in domestic and foreign investment for 1,200 new housing and development projects. They hope to obtain one-fourth of it from foreign investors but are pessimistic about their likelihood of success.³²

Iran also wants to build new road and railway linkages with its neighbors. The telecommunications sector is growing rapidly, fueled by demographic pressures, new technologies, and unfulfilled demand. In addition, Iran has to make investments to compensate for aging infrastructure in nearly all other sectors.

Aircraft

One of the most urgent tasks facing Iran is upgrading its air transportation fleet. Many of the airplanes now in service are reaching the point of being unsafe. In fact, in October 2000 Iran was forced to halt international flights by its air cargo fleet because its planes were ruled unfit to fly, primarily because of a lack of spare parts.³³

Two-thirds of Iran's fleet was built by Boeing. In 2000, after much delay, U.S. officials allowed Boeing to provide Iran with safety equipment (under warranty) being made available to past purchasers of Boeing planes on a worldwide basis. These "wing strut modification kits" were allowed to be shipped only for seven Iranian passenger planes. Shipment was denied for similarly impaired Boeing cargo planes because of dual-use export restrictions.

U.S. export restrictions also prevented Iran from buying French Airbus planes with U.S. engines. The planes were eventually sold to Iran after Rolls Royce engines from the UK were used in place of those manufactured by General Electric and Pratt-Whitney.

Boeing's losses in Iran have been estimated at \$1 billion.³⁴ For perspective, the U.S. Department of Commerce estimates that for every \$1 billion in U.S. export contracts, 11,000 U.S. jobs are created. In October 1999, an Iranian commitment to purchase four A-330 Airbus planes was announced during a state visit to France by President Khatami.³⁵ Iran has 33 other jet aircraft in its fleet, all of which need to be replaced. If Iran chooses to engage in an aggressive program of fleet renewal, the costs would exceed \$1 billion. This is but one example illustrating that because of its economic sanctions, the U.S. is forfeiting markets, and other countries are seizing the opportunities afforded them.

Electric Power Generation Facilities

Starting from a low base, Iran's annual power consumption is growing and, over the next few years, Iran will require billions of dollars in foreign investment to build new power generation facilities. Iran is already adding new sources of hydroelectric power, including construction of

³² Reuters, "Iran Seeks \$7.8 Billion Investment in Construction," October 15, 2000.

³³ AFP, "Cargo Planes Unsafe, Banned from International Flights: Paper," October 16, 2000.

³⁴ Anwar Faruqi, "Close-up: Boeing, Other U.S. Companies Lose Out in Embargo," *Seattle Times*, October 1, 1997.

³⁵ U.S. export sanctions may prevent this arrangement from being consummated because the Airbus planes in question have engines of U.S. design. See Guy Dinmore, "Sanctions Hit Iran Orders for Airbus," *Financial Times*, January 12, 2001.

the 2,000 megawatt Godar-e Landar dam. Two-thirds of Iran's power generation is from natural gas, in part because of a program to divert oil from domestic consumption so that more will be available for export. There are also environmental concerns at play, since natural-gas fired plants produce fewer emissions than those powered with other fossil fuels.

Iran has found combined-cycle natural gas plants an attractive source of power generation and has already constructed seven, with six more planned in the near future. The existing plants were built by Siemens, John Brown, and Mitsubishi.³⁶ In the absence of U.S. sanctions, General Electric would be able to compete in the Iranian market to build combined-cycle natural gas plants. The potential market for power-generation can be appreciated by noting that Iran's installed power-generation capacity is only 1.3 billion kilowatt hours per capita, little more than 10 percent of the U.S. figure of 12.73 billion kilowatt hours per capita.

Iran also seeks to generate electrical power from nuclear plants. U.S. concern about nuclear weapons proliferation has complicated objective discussion of this goal. The United States not only prohibits U.S. companies from exporting nuclear power plants and related technology to Iran, but it has successfully persuaded its European allies to do likewise. Currently, Russia is in the process of completing the construction of two nuclear power reactors in Bushehr. (These reactors had been started by the German company Siemens, in 1974, under the Shah, but the company pulled out during the Iran-Iraq War.) Russia also has plans to build two more nuclear reactors at the same site. The United States has exerted considerable pressure on the Russian government in the hope that it will not engage in the construction of the additional plants.

Some observers have noted the inconsistency in the United States opposing Iran building light-water reactors, while helping engineer a 1994 agreement with North Korea whereby it will receive a *donation* of two light-water nuclear power reactors.³⁷ Consequently, an argument has been made for a "North Korea solution" to the problem posed by Iran's interest in pursuing a civilian nuclear power program. Following the North Korean example, the United States would withdraw its opposition to the construction of civilian nuclear reactors in Iran in return for strict International Atomic Energy Agency (IAEA) safeguards to ensure that nuclear materials are not diverted to a weapons-related program.³⁸ Full-scope IAEA safeguards on the Bushehr plant *have already been imposed*, and the sale of nuclear power plants to Iran by other countries would follow the same regime because of their previous commitments to the IAEA. Moreover, Iran has been fully compliant with requests by the IAEA to inspect its nuclear facilities, including requests for special inspections.

Another argument against Iran's proposed civilian nuclear power program is represented by arguments that Iran does not *need* nuclear power, because it has such vast reserves of oil and gas. This argument suffers when a comparison is made with the U.S. nuclear power program. The United States derives 20 percent of its electrical power from nuclear reactors. During the early 1970s, when construction of nuclear power plants was gaining momentum, the United States did

³⁶ "Table 3. Gas Powerplants in the Network," *Atieh Bahar Investment Guide to Iran, 2000*.

³⁷ The terms of the agreement with North Korea were that it would receive the reactors in exchange for a commitment to remain a party to the Nuclear Nonproliferation Treaty and to halt construction of a research reactor that would have facilitated the diversion of fissile material to weapons-grade production.

³⁸ See, for example, Lee H. Hamilton, "Reassessing U.S. Policy toward Iran," speech before the Council on Foreign Relations, April 15, 1998.

not “need” nuclear power. It was less than half as dependent on imports of foreign oil than it is today, and it was essentially self-sufficient in natural gas. (Today, the United States still produces almost as much natural gas as it consumes.) Most important, however, is the fact that then – as now – the United States was able to fire its power plants by drawing on its vast indigenous reserves of coal.

Coal and natural gas are the two main sources for the non-nuclear generation of electric power in the world. Iran’s large oil reserves are not useful as a power-generation substitute. While Iran has significant natural gas reserves, it has only now begun to convert them into productive uses. The most important difference between Iran and the United States in energy generation is in their respective levels of coal reserves. The United States has 274,156 million short tons (MST) of coal reserves, while those of Iran are less than one-thousandth as large, at 213 MST.³⁹

To summarize, during the early 1970s, when the United States decided to pursue a vigorous nuclear power generation program, it was not lacking fossil fuel alternatives, consisting primarily of a reasonable level of natural gas reserves and vast coal reserves. During the same time frame, Iran had vast oil and gas reserves, but virtually no coal reserves. Since that time, the advantage of nuclear power has become more compelling from an air quality standpoint. In contrast to the process of generating power from fossil fuels, nuclear power generation produces no carbon emissions. Iran is experiencing severe problems of local pollution, and the level of emissions that Iran contributes to the atmosphere has almost tripled during the last 20 years. In contrast to fossil fuels, the generation of electrical power from nuclear plants does not release ground-level and atmospheric pollutants (although environmental issues arise because of the need to dispose of nuclear waste). Mounting concerns about the phenomenon of global warming have contributed to a reevaluation of the benefits of nuclear power as a source of electricity.⁴⁰

Iran’s plans regarding nuclear power have changed over time, but given its persistent interest in producing nuclear energy, the United States is not likely to be able to stop Iran from acquiring civilian nuclear power reactors.⁴¹ Several years ago, Iran’s intention was to rely on nuclear power for 20 percent of electricity-generation capacity. The figure now ranges from 6 to 16 percent. The advantages to Iran of partial reliance on nuclear power include the following:

- The portion of fossil fuels that would no longer be required for domestic power production could be exported at higher rates of return and as a means of earning foreign exchange.
- A higher proportion of Iran’s fossil fuel production could be directed toward its petrochemical sector, producing higher rates of return.
- Better economic planning would be facilitated because the cost of fuel for nuclear power plants is relatively constant, while the cost of fossil fuels depends on market conditions.
- Iran would not be depleting its fossil fuel resources which, while currently abundant, are ultimately finite.

³⁹ <<http://www.eia.doe.gov/emeu/iea/Table82.html>>.

⁴⁰ See, for example, the report on U.S. energy policy issued by Vice President Richard Cheney in May 2001.

⁴¹ For example, in 1976, a Stanford Research Institute study commissioned by the Shah’s government recommended that Iran pursue a long-term, 20-year strategy for utilizing nuclear power as part of a mix of electricity-generation options for long-term economic development.

- Nuclear plants can remain in operation for longer periods of time than fossil fuel alternatives. A nuclear power plant will last approximately 60 years, while a gas-fired plant will last 30 to 40 years before the expense of retrofitting exceeds the value gained by continuing the plant in service.
- While nuclear power plants are more expensive to construct in comparison to fossil fuel alternatives, they are relatively inexpensive to operate. Therefore, the cost of electricity generated declines as the initial construction costs are amortized.

It thus makes a certain degree of economic sense for Iran to take advantage of periods of high oil prices and use the budget surpluses generated by current oil production to invest in the future. By spending money now, Iran can develop an electricity-generating capacity using nuclear power plants that will last for the *next six decades*. Meanwhile, worldwide economic growth will result in increased demand for Iranian oil and natural gas, making their export even more lucrative than it is today. In addition, higher prices of oil and natural gas will reduce the current disparity in the cost per kilowatt hour of electricity generated from nuclear – versus – fossil-fuel fired plants. This differential will be reduced further if governments begin imposing a cost premium on the production of electricity from fossil fuels as an incentive for consumers to turn instead to energy sources that do not release carbon emissions.

If U.S. weapons proliferation concerns can be addressed simultaneously, the United States will be in a position to take advantage of the economic opportunities presented by Iran's interest in pursuing a civilian nuclear power program. The Nuclear Regulatory Commission has certified three advanced U.S. nuclear power plant designs, and while no new nuclear power plants are being constructed in the United States, one of the designs has been used for several plants in Japan and a variation of another U.S. design is being built in South Korea. The major U.S. manufacturers of nuclear power plants are General Electric and Westinghouse.

Looking further into the future, vigorous competition can be expected between U.S. and Russian firms for the opportunity to construct nuclear power plants in the developing world. It has been U.S. government policy to support the use of nuclear power on a worldwide basis, especially in the developing world. The Department of Energy has a \$4.5 billion program to develop a new generation of nuclear power reactors, along with a strategy to encourage their commercial use.⁴² An important part of the program is developing reactors that will produce spent fuel with characteristics that prevent it from being transformed into material useful for weapons. Problems of nuclear waste disposal are also being addressed. One new idea is to develop modules for civilian nuclear power reactors that would operate in the 100 megawatt range. These smaller reactors would be especially useful in developing countries. The modules would be "plugged in," last for 15 years or so, and when they reached the end of their useful life cycle, they would be retrieved by original vendors. This, too, would reduce proliferation concerns.

The Russians are also developing a new generation of nuclear power reactors. Theirs are "lead-cooled fast reactors," and the target for market penetration is twenty years hence. It is not yet

⁴² "Congress Approves Expanded Nuclear Energy Programs," October 3, 2000 <<http://www.nei.org>>. Congress added money to the budget for this purpose and asked the Clinton administration to provide a roadmap for expanding nuclear energy programs over the next 20-year period. Ronald Simard, senior director, Suppliers and International Programs, Nuclear Energy Institute, private communication, February 7, 2001.

clear whether this new design will be technically suitable for the development of an IAEA safeguards regime robust enough to assuage proliferation concerns. The United States is engaged with the Russians in addressing this issue, as well as in participating in joint research and development projects to design nuclear power reactors that are proliferation proof.

If U.S. power reactors are less proliferation-prone than competing Russian power reactors, an additional incentive will have been created for the United States to try to capture as large a share of the worldwide nuclear power market as possible. Unless Iran downgrades its interest in nuclear power, it will be an important component of this new market. Early entry into the Iranian market by the United States would have long-term benefits for nonproliferation and commercial reasons.

Trade in U.S. Agricultural and Other Products

Iran represents a potential annual export market for U.S. agricultural produce estimated at \$2.74 billion per year. Iran's recent drought, which has lasted for four years, has increased demand beyond this amount. Even though U.S. sanctions policy was liberalized in 1999 to permit the export of food and medicine to otherwise sanctioned countries, U.S. export financing has not been made available and, in the case of pistachio nuts, tariffs of close to 300 percent were already in place. At present, a lack of U.S. export financing has hurt the competitiveness of U.S. agricultural produce because would-be competitors offer favorable export financing through programs underwritten by their governments.

Iran also presents a potential market for U.S. exports of heavy machinery and consumer goods. Iran, however, is still pursuing a macroeconomic policy of restricting imports to protect its foreign exchange reserves and deter further inflation. Consumer goods currently account for only 14 percent of imports, in contrast to capital goods, which account for 42 percent, and "intermediary" goods, which account for the remaining 44 percent.⁴³ Another factor that has to be weighed when contemplating trade in a post-sanctions environment derives from a generalized fear on the part of Iran's conservative leadership that the widespread importation of goods from the United States and other Western countries will create a cultural onslaught that will be difficult to control and might pose a threat to state-sanctioned Islamic values.

A Cautionary Note

Although Iran is attempting bureaucratic and economic reform, and is aware of the need to improve the terms under which foreign investment is made, it remains difficult to do business there. The problems encountered are significant:

- Tax laws are inconsistent and severe; there is no intellectual property protection; labor laws protect job security to a degree that they interfere with labor market flexibility.
- Government regulations are complicated and sometimes contradictory.
- The government bureaucracy is overstaffed, inefficient in its decision-making process, and characterized by a hesitancy to make commitments that might later be subject to criticism.⁴⁴

⁴³ *Iran Country Profile and Guide* (Tehran: Atieh Bahar Consulting, 2000).

⁴⁴ *Ibid.*

- The Iranian business elite do not have experience in conducting international business. Inexperience itself and feelings of insecurity that accompany it, can lead Iranian business counterparts to make unrealistic demands with respect to terms and conditions.⁴⁵
- The underlying economic system is corrupt, with centers of economic power strongly entrenched and closely connected to the clerical leadership through a network of financial and familial ties.

The Iranian government is trying to address these problems in a variety of ways. Its initial approach was to proceed on the assumption that the establishment of a rule of law was a necessary prerequisite for successful economic and bureaucratic reform. This emphasis may change, in part because of the importance of the Khatami government's own goals in the area of economic reform, but also because the Supreme Leader has instructed the government to make addressing the country's economic problems its highest priority.

Any gains to U.S. economic interests through a trading and investing relationship with Iran will be affected by the degree of success that the Iranian government enjoys in implementing the Economic Recovery Plan of August 1998, which emphasizes privatizing state-controlled sectors and promoting market competition. The current Five-Year Plan (2000–2005) reflects these goals. More than 500 firms have been identified as targets for privatization. The sectors covered include the automotive industry, shipping, railways, banking, telecommunications, transport, postal services, and the national airline.

More than 60 percent of the Iranian economy is currently controlled by the state, with another 10 to 20 percent controlled by semi-governmental religious foundations. The Iranian constitution stipulates that the economy will consist of three sectors: state, cooperative, and private. Article 44 enumerates the components of the state sector:

all large-scale and mother industries, foreign trade, major minerals, banking, insurance, power generation, dams and large-scale irrigation networks, radio and television, post, telegraph and telephone services, aviation, shipping, roads, [and] railroads.⁴⁶

The discrepancy between this constitutional provision and the privatization program has been resolved, in part, by the Council of Guardians' right to interpret the constitution and the Expediency Council's mandate to override the constitution when doing so serves the national interest.⁴⁷

U.S. economic interests will be well served if the Majlis succeeds in obtaining either Council of Guardians Council or Expediency Council approval of its August 2000 Law on the Attraction and Protection of Foreign Investment. This law supersedes a 1956 law of the same title by broadening its scope to permit foreign investment in all areas in which Iran's own private sector is allowed to invest. The new law also has provisions for repatriation of foreign company profits in hard currency, contractual choice of national law⁴⁸ for the settlement of disputes, and

⁴⁵ *Ibid.*

⁴⁶ <<http://www.iranonline.com/iran/iran-info/Government/constitution-4.html>>.

⁴⁷ It should be noted that the Expediency Council is currently headed by former president Ali Akbar Hashemi Rafsanjani who has large personal financial interests at stake.

⁴⁸ The specific contract will stipulate the nation whose law will be followed in the settlement of disputes.

compensation in the case of nationalization in an amount equal to the full value of the investment at that point in time.⁴⁹ (The value of this last guarantee to the foreign businesses concerned will be dependent on the rate of exchange that is chosen for compensation.)⁵⁰

Iran has already taken other measures to facilitate foreign investment such as establishing three free trade zones and several special economic zones. The path has not been entirely smooth, however, and there are reports that, while the attempt to create favorable conditions for foreign investment in these zones has met with some success, bureaucratic red-tape and inconsistent policies have kept many investors away.

The government has begun to discuss the advantages of enacting legislation to protect intellectual property. There is also discussion of the advantages to be gained if Iran eventually joins the WTO. Iran submitted its initial application two years ago. If it pursues membership seriously, the ensuing negotiations would provide a strong impetus for other improvements in policies relating to commerce. In addition, Iranian commercial interaction with U.S. companies would provide valuable experience for both sides. Iran would come away from the experience with more definite ideas of how international business is conducted and what needs to be done to attract foreign investment. Such lessons have broader significance as Iran frames new policies for economic reform. Iran is trying to move forward on economic reform, but it faces serious obstacles.

⁴⁹ Babak Namazi, "The New Foreign Investment Law," *IRAN FOCUS*, Menas Associates, Ludham, United Kingdom, September 2000, 8-9.

⁵⁰ If the official rate of exchange is used, the value of compensation would be negligible under current circumstances.

III. The U.S.-Iranian Relationship

The United States and Iran have had a hostile relationship for more than two decades.⁵¹ The United States severed diplomatic relations on April 7, 1980 after reaching an impasse in negotiations with Iranian officials for the release of U.S. embassy personnel who had been held hostage by student militants since November 4, 1979. These events followed the revolution in Iran that culminated in the departure of the Shah on January 16, 1979. Because the United States had been closely allied with the Shah and had, in fact, played an important role in re-establishing him as the ruler of Iran in 1953, the anger that many Iranians felt toward the Shah was matched by anger toward the United States for being his major supporter. Over the years, additional perceptions of injury have accumulated on both sides.

Images in the Minds of Americans

Post-Revolutionary Iranian Hostility toward the United States

The humiliations visited upon the U.S. diplomats held hostage in Iran and of Iranian crowds shouting anti-American slogans and burning the American flag are some of the strong visual memories of Americans who watched and read about events during the Iranian Revolution. During the period of President Khatami's efforts to move toward détente with the United States, hostile anti-American rhetoric can still be heard at official levels.

Deaths and Abductions of Americans

The United States considers Iran complicit in the Hizbollah bombings in Lebanon of the U.S. embassy and a marine barracks in 1983 and a U.S. embassy annex in 1984. Together, these bombings caused the deaths of close to 300 U.S. diplomats and soldiers. The United States also considers Iran complicit in the Hizbollah kidnappings and assassinations of U.S. citizens in Lebanon and the prolonged periods of time that lapsed before individual hostages were released.

The United States has also faulted Iran for refusing to cooperate in attempts to gain custody of several people believed involved in the bombing of the Khobar Towers facility in Saudi Arabia in 1996 in which U.S. soldiers were killed. In fact, the outgoing director of the FBI, Louis Freeh, recommended seeking U.S. indictments of alleged Iranian perpetrators, including a senior member of the IRGC and, possibly, Supreme Leader Khamenei.⁵² The allegation of Iranian involvement was described by Saudi Arabia's foreign minister, Prince Saud al-Faisal as "premature."⁵³ When the indictments were handed down, on June 21, 2001, they did not name any Iranians and instead named 13 Saudi nationals and a "John Doe" who was believed to be Lebanese.⁵⁴ Saudi interior minister Prince Nayef bin Abdel Aziz, head of the Saudi government's investigation of the Khobar Towers bombing, responded by saying that that he did not agree entirely with the picture painted in the U.S. indictment and that once the Saudi's own investigation was completed the suspects would be tried in Saudi Arabia, not

⁵¹ See the chronology of U.S. policy toward Iran in Appendix A.

⁵² See "FBI May Seek Iranian Officials in Saudi Blast," *Washington Post*, May 7, 2001, and Julian Borger, "Test for Bush as FBI Names 'Bombers,'" *Guardian*, May 9, 2001.

⁵³ Associated Press, "Saudi Arabia Criticizes U.S. Report," May 14, 2001.

⁵⁴ George Gedda, "No proof Iran behind Khobar Blast that Killed 19, U.S. officials say," *AP*, June 22, 2001.

the United States.⁵⁵ There is also evidence to suggest that *Iraq* was behind the Khobar Towers bombing, as well as the bombing of the World Trade Center in New York City and several other plans to attack U.S. facilities.⁵⁶

Issues Relating to Weapons of Mass Destruction

The United States believes that Iran is pursuing a clandestine effort to gain nuclear, biological, and chemical weapons capabilities in spite of its treaty commitments to forgo these activities. Coupled with improvements in Iran's missile delivery capabilities, these programs are perceived as threats to Israel and to Arab countries in the Persian Gulf. They are also considered threats to the security of U.S. forces deployed in the Persian Gulf and to U.S. non-proliferation policies more generally.

Issues Relating to the Middle East

Iran's enmity toward Israel, a key U.S. ally, is profound. Iran has not recognized Israel's right to exist and has supported groups like Hizbollah, made up of Shia coreligionists who were at war with Israel during its occupation of southern Lebanon. Hizbollah is also making its influence felt on behalf of Palestinians opposing the Israel during the renewed Palestinian-Israeli hostilities that began after Ariel Sharon asserted Israel should have sovereignty over an area that included the al-Aqsa mosque. Even prior to violence that erupted in the fall of 2000, during which most of the Arab world has expressed support for the Palestinians, Iran had supported Palestinian groups like HAMAS and the Palestinian Islamic Jihad that have carried out attacks inside Israel.

Iranian Violations of Human and Political Rights

Although news of President Khatami's efforts to promote a relaxation of restrictions on social behavior and promotion of political democracy and the rule of law were welcomed by the United States, there has been a concomitant negative reaction to news of political repression.⁵⁷ The closure of reform newspapers and the imprisonment of leading publishers and journalists following the victory of reformers in the February 2000 Majlis elections creates an image that is at variance with the principle of freedom of the press. The prison sentences given to the 13 Jews accused of conducting espionage for Israel in June 2000 left an impression of unfairness and religious persecution. Iran is also charged with religious persecution because of its treatment of Iranians of the Baha'i faith. The prison sentences that were given to Iranians who attended a conference in Berlin that was disrupted by anti-regime provocateurs also contributed to an image of undue harshness and political repression.

Images in the Minds of Iranians⁵⁸

U.S. Policy during the Iran-Iraq War

Iran's grievances against the United States include U.S. policy during the eight-year war (1980-88) that followed Iraq's invasion of Iran in September 1980. The United States enforced an arms

⁵⁵ Neil MacFarquhar, "Saudis Say They, Not U.S., Will Try 11 in '96 Bombing," *New York Times*, July 2, 2001.

⁵⁶ Robert C. McFarlane and Laurie Mylroie, "The Worst Terrorist Is Still in His Palace," *Los Angeles Times*, June 3, 2001. See also, Laurie Mylroie, *Study of Revenge: Saddam Hussein's Unfinished War against America* (Washington, D.C.: AEI Press, 2000).

⁵⁷ For detailed information, see *2000 Country Reports on Human Rights Practices: Iran* and *2000 Annual Report on International Religious Freedom: Iran* (Washington, D.C.: Bureau of Democracy, Human Rights, and Labor, Department of State, 2001.)

⁵⁸ Some of the Iranian perceptions are valid, others are not. They are listed here to give the Iranian perspective.

embargo against Iran while providing intelligence to Iraq. Moreover, Iran's military arsenal was diminished because U.S. arms that had been purchased by the Shah but not yet delivered were held in the United States. Many of these arms remain subsumed within the Iran-United States claims arbitration process established by the Algiers Accords that ended the hostage crisis. Other arms purchased by Iran from U.S. contractors were not delivered because of the Reagan administration's interpretation of U.S. export control regulations.

The IranAir Incident

In mid-July 1987, the United States began escorting U.S.-flagged Kuwaiti oil tankers through the Persian Gulf to protect them from possible Iranian attack during the war. The reflagging process led to incidents in which U.S. forces were brought into direct military confrontation with Iranian forces.

Then on July 3, 1988, during the so-called tanker war, the U.S.S. *Vincennes* shot down an unarmed IranAir passenger plane, killing the 300 civilians on board. Although the United States was quick to offer compensation to the families of the victims, many Iranians, including government officials, believe that the downing was deliberate. They were also troubled by the fact that the commanding officer of the *Vincennes* was later promoted, instead of being punished for his crew's misidentification of the airliner as a hostile military aircraft.

"Frozen" Iranian Assets

Iranian officials have repeatedly claimed that the United States has unfairly refused to return billions of dollars of frozen Iranian assets. The background for evaluating this allegation is complicated. On January 19, 1981, the United States and Iran signed the Algiers Accords, in which Iran made a commitment to release the U.S. diplomats held hostage since November 1979 in exchange for the release of Iranian assets that had been frozen in U.S. banks and subsidiaries as a sanction against the hostage taking. The United States also made other commitments, including not to intervene in Iranian affairs. In keeping with the Algiers Accords, the U.S. hostages were freed and the Iranian assets were released, a sum close to \$9 billion.⁵⁹

The Algiers Accords also provided for the establishment of the Iran-United States Claims Tribunal at The Hague as the venue for binding third-party arbitration of both private and government-related claims. The tribunal has been successful in resolving essentially all of the 4,000 or more claims involving private claimants and most of the smaller government-to-government claims.

Several complicated claims are still being arbitrated, notably some very large claims lodged by Iran against the United States in which Tehran is requesting compensation for prepayments that the Shah's government made for purchases of military equipment under the Foreign Military Sales program. Other large claims involve compensation for military and other equipment purchased by Iran from private contractors but denied shipment because of U.S. export control regulations. Estimates differ, but the value of the unresolved claims could be significant.

⁵⁹ Ronald J. Bettauer, "A Progress Report on Government Cases before the Iran-U.S. Claims Tribunal," *International Arbitration Report*, January 1996. At the time this article was written, Bettauer was serving as assistant legal adviser for claims issues at the Department of State.

Iranian officials repeatedly speak of the United States as deliberately and unilaterally delaying the return to Iran of sizable assets relating to the FMS program. Some Iranians have suggested that the United States and Iran engage in a public negotiation over the final dollar amount owed by the United States, basically a sequence of offers and counteroffers of lump sum amounts leading to a “political” settlement of the assets issue. The Algiers Accords are clear, however. Its Declaration Concerning the Settlement of Claims specifically covers the FMS cases by stating in Article II, Paragraph 2, “The Tribunal shall also have jurisdiction over official claims of the United States and Iran against each other arising out of contractual arrangements between them for the purchase and sale of goods and services.” Thus, when Secretary Albright pledged in her March 17, 2000, speech to work with the Iranian government in an effort to conclude a global settlement of outstanding legal claims between the two countries, she made it clear that this process would take place within the Hague Tribunal framework.

U.S. Economic Sanctions

In 1995, Iran made its first exception to a prior policy of prohibiting foreign investment in its energy sector. In doing so, it chose the U.S. company Conoco as its partner in a major energy project. Although there were economic and technical reasons for this decision, the choice of a U.S. firm over European competitors was considered by some analysts as an overture to the United States.

The Conoco contract, however, became public in a political environment in which congressional bills had already been introduced to apply sanctions against Iran as punishment for its support of terrorism and its decision to complete the construction of its first civilian nuclear reactor. The Clinton administration responded quickly. On March 15, 1995 – ten days after the first press inquiries about the contract – Executive Order 12957 was issued prohibiting *all* U.S. firms from participating in *any* activities to develop Iran’s petroleum resources.⁶⁰ Two months later, Executive Order 12959 was issued expanding sanctions to cover all U.S.-Iranian trade and investment.⁶¹

In 1996, Congress passed the Iran and Libya Sanctions Act (ILSA) which placed sanctions on any “entity” that invested more than \$20 million per year⁶² in the Iranian petroleum sector.⁶³ (Strictly speaking, this bill applies to U.S. companies as well as to the foreign companies at which it was directed.) ILSA was extraordinary in its extraterritorial reach. It provided for a secondary boycott that would punish foreign companies that invested in Iran’s petroleum sector by denying them the ability to invest in the United States.

U.S. Caspian Policy

A principal feature of U.S. Caspian policy has been to prevent the construction of pipelines that would allow landlocked Caspian oil to transit Iran in order to reach the Persian Gulf for export to markets abroad, especially to lucrative markets in East Asia. This is reflected in the statement that former Secretary of State Albright made in May 1998, when she announced that the United States had granted a waiver of ILSA sanctions for a Total-Petronas-Gazprom contract to develop

⁶⁰ <<http://envirotext.eh.doe.gov/data/eos/clinton/19950315.html>>.

⁶¹ <<http://envirotext.eh.doe.gov/data/eos/clinton/19950506.html>>.

⁶² The legislation provided for a higher threshold, \$40 million, for the first year in which the new legislation was to be in effect.

⁶³ <<http://usinfo.state.gov/regional/nea/gulfsec/irnsanc.htm>>.

Iran's South Pars gas fields. Albright also stated that future contracts involving EU countries could be expected to receive waivers under similar circumstances. Yet, Secretary Albright and other U.S. officials declared that it was U.S. policy to "draw the line at pipelines."⁶⁴

The United States has supported a proposed pipeline to transport Caspian oil and gas from Baku, Azerbaijan, to the Turkish Mediterranean port of Ceyhan. It has also promoted a Trans-Caspian undersea pipeline to transport gas from Turkmenistan and Kazakhstan to Baku for shipment to western markets via the Baku-Ceyhan lines. Although there are strong economic and logistical arguments for Caspian pipeline routes that would transit Iran, U.S. policy and intentions regarding the ILSA sanctions stand in the way.

The United States also opposes "swaps" of Caspian oil for Iranian oil, even though such swaps are expressly allowed by the 1995 executive orders. Swaps would help the landlocked Caspian countries by allowing them to exchange Caspian petroleum exports to northern Iran for exports of similar value from southern Iran. If consummated, the swaps would reduce transportation costs for each of the parties and would give the Caspian countries sea-lane access to lucrative Asian markets. Iran resents U.S. attempts to deny it the economic benefits of a Caspian pipeline or Caspian swaps and, perhaps even more important, believes that the United States is trying to stand in the way of a natural economic and geopolitical relationship between Iran and its Caspian neighbors.

Interference in Iran's Internal Affairs

The Iranian leadership believes that Congress has allocated \$20 million for covert action to overthrow the Iranian government. President Khatami cited this in his January 8, 1998 CNN interview. Foreign Minister Kharrazi repeated the allegation in his September 28, 1998 response to Albright's June 17, 1998 invitation to join with the United States in developing a road map for improved relations. Kharrazi also criticized the United States for establishing a radio station designed to "wage a propaganda campaign against the Islamic Republic."⁶⁵ In addition, Iranian officials consider the U.S. economic sanctions as interference in Iran's internal affairs.

Unacknowledged Iranian Assistance to the United States.

Iran believes that it has been shunned by the United States, even though it served U.S. interests when it facilitated the release of U.S. hostages that had been held by Hizbollah factions in Lebanon. Iran also believes that the United States should have rewarded it in some manner for choosing to remain neutral when the United States was leading the military effort to oust Iraq from Kuwait in 1991. However, it is not surprising that Iran chose not to support Iraq during the Persian Gulf War since the conflict occurred only three years after the conclusion of Iran's own 1980-88 war with Iraq. Nevertheless, Iran did not come to the aid of its Shia correligionists in Iraq when they, along with the Kurds, tried to escape Saddam Hussein's rule at a time when the United States feared that disintegration of Iraq along sectarian lines could destabilize the region. Iran believes that this restraint on its part was also helpful to the United States.

⁶⁴ Secretary of state Madeleine Albright, Statement on "Iran and Libya Sanctions Act (ILSA): Decision in the South Pars Case," May 18, 1998. <<http://secretary.state.gov/www/statements/1998/980518.html>>.

⁶⁵ The reference is to a Farsi-language broadcasting service to Iran that was established under the auspices of Radio Free Europe/Radio Liberty. The broadcasts originate in Prague, Czech Republic, and began on October 31, 1998. The legislation establishing the service received its original impetus from the Radio Free Iran Act, S. 838, draft legislation introduced by Senator Alphonse D'Amato (R-NY) in 1995. The broadcast service is commonly referred to as "Radio Free Iran" in the United States but is called "Radio Liberty" in Iran.

IV. The Iranian Context for Engagement

Political Decision-Making in Iran

When evaluating the prospect for improved U.S.-Iranian relations, it is necessary to understand the system of political decision-making in Iran. Policy toward the United States is formulated within an elaborate system of constitutionally mandated arrangements that give primacy to the Supreme Leader and the institutions that he controls, while providing room for the expression of popular opinion through a democratically elected president and parliament, or Majlis.

The attitudes toward the United States held by the current Supreme Leader and his supporters differ markedly from those of President Khatami, the Majlis that was elected in February 2000, and the people who put them in office. Consequently, it is difficult to conceive of a near-term cohesive political leadership in Iran that would be willing *and* able to make the kinds of foreign policy decisions that will lead to a rapprochement with the United States.

The constitutional arrangements of Iran's political institutions are unfamiliar to most Western observers. First, there is the theocratic aspect. In order to appreciate the role accorded to the Supreme Leader, westerners would have to reach back in their own history to the period in which the pope was the supreme authority for religious and political matters in the Papal States.

The Iranian constitution enshrines the concept of the *velayat-e faqih* which gives the Supreme Leader absolute authority over the laws and policies of the state. This "guardianship of the juriconsult" cannot be questioned without reprisal, and the coercive powers of the state are at hand to provide an effective enforcement mechanism. According to some interpretations, the authority of the Supreme Leader is divinely mandated and thus unquestionable. Although there are democratic aspects of the Iranian system, and post-revolutionary Iran is described by Iranians as an Islamic republic, one should not lose sight of the authoritarian power that the constitution grants to the Supreme Leader.

The position of *velayat-e faqih*, or "ruling jurisprudent," is granted for life, unless its occupant has proved himself to be unworthy of the responsibilities accorded him. It has been held thus far by only two people: Ayatollah Ruhollah Khomeini, from the beginning of the Islamic Republic in 1979 until his death in 1988, and Ayatollah Ali Khamenei since then. Ayatollah Khamenei has played a more active role with respect to day-to-day policies, while many in Iran's clerical establishment still question whether he has sufficient religious credentials to merit his selection as the *faqih* in the first place.

The Supreme Leader is chosen by the Assembly of Experts, a group of 86 men elected to eight-year terms of office from a preselected group of candidates considered expert in Islamic learning. Because the Assembly of Experts is popularly elected, and because it has the ability to remove the Supreme Leader if he is unable to fulfill his duties or shows himself lacking in the personal qualities necessary for *velayat-e faqih*, it could be argued that even the Supreme Leader operates under an indirect system of popular control. The circular nature of political selection embedded in Iran's constitution, however, means that this is not really the case:

- Candidates for election to the Assembly of Experts are vetted by the Council of Guardians.

- The Council of Guardians consists of 12 members, 6 of whom are clerics chosen by the Supreme Leader, and 6 of whom are lay jurists elected by the Majlis.
- The members of the Council of Guardians elected by the Majlis are chosen from a list of candidates who have been chosen by the head of the judiciary.
- The head of the judiciary is appointed by the Supreme Leader.

The most recent election for the Assembly of Experts was held on October 23, 1998, after the Council of Guardians eliminated most of the candidates representing moderate and Islamic-left points of view.

In addition to strongly buttressing the independent power of the Supreme Leader, the constitution explicitly grants him control over Iran's armed forces and the judicial system. The Supreme Leader has the power to appoint the chief of staff of the armed forces, the commander of the regular military, and the commander of the Islamic Revolutionary Guard Corps (IRGC). He appoints the head of the judiciary, as noted, as well as the commander of the law enforcement forces. He also appoints the head of Iran's state radio and television networks, thereby controlling an important instrument for shaping public opinion. The Supreme Leader controls the security organs of the state, has the power to mobilize the armed forces, and is independent in his authority to declare war and peace.

The president and Majlis operate within the confines of this system. The Supreme Leader establishes foreign and domestic policies, which are implemented by the president in coordination with the Majlis. The president appoints cabinet ministers, with the approval of the Majlis, which also has the power to impeach cabinet ministers for malfeasance in office. The president chairs cabinet meetings and meetings of Iran's National Security Council, and, although the constitution gives the Supreme Leader the power to remove the president, it does not give him – or anyone else – the power to dissolve the Majlis.

There are several instances of deliberately constructed *parallel systems of authority*. Thus, there are regular courts and revolutionary courts; a regular army and the revolutionary guard, all of which are under the ultimate control of the Supreme Leader because of his constitutionally defined authority over the judiciary and the military. The Ministries of Foreign Affairs, Defense, and Intelligence and Security report to the president and are overseen by the Majlis, but, these are implementing agencies and subject to a parallel but superior exercise of authority by the Supreme Leader. Thus, for example, following the July 2000 withdrawal of Israeli forces from southern Lebanon, Foreign Minister Kharrazi was dispatched to consult with Hizbollah leaders and various Lebanese officials. At the same time, the more conservative former foreign minister Ali Akbar Velayati made a similar tour of the region in his capacity as the Supreme Leader's emissary. Also while the Majlis has the power to approve international agreements, the content of these agreements are determined by the Supreme Leader if and when he exercises his authority to do so.

There are other constraints as well. The president and the Majlis are elected at four-year intervals, but the conservative and only partially elected Council of Guardians has the power to vet the candidates for election and to rule on the validity of the results. These powers represent a generous interpretation of the provision in the constitution that grants the Council of Guardians

authority to “supervise” elections. When the Council of Guardians permitted Khatami to run for president in 1997, they deliberately allowed him to do so as a relatively liberal candidate, not expecting him to win. They certainly had no expectation that he would win close to 70 percent of the vote in an election marked by an especially high turnout. In February 2000, when reform candidates were elected to roughly 70 percent of the seats in the Majlis that were won outright during the first round of the elections, the Council of Guardians nullified the results in several districts and disqualified one-third of the votes cast in Tehran (a city large enough to have been allotted 30 seats). It was even unclear whether the council would allow the representatives to be seated as scheduled until Supreme Leader Khamenei stepped in and ordered the council to validate the results of the election as they stood at that moment.

In mid-August 2000, the chairman of the Council of Guardians, Ayatollah Ahmad Jannati, asserted that the powers of the council include the ability to remove members of the Majlis if they say things that imply that they do not submit to the absolute rule of the Supreme Leader. The rationale for this position was that the members of the Majlis are elected to serve Islam; therefore, if any of them make statements or propose bills that are “contrary to Islam,” they can no longer represent the people. A similar idea was presented in a conservative weekly *Jebheh*. There it was proposed that a Parliamentary Court be established under the control of the Council of Guardians. If a parliamentarian acted “inappropriately,” the court could remove him.

During the first two years of President Khatami’s term of office, his attempts to liberalize Iran by strengthening the rule of law and reducing various social restrictions were blocked by a Majlis in which conservatives held a comfortable majority. Khatami’s primary sources of strength proved to be a vigorous reform-minded press and, of course, the people who elected him. Before leaving office, the conservative Majlis passed laws designed to block reform. Among these was a restrictive press law that facilitated the subsequent closure of pro-reform newspapers and the incarceration of their publishers and journalists.

The likelihood that Khatami and the new reform-minded Majlis could have been effective in countering conservative attempts to block the implementation of their agenda must be evaluated with an understanding of the constitutionally mandated constraints that they faced. When the Iranian Majlis passes legislation, the laws cannot be implemented unless the Council of Guardians determines that they conform to the constitution and Islamic jurisprudence. If, as is often the case, the Council of Guardians fails to approve laws passed by the Majlis, the issues at conflict are resolved by the thirty-five-member Expediency Council. This body was established by Ayatollah Khomeini in February 1988, shortly before his death, and was designed to overcome legislative gridlock. Later, its role was incorporated into the revised constitution of July 1989.

The formal name for the Expediency Council is the Council for Assessing the Interests of the System. As its name implies, it is empowered to override both the constitution as well as its underpinning of Islamic law, if either step is necessary to preserve the interests of the Islamic state. It also advises the Supreme Leader with respect to the general guidelines that he establishes for the Islamic Republic.

Although it can function as a vehicle for introducing pragmatism into political decision making, the Expediency Council represents another locus of power that dilutes the impact of the

popularly elected Majlis. The council can introduce its own legislation and it has a committee structure that parallels the committees that the Majlis uses to draft legislation and oversee the functioning of government ministries. Yet it is an unelected body: its members are appointed by the Supreme Leader.

A mitigating aspect of the composition of the Expediency Council is that it includes the president and the speaker of the Majlis, along with a handful of key government officials like the minister of petroleum and the head of the central bank. Several former officials are also included, but, because of the appointive power wielded by the Supreme Leader, there is currently an overrepresentation of people who can be classified as members of the “traditional right,” who are opposed to domestic liberalization and to reconciliation with the United States.

The Expediency Council is chaired by former speaker and president Hashemi Rafsanjani, who has held considerable political power in the past and still wields power behind the scenes, including the ability to influence the policies of the Supreme Leader (in competition with President Khatami and other powerful political figures). It is important to note, however, that Rafsanjani’s political popularity was severely diminished by attacks from the reformist press during the campaign preceding the February 2000 parliamentary elections. In fact, instead of once again becoming Speaker of the Majlis, as many analysts had predicted, Rafsanjani barely won a seat from Tehran; he ranked twenty-ninth out of thirty candidates. During the campaign, the reform press alleged corrupt practices in his various business dealings and criticized the policies he pursued during his presidency including Iran’s prosecution of the Iran-Iraq War. Some investigative journalists even published reports strongly hinting that Rafsanjani was the power behind a notorious series of murders of dissident intellectuals in November 1998. These journalists are now in jail, and virtually all of the reform newspapers have been closed. Although the first order of business of the reform Majlis was supposed to be a revision of the press law that would facilitate a reopening of reform newspapers and the release of their officials from jail, Khamenei intervened to prevent draft legislation from moving forward.

The reform newspapers remained closed during the lead up to the June 8, 2001 presidential election. This maneuver by the conservatives deprived Khatami’s supporters of an important channel of communication with the electorate, while the state-controlled radio and television networks continued to support the conservative cause. Early in May 2001, police in Tehran shut down several hundred Internet cafes.⁶⁶ Nevertheless, Khatami again won an impressive victory when the elections took place.

Potential for Change in Iranian Policy

The situation described above is the context in which one must operate when assessing the likelihood that President Khatami will be able to implement reform programs, albeit gradually, and the prospects for a near-term Iranian rapprochement with the United States. One way of approaching these issues is to ask what would have to happen – operationally – before obstacles to reform and rapprochement can be overcome?

⁶⁶ Guy Dinmore, “Iran Shuts Internet Cafés,” *Financial Times*, May 14, 2001.

Gradual Reform within the System

Although there are formidable barriers to change, President Khatami is committed to a program to reform the Iranian system from within. He seeks to accomplish his goals primarily through the work of cabinet ministers, current government programs, and new legislation. His primary goals are to guarantee freedom of expression, ease social restrictions, and promote the development of a civil society governed by the rule of law. In addition, Khatami ultimately wants to establish a system of accountability for key institutions now under the control of the Supreme Leader. These include the intelligence services, the IRGC, and the economically powerful religious foundations or *bonyads*. This is a much more difficult undertaking.

At first, Khatami was able to register only limited success, largely because he had to work with a Majlis dominated by conservatives. With the dramatic support for reform candidates registered in the February 2000 elections, it was thought that Khatami would have an opportunity to fulfill his agenda through presidential-parliamentary cooperation. The Council of Guardians, however, has used its veto authority to block reform legislation. Although the views of the Expediency Council prevail if the Majlis and the Council of Guardians cannot resolve their differences over specific legislative proposals, the Expediency Council is firmly in the conservative camp. Meanwhile, Supreme Leader Khamenei exercises his authority to block legislation and prevent it from being discussed as he did on August 6, 2000, when he blocked consideration of draft parliamentary legislation promoting freedom of the press.

Several reform-minded politicians close to President Khatami have been jailed or removed from office. In the face of such pressures, Khatami has asserted publicly that he lacks the authority to perform his constitutionally mandated duty to implement the constitution's democratic provisions.⁶⁷ In fact, Khatami delayed announcing his intention to contest the June 8, 2001 presidential elections for so long that many observers believed he would rather step down than accept the limitations being dictated by the conservatives. Others believed, optimistically, that a decision by Khatami to run again would signal that he had reached an agreement with Supreme Leader Khamenei that would allow him more latitude to pursue reforms.

Many Iranians believe that in spite of the divinely sanctioned absolute power accorded the Supreme Leader in the Constitution, the tradition of Islam requires popular will to be taken into account when the Supreme Leader makes decisions. This is a theme Khatami stresses. For him the Islamic Republic is based on Islamic values and principles, but it is also based on "the people's determination, will, presence and participation." Khatami has pointed out that "even during the era of the infallible ones . . . the people exercised their supervisory role."⁶⁸

There are practical constraints that prevent the Supreme Leader from veering too far from predominant public sentiment. Although he has considerable coercive power to keep the expression of public opinion in check, he has to take into account the possibility that his policies might provoke widespread, violent reactions that would be difficult to control. Such a situation not only has the potential of destabilizing the Iranian state, but it would also tarnish the positive image of an Islamic republic that Iran seeks to present as a model for Muslims worldwide.

⁶⁷ Islamic Republic News Agency (IRNA), "President's Claim to Lack Sufficient Power Leads Iran into Crisis," December 7, 2000. Also see Gary Sick, "Iran's Elections," *Middle East Economic Survey*, May 14, 2001.

⁶⁸ Speech on June 3, 2000, on the anniversary of Ayatollah Khomeini's death.

Another possibility, though probably not a realistic one, is that the Supreme Leader will bow to public opinion, perhaps now that the June 2001 presidential election has validated President Khatami's reform program. Coming after the election of President Khatami in 1997, the local council elections in February 1999, and the parliamentary elections in February 2000, this marks the fourth time in just four years that the electorate provided a clear mandate for reform.

The reformers' arguments for popular will has a bearing on the prospect for future relations with the United States. During the first flush of their victory in the February 2000 elections, some newly elected parliamentary reformers suggested that there be a referendum on whether to reestablish U.S.-Iranian relations. This idea was taken up in the reformist press before it was closed down. In one proposal Iranians would be asked to vote to approve "talking to" the United States (with the expectation that a majority would approve) and then in a second referendum six months to a year later, the people would be asked whether they wanted to establish diplomatic relations with the United States or whether they only wanted to pursue economic relations. If implemented, such a scenario would provide the Supreme Leader with a face-saving way to change policy toward the United States. He could justify doing so, because it is the will of the people.

Near-term prospects for implementing such a plan are unfavorable. The reform newspapers are closed, and the early optimism of members of the Majlis committed to reform was diminished by the subsequent strength of the conservative backlash. Moreover, as already noted, Supreme Leader Khamenei stated on July 27, 2000 that "under current circumstances, any word on rapprochement or negotiations with the United States is an insult and treason to the Iranian people."

Even the idea that Track II people-to-people exchanges between Iranians and Americans could eventually lead to improved government relations is in jeopardy. Khamenei and many of his conservative supporters are fearful of an onslaught of "decadent" Western cultural values and "subversive" Western political ideas, and they maintain that the reform movement is being manipulated by enemies of Iran's Islamic system.

Khamenei has accused the United States of trying to introduce its political values into the Iranian reform movement in the hope of causing the downfall of the regime. In doing so, he drew an analogy between President Khatami's Iran and the demise of the Soviet Union in the aftermath of the Gorbachev reforms, an event that he attributes to Gorbachev's importation of American political concepts. Although Khatami's plans for reform are much more moderate than Gorbachev's program, the conservative leadership fears that they will lead Iran down a slippery slope to a basic change in its system of government.

More Ambitious Proposals for Reform

Various proposals have been made to eliminate institutions like the clerical courts and the revolutionary courts using the argument that they are not specifically provided for in the constitution. If successful, their elimination would deprive the conservatives of important sources of coercive power. There are also proposals that would avail themselves of mechanisms available for rolling back certain interpretations of the constitution. A primary example would be to deprive the Council of Guardians of its power to vet candidates for elections and to validate election results. The Majlis could pass a law asserting that these prerogatives are not justified by

the constitutional provision that gives the Council of Guardians the right to supervise elections. The Council of Guardians would be expected to block implementation of such a law, but the Expediency Council could overrule its decision. Another mechanism would be to draw on the power of the Expediency Council to suspend constitutional provisions by invoking the higher necessity of preserving the Islamic system.

The most far-reaching proposals for reform would require basic changes in the Iranian constitution. For example, there are proposals that would subject the Supreme Leader to popular control, either directly or indirectly through the Assembly of Experts. The most radical change would redefine the office of the Supreme Leader by providing for term limits and election by direct popular vote or by narrowing his authority to ruling over Islamic practices. Another approach would be to build upon the current relationship between the Supreme Leader and the nominally popularly elected Assembly of Experts. The election of the Assembly of Experts would be made more democratic, after which it would be granted explicit power to supervise the Supreme Leader.

The current system in Iran is not tolerant of these views. Prominent people have been jailed, placed under house arrest, or subjected to physical harassment and attempted murder for making such suggestions. In addition to the coercive force that the current regime has at its disposal, there is another barrier to far-reaching change. The constitution can only be revised by a decree issued by the Supreme Leader after consultation with the Expediency Council. Then a Council for the Revision of the Constitution is assembled, but its conclusions have to be ratified by the Supreme Leader. Only then are the proposed revisions put forward in a national referendum that must register a majority vote before the constitution can actually be changed.

Prospects for Violent Confrontation

Analysts of popular revolts have pointed out that unrest tends to break out not when conditions are at their lowest but when rising expectations have been frustrated. President Khatami has been in office for four years, and at the moment when it was expected that a reform-minded Majlis could help him fulfill his promises, the conservatives clamped down on the reform process. At this juncture, attention is being paid to the reaction of Iran's students, and it is unclear whether they will contain their anger and follow Khatami's repeated exhortations to be patient.

Iran has a disproportionately young population, largely because it encouraged high birth rates during the period immediately following the revolution. Iran's young people are generally well-educated and highly politicized. Many are strong supporters of President Khatami's reform policies, especially in the social sphere. Iran's university students tend to be even more ambitious than President Khatami in their aspirations for reform, and many are outspokenly critical of the policies followed by Supreme Leader Khamenei and of the concept of *velayat-e faqih*, more generally.

In addition to silencing prominent critics and reform newspapers, the conservative forces have used coercive methods to discourage student groups from criticizing the regime instituted by the Supreme Leader. Radical Islamic vigilante groups like the Ansar-e Hezbollah have been known to provoke violent confrontations with the students in order to create situations in which the students can be suppressed by the regime's police forces in the name of preserving public order.

The most notable encounter occurred on July 8, 1999 when members of Ansar-e Hezbollah and units of the government's law enforcement forces stormed a dormitory at Tehran University in reprisal for student demonstrations against the government closing *Salam*, a reform newspaper. One student was killed, many were wounded, and hundreds were arrested. Some of the student leaders were threatened with execution and remain in jail. Demonstrations immediately spread to campuses in other major Iranian cities, with similar results. There were violent incidents during the July 2000 commemoration on the anniversary of the July 1999 events, even though the students made an attempt to avoid behavior that could be viewed as provocative.

The possibility that events in Iran might take an ugly turn is increased by the Supreme Leader taking steps to strengthen the Basij, the paramilitary group of young men with strong religious loyalties to the Supreme Leader who are recruited during their teenage years largely from rural and poverty-stricken urban areas. The Basij supplement the IRGC and the law enforcement forces and have been given a leading role in plans for the suppression of potential domestic unrest because they are thought to be a much more reliable instrument for protecting the regime than either the IRGC or the regular military. Even the IRGC is reported to include a significant number of reform sympathizers, and the regular military forces are similarly affected. It is unlikely, however, that the IRGC as an institution would support the reformists.

The power struggle between reformers and conservatives grew in intensity during the period leading up to the June 8, 2001 presidential election. Ordinary people joined student demonstrations and a handful of riots broke out in various parts of the country, some for political reasons and others for economic reasons. President Khatami has urged his supporters to be calm and to avoid behavior that might invite retaliation, but many observers believe that if the strongly held expectations of the supporters of reform are consistently thwarted by the Supreme Leader and his conservative allies, the potential for violence will remain high.

The Role of Economic Stress

Although oil prices are high and the Iranian government is paying down part of its international debt, the current power struggle in Iran occurs in conditions of increasing economic deprivation for a large proportion of the population. Inflation and unemployment are severe amid perceptions of considerable corruption among the ruling clerical elite.

Much of the economy operates under state control. The religious foundations are part of the power structure controlled by the Supreme Leader and they, in turn, control significant parts of the economy. The foundations' relationship with the Supreme Leader enables them to enjoy special economic privileges and to operate beyond the control of the president and the Majlis. Attempts are being made to bring the religious foundations under the control of the political system, at least to the extent of their being taxed, but it is unclear whether compliance can be achieved.

All this is taking place in a situation in which the economy is structurally incapable of generating enough jobs to employ the ever-growing number of young Iranians. It is estimated, for example, that the economy will have to generate 800,000 additional jobs per year to accommodate new entrants into the job market. This is approximately 450,000 jobs beyond the economy's current job-creating capacity. The oil and gas sector, by its very nature, does not require large numbers of workers, and Iran has been relatively unsuccessful in attracting investment in sectors that

would generate more employment. It has been especially unsuccessful in creating employment opportunities for its growing number of university graduates. As Iran's press ruefully reports, one of Iran's most significant exports consists of the departure to other countries of many of its highly trained physicians, engineers, and computer scientists.

The stress on Iran's economy is being exacerbated by a severe drought that has lasted for four years and is estimated to have already affected 37 million of the 65 million people in Iran. Vast quantities of crops and livestock have been destroyed and the United Nations Office for the Coordination of Humanitarian Affairs estimates that as much as 60 percent of the rural population may be forced to migrate to cities that are also suffering from the drought and are ill-equipped to absorb them. Humanitarian disasters have been known to spark political unrest, especially in situations in which the government is already deemed to be unresponsive to other public demands.

Many of the poor who voted for President Khatami in 1997 did so with the expectation that their standard of living would improve under his leadership. These expectations have been disappointed. When the voting pattern of people in poverty-stricken areas is analyzed and the elections of May 1997 and February 2000 are compared, a 7 percent loss of support for the reformers is evident.

The Government Program for Economic Reform

President Khatami's government has been attempting to address Iran's economic problems with ambitious plans for macroeconomic restructuring that include the privatization of many state enterprises and various other measures that would introduce greater competition into the system. There are proposals for creating financial markets and for allowing greater flexibility in the state banking system, even to the point of introducing private banks. The Khatami government is keenly aware of the need to address the problems of current and future unemployment, but this in turn involves the arduous process of increasing domestic investment in productive enterprises and attracting much higher levels of foreign investment. There are also proposals for tax reform, targeted against widespread tax evasion, and for administrative reforms that would rationalize and reduce existing regulations. Some of these proposals have already been opposed by the Council of Guardians on the ground that they violate the constitution. Also, implementation of the proposals would threaten significant vested economic interests that currently enjoy the protection of the conservatives.

The vehicle for introducing many of the economic reforms proposed by Khatami's government is its third Five-Year Plan (2000-2005). In addition to the reforms already described, the plan sets targets of 8.5 percent annual growth of private investment, 7.2 percent annual growth of overall investment, and 6 percent annual growth in GDP.

Khatami must try to implement his economic reforms in a situation in which many sectors of the Iranian population are already suffering economic distress. His task will be made more difficult by the fact that the introduction of greater competition into the system will require the elimination of many subsidies that are superfluous for the rich but of extreme importance to the poor. In addition, efficiencies undertaken after the privatization of state companies will entail job cut-backs, which will add to the already severe unemployment problem.

The approach Khatami's is taking is two-fold: first, to direct subsidies only to those who really need them, and second, to compensate low-income people who will be hurt when market mechanisms destroy artificially low prices for basic goods and services. This will require balancing, efficient implementation, and the cooperation of the Council of Guardians and the Expediency Council because the constitution stipulates government provision of the basic necessities for all citizens and public ownership and government administration of all large-scale industries.

Taken in its totality, President Khatami's program for economic reform has the potential of significantly diminishing the currently privileged sectors of Iran's economy that control its "commanding heights." These groups provide much of the political support enjoyed by the conservative forces in Iran. Therefore, when they oppose the reformers for insufficient loyalty to Islam or the doctrine of *velayat-e faqih*, they are also protecting their own significant economic interests.

Implications for U.S. Policy

Given Iran's current political environment, it is difficult to conceive of it government engaging in a mutual exercise of formulating a road map for improved U.S.-Iranian relations. Power struggles and the specter of coercive reprisals make it unlikely that Iranian government officials can select and implement parallel reciprocal steps toward rapprochement without being undercut by their conservative opponents.

It is important to remember that opposition to the United States was a key characteristic of Iran's 1979 revolutionaries. Some have changed their attitudes, including a few leaders of the embassy hostage-taking episode, but Supreme Leader Khamenei and many of his conservative supporters in institutions like the IRGC are still virulently hostile toward the United States. These are the people who hold the levers of power in foreign policy.

Under these circumstances, it is unwise to link conciliatory U.S. policies to Iranian progress toward democracy.⁶⁹ Secretary Albright announced in her March 17, 2000 speech that U.S. sanctions would be lifted for Iranian carpets, caviar, and pistachio nuts as a "response to the broader perspective merited by the democratic trends in that country." She went on to express the hope that "as Iranians grow more free, they will express their freedom through actions in support of international law and on behalf of stability and peace," thereby implying that further sanctions could be lifted as Iran progresses toward democracy. The democratic trends that Albright referenced can only refer to the repeated expression by the Iranian electorate of a *desire* for greater democracy in the Iranian political system, not the attainment of democracy itself. President Khatami's 1999 introduction of a process for electing local councils is indeed

⁶⁹ This has changed somewhat under the George W. Bush administration. During his confirmation hearings, Secretary of State-designate Colin Powell spoke of the importance of the United States giving "encouragement to the *people* of Iran." Secretary Powell noted that President Khatami was elected to office because "the people of Iran were expecting a little more moderation, a little more openness in their lives." He added that while U.S. policies should take account of the serious difficulties the United States has with Iranian policies, *we should [also] let the people of Iran know that we are trying to make life better for them.* This would serve U.S. interests and interests in the region. Interchange between Powell and Senator Hagel (R-NE), January 17, 2000.

significant, but the holding of elections in Iran does not represent a new trend. Presidential and parliamentary elections have been held regularly since 1979.

There are numerous authoritarian aspects of the Iranian system of government that circumscribe the ability of democratically elected officials to influence foreign and domestic policies. If, for example, it should happen that the reformers in Iran are able to frame and implement legislation that would advance prospects for freedom of the press, unfettered expression of political opinions, and the right of individuals to have legal representation and enjoy due process during court proceedings, the United States would welcome these developments. With the recent conservative backlash, however, it could take years for further democratic measures to be implemented. The United States might therefore be unwise to hold its policies toward Iran hostage to the uncertain process of further, near-term progress toward democracy.

In addition, the U.S. practice of putting financial pressure on Iran to achieve specific changes in Iranian foreign policies should be examined with long-term U.S. strategic interests in mind. From a long-term perspective, it would seem that many important U.S. interests would be served by the existence of a democratic and politically stable Iran that is capable of operating effectively in a geopolitical environment that is inevitably created by its size and geographic location. It is less likely that democratic reforms will progress and political stability will be maintained if Iran is simultaneously in a state of economic crisis.

Solving Iran's economic problems will take time and an ability on the part of the Iranians to effect substantial changes in policy. In this context, a U.S. policy that seeks to exacerbate Iran's economic problems by imposing economic sanctions and by seeking to deny Iran the ability to roll over its debts and to obtain loans and export credits from other countries seems short-sighted and counterproductive.

V. The U.S. Context for Engagement

Executive and Legislative Roles

The 1979 revolution in Iran took place at a time when relations were changing between Congress and the executive branch concerning the formulation of foreign policy. Controversy over the prosecution of the Vietnam war had led Congress to pass the War Powers Act in 1973, and the tendency to defer to the president in the making of foreign policy increasingly eroded. Moreover, Congress and the executive branch no longer shared a mutual pride in acting in a “spirit of bipartisanship” that would allow the United States to speak with one voice in foreign affairs.

Congressional activism increased during the next twenty years at a time when, significantly, the United States did not have diplomatic relations with Iran. In part, this meant that Members of Congress had no alternative sources of information about Iran when being briefed by various interest groups and executive branch representatives. Meanwhile, Congress began to play a larger role in foreign policy making and to weigh in on a variety of issues, drafting legislation and taking seriously its oversight role with respect to the executive branch.

The powers accorded to Congress and the executive branch in the Constitution have been described as “an invitation to struggle for the privilege of directing American foreign policy.” This proved true following the 1994 congressional elections, when the Clinton presidency faced a Republican majority in the House of Representatives and the Senate. There was a significant turnover in the House and many of the new members had little experience in international affairs. At the same time, Congress became more activist with respect to Iran. Many of the U.S. policies that Iran finds most troublesome can be traced to the Congress that took office in January 1995.⁷⁰

The most important difference between members of Congress and the principal foreign policy decision makers in the executive branch is that the latter do not have the luxury of being able to focus narrowly on single issues. Instead, they must act with a *global* perspective that includes a whole array of *cross-cutting* U.S. foreign policy interests. The executive branch is responsible for implementing U.S. foreign policy and must often navigate its way through diplomatic waves caused by legislation enacted by Congress. The passage of ILSA is a case in point. Although it satisfied a congressional desire to strengthen the U.S. containment policy toward Iran, the Department of State and Treasury had to deal with its negative effects on political and economic relations between the United States and its European allies.

The Lautenberg Amendment to the Anti-Terrorism and Effective Death Penalty Act of 1996 is another example. By legislating away the sovereign immunity of Terrorism List states, it allowed plaintiffs to sue them in U.S. courts and to attach their assets to satisfy court awards. This set a dangerous precedent in international law, which, if followed by other countries, would subject the assets of the U.S. government to attachment when judgments are rendered against the United States in the national courts of other countries.

⁷⁰ See Appendix A for a detailed account of the evolution of U.S. policies toward Iran from November 1979 to the present.

In a more recent example, the Justice for Victims of Terrorism bill, as originally introduced, was described by its sponsor in the House of Representatives as serving the purpose of “sending a strong message to terrorists and their state sponsors that they cannot get away with murder.”⁷¹ The Department of State, however, would have the task of dealing with the negative impact that passage of such a bill would have on the workings of the Hague Tribunal process and on prospects for future normalization of U.S.-Iranian trade. The Department of the Treasury would have to deal with the fact that the legislation, as originally drafted,⁷² would have overridden its authority to block foreign assets in furtherance of U.S. national security and foreign policy interests, an authority that is now specifically protected in the International Economic Emergency Powers Act (IEEPA).

It is worth pointing out that Congress has the ability to initiate a sequence of interactions between itself and the executive branch that, in turn, serves to reinforce the implementation of specific policies. This process is clearly illustrated by the initiation and later use of the Terrorism List. The impetus for maintaining such a list came from Congress and pre-dated the Iranian Revolution. During the late 1970s some members of Congress became concerned that the Carter Administration was being too lax in its application of export controls on dual-use items destined for Libya and Syria (and, later, Iraq). Following incorporation of the Fenwick Amendment as Section 6(j) of the Export Administration Act of 1979, the secretary of state was required to establish a list of countries that have “repeatedly provided support for international terrorism.”

Later, legislation required the Department of State to provide Congress with a “full and complete annual report on terrorism,” which included, among other things, detailed assessments of the previous year’s record for those countries designated as repeatedly providing support for terrorism, i.e., the countries on the Terrorism List in accordance with Section 6(j) of the Export Administration Act. Iran became subject to this requirement when it was placed on the list in 1984. The degree of its support of international terrorism has been reported annually ever since.

On October 21, 1998, Congress used a major appropriations bill (PL 105-277) to mandate the establishment of the National Commission on Terrorism.⁷³ The Commission issued its report in June 2000. Its primary conclusion with respect to Iran was that:

“Iran’s support for terrorism conducted against American interests remains a serious national security concern. U.S. efforts to signal support for political reform in Iran could be misinterpreted in Iran or by U.S. allies as signaling a weakening resolve on counterterrorism.”

The commission’s citation for this assessment was the information about Iran that had been provided in the Department of State’s *Patterns of Global Terrorism 1999*.

The following month, the cycle returned to the congressional arena when Sens. Schumer and Brownback, and Rep. Brad Sherman (D-CA) cited the National Commission on Terrorism’s

⁷¹“Victims of Terrorism Press Congress to Help Them Collect,” *Wall Street Journal*, April 13, 2000.

⁷² The legislation was passed in an altered form after considerable negotiation with the administration. The specific terms of the legislation, as passed, are described below.

⁷³ *Countering the Changing Threat of International Terrorism*. Report of the National Commission on Terrorism (The Bremer Report), <<http://w3.access.gpo.gov/nct.html>>.

finding that Iran remains the most active state supporter of terrorism when they introduced legislation to “immediately end the United States importation of Iranian goods.”⁷⁴

How Could U.S. Policies Change?

Congress and the executive branch have important roles to play in any changes in U.S. policy toward Iran. This section of the report distinguishes the roles of each branch with respect to the full range of initiatives that may be considered in changing relations with Iran. The question is *What latitude does each branch possess with respect to modifying current policy?* In general, a more effective U. S. strategy toward Iran would

- remove obstacles that do not serve U.S. short- and long-term interests;
- take unilateral steps to remove unnecessary irritants in the U.S.-Iranian relationship;
- move – in a *reciprocal* manner – to address outstanding issues, assuming that there proves to be a desire for improved U.S.-Iranian relations in *both* countries.

Although some unilateral steps will be appropriate at the outset, especially when they are clearly in the U.S. national interest, and while modest initial unilateral steps should be taken to unfreeze the relationship by removing unnecessary irritants, further steps will need to be associated with reciprocity on the part of Iran. The following section presents *an array of steps* that can be taken separately by the executive branch and by Congress.

Potential Executive Branch Initiatives

A process of adapting U.S. policy toward Iran to existing international conditions and long-term U.S. geopolitical interests can be initiated much more easily by the executive branch than by Congress. Should the United States want to move beyond the current stalemate, the following are key steps that could be taken:

1. Removal of the Fingerprinting Requirement for Visiting Iranians⁷⁵

The regulation requiring the fingerprinting and photographing of all Iranian visitors, offends Iranians and is a clumsy instrument for achieving the purpose it is designed to serve. Waivers can be sought for individual high-profile cases, but fingerprinting nevertheless constitutes an impediment to achieving positive benefits from the Track II non-governmental, people-to-people exchanges that the U.S. government otherwise endorses. Iran has threatened to demonstrate the offensiveness of the practice by fingerprinting incoming U.S. visitors.

Because the procedure is a discretionary regulation, carried out by the Immigration and Naturalization Service at the direction of the attorney general, the president has the power to direct that the practice be halted. He can back up such a decision by pointing out that even the Department of State’s *Patterns of Global Terrorism* does not allege that Iran is targeting U.S. citizens and assets. Moreover, the FBI and the INS have other, much less intrusive, measures for screening applicants for visas and checking visitors against their data bases of known or suspected terrorists.

⁷⁴ S. 2947 and H.R. 5006. 106th Cong., 2nd Sess., July 27, 2000. Neither bill was reported out of committee.

⁷⁵ Federal Register: September 5, 1996 (Volume 61, Number 173).

2. Granting Permission for “Executory” Contracts

Licensing policy pursuant to the 1995 and 1997⁷⁶ executive orders banning U.S. trade and investment in Iran could be modified to permit U.S. companies to negotiate and sign contracts that could be executed once the embargo is lifted. To support this process, the firms could be allowed to obtain licenses to open offices in Iran, hire staff, write and design plans, and carry out preliminary studies and engineering and technical surveys.

There is precedent for doing this. On December 14, 1992, the Bush administration permitted such activities in Vietnam, although there was a complete trade embargo at the time. The contracts became enforceable when the embargo was lifted in February 1994. A step like this would benefit U.S. businesses that want to invest in the Iranian oil and gas sectors. These firms are rapidly falling behind their European and Asian competitors. Although ILSA is still on the books, companies from Australia, Canada, China, France, India, Italy, Malaysia, Norway, Russia, Spain, and the United Kingdom are conducting exploratory studies and signing contracts in Iran. The United States has not granted waivers for these contracts. As it did before the first – and only – ILSA waiver was granted for Total-Petronas-Gazprom in May 1998, the U.S. government is engaged in a deliberately time-consuming process of studying each deal before reaching a waiver decision.

During the relatively short period during which Iran has welcomed foreign investment, its energy sector has received \$10 billion from investment contracts. Iran’s Deputy Oil Minister Seyyed Mehdi Hoseyni is reportedly anticipating another \$8 billion in contracts will be finalized soon.⁷⁷ Of the 43 buy-back contracts currently on tender, 10 have been formalized and many others are in advanced stages of negotiation. U.S. energy firms continue to be penalized unfairly in the name of foreign policy objectives that U.S. unilateral sanctions have been unable to deliver.

U.S. engineering and construction firms are also losing out to their European, Japanese, and South Korean competitors. In addition to immediate financial losses, there are also costs over the longer term as large projects are designed using European or Asian equipment and standards. It will become increasingly difficult for U.S. firms to regain market share the longer sanctions remain in place. Foreign competitors are currently gaining valuable in-country experience, which will give them an advantage in the competition for future contracts.

If executory contracts were allowed, project proposals could help demonstrate the technological contributions that U.S. firms can make to the Iranian economy. In addition, the negotiation of contracts that can only be implemented after sanctions are lifted would provide additional incentives for Iran to move toward a more normal relationship.

3. Granting Licenses for Oil Swaps

The president also has the authority to establish policy guidelines allowing the Department of the Treasury’s Office of Foreign Assets Control to license U.S. companies to participate in oil swaps between Iran and neighboring Caspian Sea countries. This can be done within the context

⁷⁶ Executive Order 12959 of May 6, 1995 was clarified and tightened by Executive Order 13059 of August 19, 1997.

⁷⁷ Energy Information Administration of the U.S. Department of Energy, “Iran,” May 2001 <www.eia.doe.gov/emeu/cabs/iran.html>.

of the existing trade and investment ban because an exception allowing Caspian swaps was part of the original 1995 executive order and was reaffirmed in the executive order of 1997.

- Swaps would achieve the originally stated goal of helping land-locked Caspian states get their energy resources to market. They would benefit economically, thereby helping ensure internal political stability. By providing an alternative to export routes that transit Russia, swaps would also contribute to the political independence of states trying to break away from the network of economic dependencies created in the former Soviet Union.
- Swaps would allow market mechanisms to work. The applications for licenses to swap would in and of themselves be indicative of the economic advantage of swaps in comparison with transporting the same quantities of oil over long-distance pipelines or by routes that involve a combination of barge and railway transport.
- Swaps would help diversify the energy supply by facilitating Caspian energy resources getting to market. Diversity of supply is a declared goal of U.S. energy policy and is especially important under current conditions of a very tight oil market. There is an ever-present danger that political instability in several key oil-producing countries will lead to supply disruptions and Iraq could provoke an oil crisis by deliberately reducing its exports.

4. Lifting the Ban on Imports from Iran

With the exception of the recent allowance for imports into the United States of Iranian carpets and certain foodstuffs, all other imports from Iran are banned by the October 29, 1987 executive order and the general trade and investment ban imposed by the May 6, 1995 executive order. The 1987 order was issued under circumstances that have changed markedly. Hizbollah factions are no longer holding U.S. hostages, and the United States is no longer engaged in the military encounters with Iran that were undertaken during the Iran-Iraq War.

The 1987 sanctions, which suddenly closed the U.S. market to Iranian exports of crude oil, had the immediate effect of causing Iran severe economic hardship. Iran has long since adjusted to the dislocation. In fact, Iran is the second largest exporter in OPEC and the fifth largest exporter worldwide. Iran also possesses the fifth largest oil reserves. Iran's reserves are exceeded only by those of Saudi Arabia, Iraq, the UAE, and Kuwait.⁷⁸ Over the longer term, Iran's oil reserves will prove to be significant. They are larger than all of the oil reserves in Africa and also larger than the oil reserves of Central and South America combined.

Meanwhile, the United States has become more vulnerable as an importer of crude oil. U.S. domestic production has declined by more than 15 percent since 1987, and there has been a corresponding increase in dependency on crude oil imports reinforced by increased consumption during the same period. Under the terms of the UN oil-for-food program, Iraq has at times been the sixth largest exporter of crude oil to the U.S. market. In October 2000, for example, the United States depended on Iraq for close to 7 percent of its crude oil imports.⁷⁹

⁷⁸ *BP Amoco Statistical Review of World Energy 2000* (London: BP Amoco, 2000), 4.

⁷⁹ The leading oil exporters to the U.S. market (in rank-order) are: Saudi Arabia, Venezuela, Canada, Mexico, Nigeria, and Iraq. See table 35 of Imports of Crude Oil and Petroleum Products into the United States by Country of Origin <http://www.eia.doe.gov/pub/oil_gas/petroleum/data_publications/petroleum_supply...

The ability to import crude oil from Iran would diversify U.S. sources and reduce the vulnerability of the United States to a sudden supply disruption.⁸⁰ There have already been instances in which Iraq has slowed or halted oil exports for political reasons. It may do so again, either as a means of deliberately hurting the United States or as a bargaining tactic for negotiating the terms of the oil-for-food program. During low U.S. oil inventories and refining bottlenecks, an Iraqi export cut-off could be disruptive to the U.S. economy.

Lifting the import ban would be well received in Iran. In the non-oil sector, Iran is capable of exporting chemicals, steel, copper, and some varieties of manufactured goods. Lifting the ban across the board could provide economic benefits contributing to Iran's long-term political stability. An important part of the Iranian government's economic reform program is its goal of promoting a diverse set of exports to create jobs and reduce Iran's dependency on oil exports for close to 80 percent of its foreign exchange. Job-creation is especially important because of the political volatility inherent in continuing severe unemployment among Iran's disproportionately large youthful population. Over time, this demographic pressure will only intensify.

5. Lifting the Ban on U.S. Trade and Investment

In general, the current U.S. policy of blocking investment in Iran's energy sector is inconsistent with a policy of planning for long-term growth in U.S. demand for energy. It is estimated that by 2010, U.S. oil consumption will have increased by 4 billion barrels per day and its natural gas by 5.8 trillion cubic feet per day.⁸¹

The 1995 and 1997 executive orders imposing a total trade and investment embargo on Iran were issued for now familiar reasons: to sanction "Iran's continuing support for international terrorism, including support for acts that undermine the Middle East peace process, as well as its intensified efforts to acquire weapons of mass destruction." Advocates of retaining the present ban suggest that it has had an influence in moderating Iranian behavior and has the potential for continuing to do so. (This is somewhat at variance with the Clinton administration's position that it had seen "no change" in Iran's behavior with respect to these issues.) Advocates of lifting the executive orders argue that unilateral sanctions are inherently ineffective and that Iran's ability over the last few years to break out of its political and economic isolation proves this point. It has also been argued that the economic impact of the trade and investment ban is proving to be more harmful to the United States than it is to Iran.

As in the case of the 1987 import ban, circumstances have changed since the imposition of the 1995 trade and investment ban. The embargo predated President Khatami's May 1997 electoral

/table_35.txt>. Country distribution of monthly oil imports fluctuates. The most recent data available is for February 2001. At that time, Iraq accounted for 3% of U.S. oil imports and was preceded in its country ranking by Saudi Arabia, Canada, Venezuela, Mexico, Nigeria, Angola, Norway, and Kuwait. *Ibid.*

⁸⁰ Oil is fungible, i.e., oil from one country can be substituted for that of another, but interruption of supply from a particular country causes market dislocations and price spikes.

⁸¹Current U.S. consumption of oil is 18.49 million barrels per day, according to the most recent (1999) statistics presented in the *BP Amoco Statistical Review of World Energy 2000*. The U.S. Department of Energy's Energy Information Administration projects U.S. consumption rates in 2010 at 22.5 billion barrels per day of oil and 27.0 trillion cubic feet of natural gas. See table A4, World Oil Consumption by Region, Reference Case, 1990-2020 and table A5, World Natural Gas Consumption by Region, Reference Case, 1990-2020. <http://www.eia.doe.gov/oiaf/ieo/tbla1_a8/html>.

victory by two years and its sponsors therefore could not take into account the overwhelming popularity of the reform movement, nor could they take into account the Iranian government's current program for economic and political reform. Supporters of the import and trade and investment sanctions should ask themselves whether U.S. trade and investment in Iran would help or hinder progress toward fulfilling the reform agenda.

Trade and Terrorism

There is debate among analysts over the extent to which Iran is still supporting international terrorism. The Department of State's *Patterns of Global Terrorism* describes only slight progress when the pre-Khatami years of 1996 and 1997 are compared with the post-Khatami years of 1998 and 1999. The report released on April 30, 2001, describes Iran as remaining the most active state sponsor of terrorism, primarily because it "provided increasing support to numerous terrorist groups, including the Lebanese Hizballah, HAMAS, and the Palestine Islamic Jihad (PIJ), which seek to undermine the Middle East peace negotiations through the use of terrorism."⁸² Some analysts, however, contend that there has been an improvement in Iran's record.⁸³ An August 2000 Congressional Research Service report points out that "no major international terrorist attacks have been linked to Iran since Khatami took office."⁸⁴ In any event, the linkage between general restrictions on trade and terrorism are tenuous at best.

Trade and the Middle East Peace Process

Many observers took heart from President Khatami's December 1997 statement that Iran would accept any Middle East peace agreement acceptable to Palestinian leader Yasir Arafat. Moreover, there were times during the summer and early autumn of 2000 when an Israeli-Palestinian peace agreement seemed within grasp. It is worth noting that Khatami's statement occurred almost immediately upon his ascendancy to the presidency, a time when he may have enjoyed more flexibility on the issue than was later the case.

The Supreme Leader has used his power to set the broad outlines of Iran's foreign policy to make certain that Iran speaks with one voice on the issue of Israel and the Arab-Israeli conflict. In addition, the violence that broke out between Palestinians and Israelis following the September 2000 visit by Ariel Sharon to the al Aqsa Mosque⁸⁵ served to increase the stridency of Iran's anti-Israeli rhetoric:

- President Khatami denounced the Israelis as "brutal and barbaric" and said that their treatment of the Palestinians was an insult to the Islamic world;⁸⁶

⁸² *Patterns of Global Terrorism 2000*. The report generated considerable controversy because the activities of Palestinian groups during the Israeli-Palestinian clashes that followed the al-Aqsa Intifada were defined as terrorism, whereas the reprisals by the Israelis were not.

⁸³ See, for example, R. Jeffrey Smith, "Khatami Wants to End Terrorism, Officials Say; Intelligence Sources' View Counters State Department's Portrayal of Iran," *Washington Post*, May 5, 1998.

⁸⁴ Kenneth Katzman, "Terrorism: Near Eastern Groups and State Sponsors, 2000," August 17, 2000, 26.

⁸⁵ The Temple Mount in Jerusalem is also the location of the al-Aqsa Mosque, a shrine of profound religious significance to Muslims worldwide.

⁸⁶ AFP, "Khatami Blasts 'Barbaric' Israelis, Hails Intifada," December 21, 2000.

- Foreign Minister Kharrazi called for the establishment of an international criminal court to try Israeli officials for war crimes in the occupied territories;⁸⁷
- Supreme Leader Khamenei called on Arab states to cease supplying oil to countries that support Israel⁸⁸ and reiterated his long-time assertion that Israel is a “cancerous tumor” in the Middle East.⁸⁹

Since the 1979 revolution, Iran has used harsh anti-Israeli rhetoric as a means of burnishing its leadership credentials in the Islamic world. Iranian rhetoric is often more uncompromising than even the “frontline” opponents of Israel. Ironically, Iran enjoys the luxury of engaging in such rhetoric precisely because it is actually on the sidelines of the Middle East conflict.

There is also an aspect of power politics in Iran’s vociferous stance toward Israel. Iran fears the prospect of an increased Israeli presence in the Persian Gulf and the possibility that diplomatic relations and a *de facto* alliance between Israel and the Arab monarchies may occur. It also feels threatened by recent developments in Israeli-Turkish military cooperation, as well as by Israeli inroads in the newly independent Caspian Sea countries. The strong U.S. presence in the Persian Gulf and U.S. attempts to interfere with transportation routes linking Iran with its neighbors are additional factors that contribute to an Iranian sense of encirclement. Within this context, Iran sees the level of its expressed hostility toward Israel as a potential bargaining chip that can be used to gain leverage with the United States and with Israel itself. In other words, the level of Iranian hostility toward Israel is somewhat negotiable.

Meanwhile, the Israeli withdrawal from southern Lebanon in July 2000 has removed the stated rationale for Iranian support of the military activities of Hizbollah. Iran had argued that Hizbollah was performing the justifiable task of opposing an occupying force on Lebanese soil. Although many people believed that the Israeli withdrawal would close the chapter of Iranian involvement in the Arab-Israeli conflict, Israeli reprisals during the al-Aqsa intifada provided an impetus for Iran to reenter the fray. In doing so, Iran was vocal in encouraging the Palestinians to use the withdrawal of Israeli forces from southern Lebanon as a *model* for recovering Palestinian territory.

Over the longer term, however, continued Iranian support of rejectionist groups like HAMAS and the PIJ will be dependent, in part, on the outcome of Palestinian-Israeli peace negotiations and on the possibility of a future peace agreement between Israel and Syria. Although Iran represents a significant presence in Lebanese politics, it plays a marginal role, at best, with respect to the Palestinian diaspora.

In the future, even if Arafat signs a peace agreement with Israel, it is still likely that rejectionist groups will engage in a campaign of violence to express dissatisfaction with its terms. At this point, Iran will have to decide whether – and how – to continue its support for these groups. If an Israeli-Syrian agreement is concluded, Syria will be expected to rein in the activities of Hizbollah and the Palestinian rejectionist groups. Under such circumstances, it would be almost

⁸⁷ Reuters, “Iran Foreign Minister Denounces Israeli War Crimes,” November 19, 2000.

⁸⁸ Reuters, “Iran Urges Oil Ban on States Backing Israel,” November 22, 2000.

⁸⁹ Reuters, “Iran Leader Urges Destruction of ‘Cancerous’ Israel,” December 15, 2000.

impossible for Iran to follow an independent course by continuing its own support for these groups.⁹⁰

Trade and Weapons of Mass Destruction

Events since the passage of the 1995 executive order have only increased the motivation of forces in Iran seeking to acquire WMD and long-range missile capabilities.

- **Iraq's WMD Potential**

Today, in contrast to 1995, UN arms inspectors are no longer allowed into Iraq and international support for the UN sanctions regime is weakening. Iran has good reason to fear a militarily resurgent Iraq in a post-sanctions environment. When the UN disarmament team was able to operate within Iraq, it destroyed materiel and production facilities for weapons of mass destruction, but there is no certainty that the task had been fully accomplished when UN inspectors were forced to withdraw.

Because Iraq's WMD expertise was so advanced before the Persian Gulf War, it is estimated that it would take it only five years to produce a fully operational nuclear weapon, and only two years if it were able to obtain fissile material from an outside source. Iran has keen memories of Iraqi missile attacks on its cities during the Iran-Iraq War, and it also has had the experience of being attacked with Iraqi chemical weapons.

- **Pakistan and India as Nuclear States**

Following the detonation of nuclear devices by India and Pakistan in May 1998,⁹¹ Iran faced nuclear-capable regional powers to its east and a weakened international non-proliferation regime. Iran already lives in a region in which Israel has a known but undeclared nuclear weapons capability. Each of these facts contributes to Iran's incentive to acquire nuclear weapons as well.

In contrast to issues of U.S. concern where scenarios can be envisioned that would allow the United States to come to a determination that Iran is no longer supporting international terrorism or interfering in the Middle East peace process, it is highly unlikely that *any* government in Iran will consider it prudent to foreclose the nuclear weapons option.

Even if the reformers are able to control the activities of Iran's military establishment and the IRGC, they are likely to face strong pro-nuclear sentiments on the part of their supporters

⁹⁰ Iran has been providing a significant portion of the financial resources of Hizbollah, HAMAS, the PIJ, and the PFLP-GC, but Syria exerts administrative and logistical control over the areas in which these rejectionist groups operate. It is as yet unclear, however, whether President Bashar al -Asad will be able or willing to exercise the same level of control that was wielded by his father.

⁹¹The possibility of future (non-nuclear) military conflict between Iran and Pakistan cannot be ruled out. Pakistan is a key supporter of Afghanistan's Taliban regime and played an important role in helping to bring the Taliban to power. Iran came close to declaring war against the Taliban regime in 1998, after 12 Iranian diplomats were killed by Taliban forces. Tensions between the two countries remain. The civil war in Afghanistan has not reached a conclusion, and Iran is still supporting anti-Taliban forces in the north. In addition, Iran is providing sanctuary to more than 1 million Afghan refugees in areas close to the Afghan-Iranian border. The border area is also the site of a significant drug war pitting Iranian interdiction efforts against drug trafficking originating in Afghanistan, with some back-up production facilities in Pakistan.

because of the national security issues at stake. Public opinion in Iran is not likely to differ from public opinion in India and Pakistan, where attainment of nuclear weapons was seen as a source of national pride.

There has not yet been a national debate in Iran on the nuclear weapons issue, and the Khatami government continues to maintain that Iran is in full compliance with its obligations as a party to the Nuclear Nonproliferation Treaty and is not seeking a nuclear weapons capability by clandestine means. Therefore, continuing to link the lifting of the 1995 trade and investment embargo to a verifiable Iranian commitment to end its alleged clandestine WMD programs is essentially to say that the embargo will be permanent. Even under the most stringent inspection regime, there will be those who believe that Iran is continuing such programs in an undetectable manner. Multilateral export controls are the more appropriate means for addressing the proliferation issues.

6. Improving the Patterns of Global Terrorism Reports

Some of the most significant barriers improved U.S.-Iranian relations can be traced to legislation that references the Terrorism List used for export control purposes in accordance with 50 U.S.C., Section 2405(j). Such legislation either denies Terrorism List countries the benefits of various forms of U.S. assistance or deprives them of general benefits that they would otherwise enjoy.

- Terrorism List countries, as noted earlier in this report, cannot participate in the Peace Corps program, Export-Import Bank initiatives, or Agricultural Trade and Development programs. They also cannot receive bilateral U.S. assistance. U.S. taxpayers cannot receive foreign tax credits in instances in which they are permitted to invest in these countries. Export of Munitions List items are prohibited to these countries and export financing is supposed to be denied to third countries selling lethal equipment to Terrorism List countries.

The prohibition against bilateral U.S. assistance to Terrorism List countries means that many of the *modest first steps* toward Iran that have been suggested by analysts and former government officials cannot be implemented. Not only is the U.S. government prohibited from assisting Iran in matters like narcotics control and the protection of the environment, but such programs as educational exchange through the U.S. Agency for International Development programs are also impossible under current legislative circumstances.

- Terrorism List countries are denied sovereign immunity from lawsuits filed by U.S. plaintiffs in U.S. courts. This exception to the Foreign Sovereign Immunities Act subjects countries like Iran to the possibility of having their assets seized in order to satisfy the awards granted in such lawsuits. *This legislative stipulation may prove to have the most dramatic long-term negative impact on relations between Iran and the United States.* As already noted, the victims of terrorism lawsuits that are made possible by depriving Iran of a long-standing right will, at the very least, complicate the ability of the United States to pay Hague Tribunal awards to Iran.

To the extent that they are still outstanding at the time of a future normalized trading relationship between the United States and Iran, the writs of attachment that U.S. courts have validated in victims of terrorism lawsuits will allow liens to be placed on the assets of

Iranian government “entities,” when they become involved in trading relationships with the United States.

In addition to legislation linked to the Terrorism List, perceptions of Iran as a supporter of terrorism also affect other legislation and executive branch regulations. As noted, the executive orders of 1987, 1995 and 1997 referenced Iranian support of international terrorism as a key reason for their promulgation. The Iran and Libya Sanctions Act of 1996 declares that “the Government of Iran’s . . . support of acts of international terrorism endanger the national security and foreign policy interests of the United States and those countries with which the United States shares common strategic and foreign policy objectives.” This legislation will expire in August 2001, but a strong campaign for its renewal for another five years has been launched by the American Israel Public Affairs Committee (AIPAC), with strong support from its allies in Congress.⁹²

Because so much hinges on whether a particular country has been placed on the Terrorism List, the public justification for such placement should be presented in a manner that reflects analytic rigor in the formation of the basic conclusions and provides as much information as possible, given the necessity to protect intelligence sources and methods. The basic document for doing so is the *Patterns of Global Terrorism* report that is published annually by the Department of State.

Patterns of Global Terrorism

When Congress required the Department of State to produce annual country reports on terrorism, it imposed a requirement for “detailed assessments” of the terrorism-relevant activities of each of the Terrorism List countries. This requirement applies not only to currently identified Terrorism List countries, but also to any country that has appeared on the Terrorism List during the preceding five years.

One aspect of *Patterns of Global Terrorism* that has a bearing on how Iranian policies are assessed derives from the basic definitions that it employs. International terrorism is defined as “terrorism involving citizens or the territory of more than one country,” a non-controversial assumption, but “*terrorism*” is defined as “premeditated, politically motivated violence perpetrated against noncombatant targets by *subnational* groups or *dandestine* agents, usually intended to influence an audience” (emphasis added).

This definition is drawn from Title 22 of the United States Code, Section 2656f(d) and is part of the legislation that mandates the annual country reports. It is important to note, however, that *this definition focuses attention on only one strand of the whole spectrum of politically motivated violence that occurs on a worldwide basis*.⁹³ Moreover, the definition of a subnational group as being terrorist is biased toward the perspective of the nation-state. Most terrorist groups are operating in a context in

⁹² Hearings on ILSA renewal were held by the Subcommittee on the Middle East and South Asia of the House Committee on International Relations on May 9, 2001. The hearings were somewhat skewed. Three witnesses were invited to argue the case for ILSA renewal: former senator Alphonse D’Amato, who introduced the original ILSA legislation in 1996; Howard Kohr, the executive director of AIPAC; and Patrick Clawson of the Washington Institute for Near East Policy. The only witness presenting an opposing position was William A. Reinsch, president of the National Foreign Trade Council, Inc. and vice chairman of USA*Engage.

⁹³ For example, it absolves nation states from being judged for “politically motivated violence perpetrated against noncombatant targets and intended to influence an audience.”

which a nation-state attempts to blunt their impact through police and military action. Such a situation usually devolves into a cycle of violence and counterviolence. Because of the analytic restriction focusing only on the activities of the subnational or clandestine group, only one side of the cycle of violence is examined.

The phenomenon considered by the Department of State as “terrorism” is often called asymmetrical warfare by military analysts. From this latter perspective, it is taken as given that because insurgent and nationalist groups generally cannot match the conventional military forces of their nation-state adversaries, they rely instead on sabotage and clandestine attacks on official and noncombatant targets. As pointed out in the *New York Times* coverage of the release of *Patterns of Global Terrorism 1996*, “If a nation’s air force bombs civilians, that is not terrorism; if civilians blow up a plane, it is.”⁹⁴ This observation is not meant to absolve separatist and nationalist insurgencies of opprobrium for the destructive actions that they undertake, but to put these actions in a broader political and military perspective.

The introductory section of recent *Patterns of Global Terrorism* reports takes note of this problem, pointing out that “terrorist acts are part of a larger phenomenon of politically inspired violence, and at times the line between the two can become difficult to draw.” The reports, however, fail to inform the reader of the larger context of politically inspired violence when it lists allegations of terrorism under country headings.

Latitude for Improvement

In the course of preparing *Patterns of Global Terrorism*, the Department of State has latitude to improve the analytical categories that it employs. The most important improvements relate to statements of comparison and the advisability of distinguishing between different kinds of terrorism. Such changes would facilitate an evaluation of the extent to which the record of each Terrorism List country changes over time. The factors described below should be applied across the board, but they will be discussed here in terms of their impact on the assessments made about Iran.

Statements of Comparison. The most misleading aspect of the approach that the Department of State takes in *Patterns of Global Terrorism* is that the reports do not compare Iran’s actions to international terrorism in its totality. The reports instead produce a narrow view by assessing Iran’s support of international terrorism only as it exists in comparison with the records of other “state sponsors” of terrorism.

The emphasis on state-sponsored terrorism dates back to 1981 and the beginning of the first Reagan administration. This administration came into office with the intention of making the point that past international political relationships had changed to the extent that nation-states had begun to engage in terrorism themselves and to assist terrorists by providing sanctuary, arms, training, logistical support, financial backing, or diplomatic facilities. Almost twenty years have passed since this observation was made and *Patterns of Global Terrorism 1999* points out that there is now a trend in international terrorism *away* from state-sponsored groups. Instead, most international terrorism is now caused by “loosely organized, international networks,” like the group headed by Osama Bin Laden.

⁹⁴ Tom Weiner, “Terrorism’s Worldwide Toll Was High in 1996, U.S. Report Says,” *New York Times*, May 1, 1997.

Nevertheless, Iran's record is evaluated exclusively within the category of state sponsors of terrorism. Thus, in recent years *Patterns of Global Terrorism 1996* described Iran as "the premier state sponsor of terrorism in 1996"; *Patterns of Global Terrorism 1997* described Iran as "the most active state sponsor of terrorism in 1997"; *Patterns of Global Terrorism 1999* described "certain state institutions...[as making] Iran the most active state sponsor of terrorism"; and *Patterns of Global Terrorism 2000* stated that "Iran remained the most active state sponsor of terrorism in 2000."

By the time these conclusions reach newspaper headlines, the qualifying phrase "state sponsor" is usually dropped, and Iran is depicted being *the* primary source of worldwide terrorism, as in the following examples:

- "U.S. Report Calls Iran No. 1 Terror Sponsor, Despite New Leader."⁹⁵
- "Iran Still Leading Terrorism Sponsor, Report Says."⁹⁶
- "Iran Ranked No. 1 Terrorist Country by State Department."⁹⁷

Headlines like this affect the perception of Iran held by the public at large and they also affect views of Iran held by members of Congress and by officials in the executive branch.

Under current circumstances, it makes little sense to compare Iran's behavior to that of most of the other designated state sponsors of terrorism: Cuba, Iraq, Libya, North Korea, the Sudan, and Syria. North Korea and Cuba remain on the Terrorism List because they continue to provide asylum for a small number of foreigners who committed acts of terrorism many years ago. Iran's record is described as outweighing that of Iraq, Libya, and the Sudan largely because of Iran's support of groups that oppose the current modalities of the Middle East peace process by means that include violence.⁹⁸

Ironically, Iran's record in this respect is described as outweighing that of Syria. While Iran gives financial support to groups like Hizbollah, HAMAS, the PIJ, and the PFLP-GC, it is Syria that gives these groups political direction and support. Consequently, it is expected that Syria would have the ability to restrict the activities of these groups in the context of a potential Syrian-Israeli peace agreement.

It is surprising that Iran is annually described as the perpetrator of more acts of state-sponsored terrorism than Iraq. Yet there is convincing evidence that links Iraq to a number of high profile incidents:

- the February 26, 1993, World Trade Center bombing in New York City;
- plans to bomb the United Nations building and other New York targets (before the arrests of some of the conspirators on June 24, 1993);

⁹⁵ Philip Shenon, *New York Times*, May 1, 1998.

⁹⁶ R. Jeffrey Smith, *Washington Post*, May 1, 1998.

⁹⁷ Associated Press, George Gedda, May 1, 2001.

⁹⁸ *Patterns of Global Terrorism 1999* states that Libya may still have ties to the PIJ and PFLP-GC.

- plans to bomb U.S. commercial airliners flying Pacific routes on January 17, 1995 (the fourth anniversary of the beginning of the Persian Gulf War);
- the November 13, 1995, bombing of facilities of the U.S. training mission for the Saudi National Guard in Riyadh, Saudi Arabia; and
- the June 25, 1996, bombing of the Khobar Towers housing complex for U.S. pilots in Saudi Arabia enforcing the no-fly zone over southern Iraq.⁹⁹

In addition, since the outbreak of the al-Aqsa Intifada in late September 2000, Iraq has provided considerable rhetorical and financial support to Palestinian rejectionist groups.

Instead of comparing state sponsors of terrorism to each other, a different approach could be taken. *Patterns of Global Terrorism* reports are now required by Congress to provide a list of terrorist acts of major significance. Consequently, in addition to the brief sketches of each Terrorism List country, *Patterns of Global Terrorism 1999* presents a chronology of the year's major incidents. In each instance, the country in which the attack occurred is noted, along with the identity of the suspected perpetrators, but no analytical linkage is drawn between the country reports and the chronology.

If Iran's annual record were evaluated in terms of its contribution to that year's "significant terrorist incidents," a very different picture would emerge. One hundred sixty major terrorist incidents were listed for the year 1999, and Iran was not associated with any of them. If the Department of State had chosen to make use of this more meaningful comparison, the headlines in the press might have read: "Iran Not Responsible for Major Terrorist Incidents."

Different Kinds of Terrorism. The country assessments in *Patterns of Global Terrorism* consist of narratives in which distinctions are not made between different types of support for terrorism. The following categories of support, however, illustrate that there are differences:

- acting in *self-defense* against attacks by others.
- undertaking "*direct actions*" whereby government entities or hired operatives kill or inflict casualties or destroy property.
- providing *material support to subnational groups* that are themselves engaged in activities that include terrorist methods.
- providing *safe haven* to groups that have been defined as being terrorist.

The relevance of drawing such distinctions can be illustrated using the four major allegations against Iran in *Patterns of Global Terrorism 1999* that were extracted and repeated in the National Commission on Terrorism's report released in June 2000:

1. "Iran's security forces conducted several bombings against Iranian dissidents abroad."
2. "Iran has increasingly encouraged and supported – with money, training and weapons – terrorist groups such as Hizbollah, HAMAS, the PIJ and Ahmed Jibril's PFLP-GC."

⁹⁹ See Mylorie, *Study of Revenge: Saddam Hussein's Unfinished War against America*.

3. “Iran also provides support to terrorist groups in North Africa and South and Central Asia, including financial assistance and training.”
4. “Iran continues to provide a safehaven to elements of the PKK, a Kurdish terrorist group that has conducted numerous terrorist attacks in Turkey and against Turkish targets in Europe.”

Closer examination of the evidence reveals that the allegation that Iran’s security forces conducted bombings against Iranian dissidents abroad actually falls within the category of self-defense against terrorism because the people that the Department of State describes as Iranian dissidents were members of the Iraq-based Mujahedin-e Khalq Organization (MKO), a group that the Department of State classifies as a terrorist organization. The allegation that Iran supported terrorist groups like Hizbollah, HAMAS, the PIJ, and the PFLP-GC is presented without explaining the political purposes the groups purport to advance. The allegation that Iran supported terrorist groups in North Africa and South and Central Asia is not supported by any evidence at all. Finally, the allegation that Iran provided safehaven to elements of the PKK is supported only by the fact that the brother of PKK leader Abdullah Ocalan, himself a senior member of the PKK leadership, lived in Iran during part of the year.¹⁰⁰

In addition, there have been instances in the country assessments presented in *Patterns of Global Terrorism* where a misleading impression is created because past events are referenced alongside events that occurred during the year the report covers. Again, this makes it difficult to assess a change in behavior over time.

7. Achieving a Final Settlement of the Hague Tribunal Claims¹⁰¹

Although the Clinton administration put itself on record as being prepared to join with Iran in concluding a global settlement of the outstanding legal claims being arbitrated by the Hague Tribunal,¹⁰² the difficulty of achieving this goal should not be underestimated. Nevertheless, if a global settlement is in fact reached, the executive branch has the authority to make payment to Iran without seeking approval from Congress – *no matter how high the amount.*¹⁰³

In the aftermath of the Victims of Terrorism legislation passed in October 2000,¹⁰⁴ however, the United States first must be satisfied that Iran has responded appropriately to the existence of the victims of terrorism rights that were subrogated¹⁰⁵ to the U.S. government. The evaluation of whether Iran has, in fact, satisfied these claims is left to the executive branch.¹⁰⁶ Iran, however, is

¹⁰⁰ A more detailed analysis of *Patterns of Global Terrorism* is presented in Appendix B.

¹⁰¹ Please see Appendix C for a detailed discussion of matters relating to settlement of the Hague Tribunal claims.

¹⁰² U.S. representatives to the Hague Tribunal, however, never broached the subject to their Iranian counterparts.

¹⁰³ Payment can be made from the Treasury Department’s Judgment Fund, a “permanent and indefinite” appropriation that does not have a cap requiring it to be replenished by congressional authorization upon being exhausted. In fact, because the appropriation is permanent and indefinite, it is never “exhausted.”

¹⁰⁴ Described in Appendix A.

¹⁰⁵ Subrogation is the substitution of one for another as a creditor so that the new creditor succeeds to the former’s rights. In this instance, the monetary awards granted by U.S. courts to plaintiffs in the Victims of Terrorism cases were transferred from the plaintiffs to the U.S. government.

¹⁰⁶ Congress will be paying keen attention to the evaluation that the executive branch makes.

unlikely to accept responsibility for the specific terrorist incidents involved or to provide financial compensation to the victims or their families – actions that would enable the United States to conclude that Iran had “responded appropriately.” As already noted, Iran does not recognize the jurisdiction of the U.S. courts that made the awards, and Iran has consistently denied links with terrorism. *It is therefore difficult to believe that Iran could acknowledge the premise underlying the subrogated claims, even in the interest of achieving the rapid disbursement of money that a global settlement of outstanding U.S.-Iranian claims would represent.*

Potential Congressional Initiatives

Changes in U.S. congressional policy toward Iran are more difficult to envision than are changes from the executive branch. Although several members of Congress have indicated an interest in pursuing an opening toward Iran and would like to participate in meetings with Iranian parliamentarians, the general mood in Congress is still marked by considerable concern about Iranian intentions and potential capabilities. Interest groups that oppose a softening of U.S. policy toward Iran have been very effective in their lobbying of Congress.

The National Council of Resistance (NCR), the political wing of the Iraq-based MKO, has been influential. There is an interesting disconnect, however, between the perceptions of the NCR held in Congress and those held in the Department of State. In October 2000, a majority of the members of the House of Representatives went on record as favoring the United States recognizing and providing material support to the NCR in its efforts to overthrow the current Iranian regime. In contrast, while the Department of State believes that the NCR and MKO together form the most active armed Iranian dissident group, it has listed the MKO as a terrorist organization. State goes on to describe the NCR and MKO as following a philosophy that combines Marxism and Islam, while having a history that is “studded with anti-Western activity.”¹⁰⁷ Nevertheless, on October 11, 2000, the NCR was able to persuade a bipartisan majority of 225 members of the House of Representatives to issue a “Statement of Iranian Policy” that said,

Only our [congressional] support for the Iranian people’s aspirations for fundamental change, and the democratic goals of the National Council of Resistance, can contribute to the promotion of peace, human rights and stability in this [Iranian] part of the world.¹⁰⁸

Meanwhile, supporters of Israel have contributed to strongly held perceptions in Congress that Iran continues to pose a threat to the security of Israel through terrorism, support of opponents of the peace process, and pursuit of WMD capabilities. These perceptions are reinforced each time executive branch spokespersons assert that Iran has not changed its behavior in regard to these matters. Anxieties are also raised each time Iran tests a missile with a range that can reach Israel.

In addition, political repression in Iran focuses attention on its violations of internationally accepted human rights. In one especially dramatic instance, Iranian participants in a meeting held in Berlin by the Heinrich Böll Foundation were arrested upon their return home, and most were subject to prison terms ranging from four to ten years. The prison term of the most politically

¹⁰⁷ *Patterns of Global Terrorism 1999.*

¹⁰⁸ Associated Press, “House Issues Iran Policy Statement,” October 11, 2000.

outspoken defendant was to be followed by five years of internal exile.¹⁰⁹ One participant faces the possibility of execution because at the conference he stated that Islam should not dictate the way women in Iran dress. Rather it should be a matter of personal choice.

Another problem area in human rights that influences Congress is the Iranian government's treatment of 350,000 citizens of the Baha'i faith. The ruling Shia clergy consider the Baha'i Islamic heretics. Members of Congress also believe that the trial of a group of Jewish Iranians accused of spying for Israel was motivated by the desire of the judiciary to intimidate Iran's entire Jewish community. Human rights abroad and religious freedom are of such salience in Congress that the Department of State has been tasked with producing annual country-by-country reports to Congress on these issues. Iran does not fare well in either of these reports.¹¹⁰

At the same time, however, some members of Congress have begun to focus on the counter-productive nature of unilateral U.S. sanctions as a mechanism for achieving U.S. foreign policy goals. Data publicized by interest groups like USA*Engage and the National Association of Manufacturers have called attention to the large number of countries subjected to unilateral U.S. sanctions and the plethora of foreign policy purposes that the sanctions seek to achieve. They also present data describing the cumulative cost of these sanctions to the U.S. economy. Not only are export and investment opportunities lost, with concomitant losses of income for companies and workers, but the proclivity to impose unilateral sanctions serves to damage the reputation of U.S. exporters as "reliable suppliers."

There is also growing concern that most unilateral U.S. sanctions regimes are too broad. By targeting U.S. economic relationships with entire countries, they often harm innocent populations abroad without altering the behavior of leaders. This is especially true when the leaders of the targeted countries have authoritarian or totalitarian power at their disposal, as is often the case. These leaders are able to redirect their internal economic resources to continue objectionable activities. The economic privation resulting from sanctions is absorbed by their politically powerless populations.

To redress some of these failings, sanctions reform legislation was introduced in the Senate by Richard Lugar (D-IN) on January 7, 1997, with companion legislation introduced by Lee Hamilton (D-IN) in the House of Representatives on October 23, 1997.¹¹¹ If passed, the legislation would do the following:

- require the president to assess the likelihood that proposed sanctions will achieve foreign policy or national security objectives within a reasonable period of time;

¹⁰⁹ In a move attributed by some observers to the impact that President Khatami has had in his attempt to reform the judiciary, the appeals court reduced the initial sentence to six months in jail – time already served – and overruled internal exile. See Guy Dinmore, "Tehran Cuts Sentence of Dissident," *Financial Times*, May 16, 2001.

¹¹⁰ See Bureau of Democracy, Human Rights, and Labor, *Country Reports on Human Rights Practice, 2000* (Washington, D.C.: Department of State, February 2001).

<<http://www.state.gov/g/drl/rls/hrrpt/2000/nea/index.cfm?docid=786>> and *2000 Annual Report on International Religious Freedom* (Washington, D.C.: Department of State, September 2000)

<http://www.state.gov/www/global/human_rights/irf/irf_rpt/irf_iran.html>.

¹¹¹ S. 1413 and H.R. 2708, Enhancement of Trade, Security, and Human Rights through Sanctions Reform Act.

- ask the Congressional Budget Office and the International Trade Commission to report on the sanctions' likely short- and long-term costs to the U.S. economy;
- require all U.S. sanctions to terminate within two years of initiation unless reauthorized;
- require all sanctions regimes to include presidential authority to adjust or waive sanctions if deemed necessary to protect the national interest.

The Lugar and Hamilton bills were co-sponsored by 38 percent of the Senate and by 26 percent of the House. During 1997 and 1998, there seemed to be momentum in Congress for comprehensive sanctions reform, but opposition at the committee level by Sen. Jesse Helms (R-NC) prevented the bills from coming to a floor vote.

Consequently, sanction reform efforts in Congress are now directed toward achieving narrowly framed exceptions to existing regimes. The proposed Lugar-Hamilton legislation served to increase congressional awareness of the need to be more prudent when turning to economic sanctions as a means of responding to the pressures of domestic politics in the name of serving foreign policy and national security goals. Within this context, there are several things Congress can do to improve U.S.-Iranian relations.

1. Meetings between Parliamentarians

If the leadership in Iran is willing to grant permission, and if the logistics can be worked out, exchanges between members of Congress and their parliamentary counterparts in Iran would have both symbolic and practical value. Such meetings would help break down communication barriers, the “walls of mistrust” alluded to by President Khatami in his January 1998 CNN interview. Such meetings could also correct mutually held negative stereotypes. Under ideal circumstances, meetings between members of Congress and members of the Majlis could result in a genuine exchange of views, clarification of positions, reduction in tensions, and future government-to-government dialogue.

2. Hearings on U.S.-Iranian Relations

Congressional committees have held periodic hearings on Caspian energy resources and transportation routes, as well as the proliferation of WMD, national missile defense, international terrorism, and human rights. Iran has been discussed in relation to each of these subjects, but there have not been hearings that examine U.S.-Iranian relations in a broader context. It would be valuable to hold hearings focusing on the current dynamics of political and economic change in Iran and the implications for U.S. foreign policy. Such hearings would be useful in educating members of Congress, the press, and – through the press – the public at large. If a representative array of witnesses were chosen, a useful debate about current U.S. policy toward Iran could be held.

3. Modification of Existing Legislation

It is difficult to change legislation once it is enacted. There are, however, differing degrees of difficulty. Some of the legislation currently affecting U.S.-Iranian relations can be modified at the margins through a process of “carving out” exceptions. Other legislation, like ILSA, requires reauthorization and can be allowed to expire if there is insufficient congressional support to reintroduce – and pass – the same basic provisions. The most difficult challenge is legislation that can only be changed by repeal.

If attitudes in Congress toward Iran were to soften, a carving out of exceptions to legislative prohibitions would be a positive gesture. For example, when legislation was enacted requiring the United States to withhold funds otherwise due international organizations in proportion to the extent to which these organizations were funding programs in Iran (and several other countries), exceptions were made for the International Atomic Energy Agency (IAEA) and the United Nations Children's Fund. Other "excepted" international organizations could be added to this list.

By extension, *current prohibitions against U.S. bilateral assistance to Terrorism List countries could be modified to allow exceptions for certain non-controversial types of assistance*, such as promotion of educational exchanges and provision of U.S. financial aid and technical assistance for programs designed to protect the environment, promote health, and control drug trafficking and abuse.

The same kind of exceptions could be added to legislation that currently requires U.S. executive directors of international financial institutions to use the "voice and vote" of the United States to oppose any loan or other use of funds destined for Terrorism List countries.¹¹²

4. Halting New and Renewed Sanctions Legislation

Congress will need to make decisions on bills imposing new sanctions on Iran or extend the life of existing sanctions. First, there are the "roll-back" bills of Sen. Schumer and Rep. Sherman that would foreclose importing Iranian goods (including those currently allowed) until Iran has shown substantial progress in respecting the rights of ethnic and religious minorities, ceased support for international terrorism, and terminated its weapons of mass destruction and ballistic missiles programs. Support for this legislation grew following the September 21, 2000, court decision not to void or substantially reduce the sentence of the 10 Iranian Jews prosecuted for alleged espionage in cooperation with Israel.

These bills are unlikely to pass, in part because of the groundwork laid by the Lugar-Hamilton sanctions reform bills and their emphasis on the need to be realistic about the foreign policy goals that can be achieved through unilateral sanctions.

Second, there is the issue of whether ILSA will be renewed when it expires in August 2001. While ILSA has not achieved its desired effect, and foreign companies are investing in Iran's energy sector at a rapid pace, the same political forces endorsing ILSA in 1996 have mounted an energetic campaign to renew it for another five years (2001-2006). If ILSA is renewed, the Bush administration will have to decide whether to continue the Clinton administration commitment to issue national interest waivers for the companies of EU countries. It will also have to decide whether to extend this policy to non-EU countries since Australian, Canadian, Chinese, and Japanese companies have now signed oil and gas contracts in Iran.

5. Repealing Existing Legislation

A prime candidate for repeal is Section 221 of the Antiterrorism and Effective Death Penalty Act of 1996 that permits U.S. citizens to sue Iran in U.S. courts. Repeal of Section 221 would be difficult to achieve because of widespread sympathy for the victims of terrorism, but advocacy of repeal is not beyond the bounds of discussion and has found editorial expression in the pages of

¹¹² The United States was able to stop World Bank lending to Iran, but by 2001 the weight of the U.S. vote was insufficient to prevent such lending.

the *Washington Post*.¹¹³ The *Post* editorial focused on the importance of preserving the president's ability to conduct foreign policy without interference, but there are other problems as well. Section 221 is part of a broader trend that increasingly places important issues of foreign policy in the hands of plaintiffs and the courts. These issues are best dealt with through diplomacy, or by international tribunals when they involve transgressions of international law. Domestic lawsuits against foreign states run the risk of politicizing the U.S. court system.¹¹⁴ They also risk encouraging similar actions by other countries with potentially troublesome consequences for the United States.

Although there are several steps that Congress could take to improve U.S.-Iranian relations, none exists in more than theory. Negative attitudes toward Iran are still too widespread and firmly entrenched in Congress for positive legislative change. The most that can be expected in the foreseeable future is that proposals to roll back the March 17, 2000, liberalization on Iranian exports will be defeated. Further steps by Congress will most likely have to follow executive branch action and reciprocation by Iran.

If meetings between U.S. and Iranian parliamentarians do take place, they could have a salutary effect on congressional attitudes more generally. A situation could even develop in which the natural political competition between Congress and the Executive Branch manifests itself in congressional initiatives to establish a more positive policy toward Iran.

Such initiative might include abolishing Farsi broadcasts to Iran, which Iran views as interference in its internal affairs. Reducing ILSA's impact on the Iranian petroleum sector would also assuage Iranian sensitivities, because ILSA, too, is considered U.S. interference.

Nevertheless, neither of these steps will have any practical effect on U.S.-Iranian relations. The Farsi broadcasts are fairly innocuous in content, and ILSA's renewal is unlikely to deter foreign firms from continuing to invest in Iran. The executive orders barring U.S. companies from trade and investment in Iran, however, cannot be lifted while ILSA remains in effect, because the United States can not penalize foreign companies for activities that are permissible for U.S. firms.

The introduction of legislative exceptions to existing Terrorism List prohibitions would have a much more important effect on U.S.-Iranian relations. *If U.S. financial and technical assistance to Iran were made possible for a carefully defined group of foreign aid projects – and if Iran were willing to accept such assistance – it would go a long way toward reformulating normalized U.S.-Iranian relations.*

Moving U.S. Policy Forward

The preceding section details steps that the executive branch and Congress could each take to remove unnecessary obstacles to the achievement of U.S. near-term and longer-term interests. Some of these steps, such as the removal of economic sanctions, have a dual purpose: they serve U.S. interests and could contribute to an improvement in the U.S.-Iranian relationship. Other

¹¹³ "Frozen Assets," May 15, 2000.

¹¹⁴ Anne-Marie Slaughter and David Bosco, "Sue Terrorists, Not Terrorist States," *Washington Post*, October 28, 2000. Also see *idem*, "Plaintiff's Diplomacy," *Foreign Affairs*, 79, no. 5 (September/October 2000).

steps focus solely on the U.S.-Iranian relationship, but an improvement in this area is also posited to serve U.S. national interests, especially in the long term.

A Major Policy Review

The changes that have occurred in Iran since the election of President Khatami in 1997 and the complicated political and economic cross-pressures that Iran is now experiencing internally would appear to argue for a major review of U.S. policy. A review is all the more urgent because key U.S. policies toward Iran that are now in place were designed and implemented during the years of the first Clinton administration and much has changed since then, not only in Iran, but also in the geopolitical arena.

Dialogue with Congress

If the George W. Bush administration decides on a broader approach toward Iran, there needs to be greater dialogue with Congress on the relevance of Iran to U.S. interests:

- Iran's geopolitical importance needs to be emphasized and explained.
- The extent to which Iran has changed domestically and in its international behavior should be discussed.
- Iran's significance with respect to current U.S. energy requirements and long-term U.S. energy security is another subject that should be flagged for congressional attention.

At the same time, the executive branch needs to choose policy initiatives toward Iran carefully so that they will not lead to a confrontation with Congress that would polarize attitudes toward Iran. Such an outcome would make improving relations even more difficult.

Executive Branch Latitude

Despite a plethora of obstacles, the executive branch possesses substantial latitude and authority to take new initiatives toward Iran, and it should make use of the instruments at its disposal. The most significant impediments to improved relations are trade and investment sanctions mandated in the executive orders of 1995 and 1997 and the policy of discouraging pipelines across Iran to transport Caspian Sea oil. These policies could be changed immediately if, for example, recommendations to do so emerged from a new policy review.

VII. Thinking Beyond the Stalemate

There are steps that the United States can take – in its own interest – to remove obstacles created by past policy initiatives. Policies that have been ineffective or counter-productive should be changed if doing so will promote U.S. geopolitical, economic, or energy interests. These steps include relaxing the economic sanctions currently in place against Iran. These sanctions deprive U.S. companies of the ability to compete with European and Asian firms in developing Iranian energy resources and diminish Iran's ability to contribute to satisfying U.S. and worldwide energy demands. These steps should not be held in reserve as “bargaining chips” on the dubious assumption that they can be used as levers to change Iranian foreign or domestic policy.

The relaxing of U.S. economic sanctions to serve U.S. interests, however, will have the collateral effect of providing an opportunity for commercial engagement with Iran. Commercial engagement, in turn, may have the salutary effect of facilitating political engagement at a later, more propitious time.

Although an improved U.S.-Iranian relationship is not an end in itself, it could serve long-term U.S. interests, especially in the geopolitical sphere. Therefore, one of the purposes of this report has been to examine the opportunities and impediments that will affect efforts to reformulate the U.S.-Iranian relationship in a way that will enable the two countries to rise to the standard of normal international discourse. The challenges to U.S. policy makers in pursuing this endeavor are numerous and serious, but there are ways to move forward.

There are years of enmity on both sides of the relationship and basic conflicts of interest between Iran's aspirations for great power status in the Persian Gulf and U.S. commitments as the primary guarantor of Persian Gulf defense. The U.S. commitment to global non-proliferation also plays a role. In addition, the United States and Iran have sharply differing attitudes toward the Arab-Israeli conflict. Here, the Iranian position is different only in degree from that of many Arab countries whose governments have had good relations with the United States.

The development of a U.S.-Iranian relationship characterized by all of the strands of normal interaction between nations would enable the United States to further its broader national interests. Normalized relations are especially important when U.S. geopolitical and energy-related interests are considered. This is true of the short-term, and even more so when U.S. interests are considered within a mid- to long-term timeframe.

The inherent obstacles and the pace at which U.S.-Iranian rapprochement can proceed differ with respect to each of the major strands of traditional international engagement: diplomatic, economic, political, and military. Distinction can also be drawn between people-to-people and government-to-government contacts. Nongovernmental organizations (NGOs) can provide bridges between these two types of activities.

The United States has more latitude to initiate engagement in some areas than in others. For example, the United States is in control of resuming economic relations with Iran by lifting the sanctions against U.S. trade and investment. Iran is already on record as welcoming trade and investment from the United States. A relaxation sanctions would represent a return to the traditional U.S. foreign policy approach of using commercial power in a positive, rather than a

punitive way. Also, unilateral sanctions have generally not accomplished foreign policy objectives. Even multilateral sanctions regimes have increasing difficulty maintaining their effectiveness over long periods of time.

The imposition of unilateral economic sanctions has a value in domestic U.S. politics. They cause the public to “feel good” because various emotion-laden issues are addressed. They also allow specific interest groups to demonstrate success to their supporters. Perhaps most important, they allow U.S. politicians to appear to the electorate as though they are addressing important problems. In this respect, the unilateral U.S. sanctions provide policy makers with a “quick fix,” but in reality they side-step the more arduous process of seriously addressing foreign policy problems through diplomacy and negotiation. Thus, the problems theoretically addressed by sanctions remain and, over time, may actually get worse. A case in point is the attempt to reduce Iran’s approach to Middle East peace to fit within the narrow box of “criminalized” international terrorism.

Relaxing economic sanctions against Iran would be consonant with the long-standing U.S. commitment to comprehensive and worldwide free trade. Relaxing sanctions would also enable the United States to return to a more traditional and durable principle in international politics – the expectation that economic and commercial relationships have a positive effect on political and diplomatic relations. As former British foreign secretary Lord Owen put it, “One way to build a peaceful world is to invest in each other’s economies. Just as there should be political dialogue between countries, there should also be economic, business, and trade dialogue.”¹¹⁵

The pursuit of U.S. national interests should be the primary consideration in evaluating a potential change in the sanctions policy. U.S. national interests would be served in direct and indirect ways by a policy shift. An important direct effect would be movement toward ensuring an adequate and uninterrupted supply of energy. Indirectly, improved U.S.-Iranian relations would allow the United States to accomplish other goals, especially those related to the geopolitics of the Persian Gulf, the Caspian region, and Afghanistan.

The United States is likely to find that *economic engagement can open the doors to political engagement*. The Iranian leadership is much more likely to go further than it has in the past in facilitating people-to-people contacts and in supporting a sequence of preliminary steps toward normalized diplomatic and political relations once economic sanctions are removed.

Moving toward improved relations will require a completely different approach toward U.S.-Iranian relations than that followed by U.S. policy makers since the Dual Containment strategy was enunciated in May 1993 and the trade and investment embargo was imposed in May 1995. As noted above, much has changed since then.

- The desire for political reform on the part of the Iranian people has grown, as indicated by the overwhelming success of reform candidates in the past four elections.
- At a geopolitical level, Iraq is no longer as prostrate as it appeared to be in 1993, just two years following the conclusion of the Persian Gulf War. The UN regime of economic sanctions against Iraq is eroding, and the near-term possibility of a resurgent and

¹¹⁵ “UK Should Help Bring U.S.-Iran Closer,” *Tehran Times*, September 28, 2000.

problematic Iraq cannot be ruled out. In such a situation, a return to a *balance of power* approach to deter Iraqi aggression would benefit from improved U.S.-Iranian relations.¹¹⁶

In addition, the efficacy of a quid pro quo approach toward Iran in the expectation that it will eventually modify its foreign policies to attain the benefits of free trade and investment with the United States has been called into question. Iran has not given any indication that it is willing to participate in such bargaining. Iran's concern about its sovereignty and independence precludes the success of such an approach. The current political struggle in Iran between conservatives and reformers also argues against the efficacy of a quid pro quo strategy. For such an approach to work there must be united leadership on the part of each country.

In contrast to U.S. economic sanctions policy, the reestablishment of diplomatic and political relations between the United States and Iran requires *reciprocal* steps by each side. Even people-to-people and NGO interaction face current constraints because of Iranian reluctance to open itself up to such contacts.¹¹⁷ Iran has also been uncooperative with respect to U.S. attempts to engage in diplomacy of a limited nature. For example, it has refused to allow U.S. diplomats to visit the U.S. interests section at the Swiss embassy in Tehran. It also rejects a low-level U.S. diplomatic presence that would make it possible for Iranians to have visa applications processed in-country.

There is, however, a positive side to this situation. There is a widespread expectation in Congress that Iran will have to reciprocate in some identifiable manner before the United States carries conciliation any further. Iranian reciprocity in moving toward improved diplomatic, governmental, and people-to-people relations can be used as a criterion for U.S. moves toward further engagement.

A Changed Strategy

Thus far, the United States has followed an explicit policy of conditional engagement with respect to Iran. U.S. economic sanctions are to be lifted only when Iran ceases support of international terrorism, its support for groups opposing the U.S.-brokered Middle East peace process, and its efforts to acquire technology, materials, and assistance needed to develop nuclear weapons. In contrast, what is being proposed here is the *lifting of U.S. economic sanctions because it is in the U.S. national interest to do so*. Such action should not be delayed until Iran changes its behavior, because time would be lost in working toward long-term U.S. energy and economic requirements. At the same time, the United States could follow a policy of *flexible conditional engagement in its efforts to reestablish diplomatic and government-to-government relations*. The expectation of reciprocity would also apply to U.S. support for cultural exchanges, interaction between nongovernmental organizations, and other forms of people-to-people endeavors.

The current power struggle between conservatives and reformers in Iran guarantees that the path toward further democracy is unlikely to be smooth. Therefore, *instead of making U.S. policy*

¹¹⁶ See Zbigniew Brzezinski, Brent Scowcroft, and Richard Murphy, "Differentiated Containment," *Foreign Affairs*, 76, no. 3 (May/June 1997).

¹¹⁷ A damper is placed on people-to-people contacts because Iran is not fully cooperative in granting visas. The conservative leadership in Iran is also fearful of what they see as the possible subversive effects of Western ideas.

contingent on internal developments in Iran, U.S. policy makers should focus on rebuilding diplomatic and political relationships with Iran to a point at which the serious disagreements can be addressed.

De-linking U.S. engagement from progress on democracy and political reform in Iran does not mean that the United States is disinterested in seeing these developments come to pass. The political climate in the United States will remain one in which the Iranian leadership is viewed unfavorably as long as it persists in punishing dissent and is insensitive to the need to protect internationally recognized human rights, including the right to practice religion without fear of persecution.

Another motivation for further political and economic reform in Iran is that such developments will contribute to Iran's political stability and economic health. If U.S. policy makers were to ask themselves what kind of Iran they would like to see five years from now, it should be an Iran that is economically viable and politically stable. Within five years, Iran's burgeoning young population will be entering the political and economic system for the first time. This will increase pressure on the government to deliver social and economic services and could lead to political and economic crisis if the government is unable or unwilling to respond.

If avenues of political expression are closed and if, in addition, economic deprivation is severe, political extremism is a high probability. In such a situation, the United States will not be able to count on Iran to help ensure geopolitical stability in the Persian Gulf region. In fact, an Iran engulfed in political extremism will cause additional problems for U.S. interests in the Persian Gulf.

Communicating with Iran

The Clinton administration made it clear that it wanted to engage in officially authorized discussions with Iran which, presumably, would have been acknowledged publicly, and would have allowed the principal concerns of each country to be put on the table. Insistence on an officially authorized dialogue was in part a reaction to the U.S. experience in 1986, when U.S. and Israeli emissaries reached a secret understanding with political leaders in Iran only to have the mission exposed by opponents of the Iranian negotiators. Circumstances are different now. The relationships among the political factions in Iran are much more transparent. Also, if U.S.-Iranian discussions did not result in any explicit bargains – in particular, bargains that depart from publicly stated U.S. policy goals – political fall out would be minimized.

There is also an alternative point of view concerning the Clinton administration's position that the agenda of an authorized government-to-government dialogue should include all issues of principal concern to the two parties, including U.S. concerns about terrorism, the Middle East peace process, and weapons proliferation. Many former government officials have expressed opposition to the Clinton administration's approach. According to one former senior national security official, "We should talk to *anyone* and in *any venue* that the Iranians find comfortable."¹¹⁸ Another feels that "we can communicate with Iran through the Iranian ambassador to the UN

¹¹⁸ For example, in 1980, when the Iranians were ready to negotiate with the United States for the release of the hostages, they identified an emissary and let the United States know that they were ready to talk through him. See Gary Sick, *All Fall Down: America's Tragic Encounter with Iran* (New York: Random House, 1985), 308-9.

or through Iranian ambassadors in European capitals – what we want is a publicly *unacknowledged, reliable* channel of communication.”

Former officials also point out that there will have to be many private, bilateral discussions, conducted away from the spotlight of media attention, before the U.S.-Iranian relationship will have thawed sufficiently to enable the parties to address the really important issues between them in a constructive manner. For example, Lee Hamilton notes that a discussion on nuclear weapons cannot take place during the *first* U.S.-Iranian conversation. The issue is such a point of contention, that it would not be appropriate to raise it until the “hundredth” conversation.

Another potential problem is that the leaders of Iran and the United States may have different preconceptions of what a dialogue involves. The United States may be speaking of general conversations that would set the stage for later substantive discussions, while Iran may be expecting full-fledged negotiations in which the United States pressures it to capitulate on issues of concern to Washington. Many Iranian leaders feel that they lack diplomatic experience and that their negotiators could be outwitted by their American counterparts. In addition, the deployment of the U.S. Fifth Fleet nearby could be viewed as an implicit form of pressure placing Iran at a disadvantage.

Steps toward U.S.-Iranian Engagement

Before pursuing reciprocal engagement with Iran, the United States should take the unilateral step of removing some of the outstanding irritants in the relationship. These steps are few in number and could be taken with minimal cost. Rescinding the policy of fingerprinting and photographing all Iranian visitors to the United States is one such measure. Others include reversing practices that “demonize” Iran and prohibit a reasoned and utilitarian approach to the outstanding problems between the two countries.

Coordinate with Europe, Japan, and Others

The United States should work more closely with European countries, Japan, and other nations to promote coordinated engagement with Iran. For example, working with the European Union would enable the United States to profit from groundwork that has already been laid. Ultimately, it may be possible for the United States and the Europeans to frame joint policy initiatives toward Iran that will be more effective than if undertaken independently. In addition, the Iranians would be more likely to accept a U.S. approach that is folded into European initiatives because it would be less controversial at home.

Lead with the Commercial Sector

Once economic sanctions are removed, the United States will be able to draw upon the positive effects of commercial engagement with Iran. There is reason to believe that economic engagement will prepare the way for political engagement. Contacts on a personal level become possible, and each side has an opportunity to learn about the cultural values of the other. Although economic relations are not free of potential misunderstandings and culturally imposed difficulties, in general they provide mutually beneficial rewards. Once these rewards become manifest, the positive attitudes they engender can likewise affect general attitudes toward the other nation.

De-Link Issues

The United States, in developing a strategy to maximize its interests, should de-link interests that can be pursued directly (geopolitical, energy, and economic) from those that can be more effectively pursued multilaterally (WMD, terrorism). Eventually, better relations with Iran should also help with difficult security issues.

Timing

A new U.S. strategy must take into account the full range of national interests at stake and the overall geopolitical environment to determine options that are both desirable and feasible. Some will be more feasible in the short term, while others must wait for a more favorable political climate. The timing of any approach, as well as its overall pace and scope, must, of course, take Iran's behavior into account. Nevertheless, acting sooner rather than later will increase the U.S. ability to influence positive trends and developments in Iran.

A Plan of Action

Several kinds of engagement are theoretically possible:

- unofficial Track II dialogue;
- contacts between U.S. and Iranian nongovernmental organizations;
- commercial engagement;
- early forms of diplomatic engagement;
- unofficial parliamentary exchanges;
- low-level government-to-government engagement;
- military confidence-building measures;
- normal diplomatic relations;
- full government-to-government relations; and
- military cooperation.

There is a natural sequence to taking these steps, but many of these “phases” can be pursued simultaneously. Moving along the path of one form of engagement should not be made contingent on the achievement of similar progress in another area – but reciprocity from Iran should be expected when engagement is taken as a whole. In some instances, moving ahead will be cost-free to the United States, but in others the United States will need to amend existing legislation to gain some freedom of maneuver.

PHASE ONE

The United States should continue and reinforce existing forms of engagement with Iran. As things now stand, there have been a few instances of U.S.-Iranian cultural and sports exchanges, and Track II contacts between scholars and former government officials. In addition,

nongovernmental organizations have established forums that include U.S. and Iranian participants.

Track II Dialogue.

Approximately six meetings per year have brought U.S. scholars and former government officials in contact with their Iranian counterparts. Similar contacts between U.S. and Soviet participants were useful for both sides during the cold war. One benefit of Track II contacts is that the participants usually have close relations with their respective governments that enable them to explain the nuances of government policies. Such people – especially former officials – can also convey new ideas to active policy makers.

Contacts between Non-governmental Organizations

NGOs have been growing in number and influence throughout the world. One of the primary factors contributing to their growth is the ease with which they can now communicate with their members on issues of concern. Because of the recent revolution in communication, national boundaries are not the impediment they once were. Iran is receptive to international NGOs, and local NGOs in Iran are growing in number. The United States, for its part, is in the process of trying to make it easier for U.S.-based NGOs to operate in Iran. If the effort is successful, NGOs will be able to obtain a general license permitting them to enter into transactions necessary to carry on their work there. Under current regulations, U.S. NGOs have to obtain a separate license for each activity that they undertake.¹¹⁹

Many NGOs have agendas relevant to pressing problems that Iran faces. Two such examples are the environment and narcotics control. Using these issues as examples, it is possible to illustrate the two-fold importance of NGOs. They can bring Iranians and Americans together in working relationships addressing the problem at hand, and can serve as *bridges to future government-to-government relations*¹²⁰ U.S.-based NGOs can make Iranians aware of U.S. government programs and can hold meetings at which U.S. government officials are participants. NGOs can also promote U.S.-Iranian contacts in areas of special interest to the United States. U.S. trade and investment in a post-sanctions Iran is a primary example.

The Environment

Iran currently faces a variety of severe environmental problems, the most prominent of which is air pollution. Tehran is one of the seven most heavily polluted cities in the world. In addition, Iran suffers from the effects of deforestation and desertification. Its heritage of biodiversity has been diminished, and many animal species have become extinct. Iran suffers from a natural shortage of drinking water, which is exacerbated by the contamination of rivers and coastal waters by urban wastewater runoff. Overfishing is a problem and wetlands and reservoirs are being jeopardized for industrial and agricultural purposes. Oil and chemical spills have caused pollution of the Persian Gulf and Caspian Sea.

¹¹⁹ Sanctions against U.S. financial transactions in Iran require separate applications for exemptions for each activity otherwise prohibited.

¹²⁰ This section of the report describes examples of some of the kinds of things that NGOs can do in the fields of environmental protection, narcotics control, and the promotion of trade and investment. A subsequent section of the report will use the same three categories to present examples drawn from U.S. government programs.

Iran's air pollution problems are at a critical stage. Since the revolution, energy consumption and collateral carbon emissions have increased by 280 percent as a result of rapid population growth and fuel subsidies that eliminate incentives for fuel efficiency.

A combination of factors contribute to the air pollution in Tehran. The city is located in an area with topological characteristics similar to Los Angeles, California, where surrounding mountains trap polluted air. According to official estimates, 75 to 80 percent of Tehran's air pollution is caused by automobiles. More than one-fourth of the cars in the city are more than 20 years old and thus lack catalytic converters. In addition, low-quality, leaded gasoline and diesel fuel with high sulfur content is pervasive. Mass transit alternatives are insufficient.

The Iranian government is aware of these problems but is only now beginning to address them. The position of a vice president for the environment and a National Environment Plan of Action were introduced in 1997. A comprehensive plan of action for Tehran was developed in cooperation with the World Bank, Japanese experts, and Iranian environmentalists and includes steps to rehabilitate public transportation and to phase out old automobiles.¹²¹

The positive role that NGOs can play in helping Iran address its environmental problems is best illustrated by an innovative program of U.S.-Iranian cooperation launched by Search for Common Ground. Because some Iranian NGOs are addressing environmental issues, conditions already existed for forging partnership arrangements in this area. Among other activities, the U.S.-Iranian programs have included trips to the United States by Iranian experts to learn about U.S. approaches to environmental problems and the development of environmental law in the United States.¹²²

Narcotics Control

Iran has two basic drug control problems. First, Iran has become a preferred route for transporting drugs produced in Afghanistan and Pakistan to markets in Europe and the oil-rich countries of the Persian Gulf.¹²³ Second, close to 40 percent of the drugs that enter Iran are diverted for domestic use. The dimensions of the problem can be illustrated by the motivation of producers and consumers. Income from drugs produced in Afghanistan finance the Taliban. An estimated 90 percent of the heroin consumed in Europe comes from Afghanistan.¹²⁴ Iran has tried to halt trafficking across its borders,¹²⁵ and the cost has been high. Thirty thousand troops

¹²¹ U.S. Department of Energy, United States Energy Information Administration "Iran: Environmental Issues," <<http://www.eia.doe.gov/emeu/cabs/iranenv.html>>.

¹²² Correspondence with Stacy Heen, US-Iran Program Director, Search for Common Ground, October 27, 2000.

¹²³ UN officials have reported that in Afghanistan the Taliban issued a *fatwa* prohibiting the growing of opium because it is ungodly and warning against addiction to opium. The United Nations views this move with "cautious optimism." See "Afghanistan's Opium Fiends," *Economist*, February 24, 2001. The Department of State, however, reports that there has not been a concomitant decline in drug trafficking from Afghanistan into Iran. Officials speculate that there has been no decline because previously produced supplies of opium were kept in storage after the ban on cultivation was promulgated.

¹²⁴ Andrew North, "Hidden Drugs War Raging behind Iran's Own Maginot Line," *Independent* (London), October 24, 2000.

¹²⁵ According to A. John Radsan, director of the Narcotics Traffic Control Project at the American-Iranian Council, it is beginning to appear that this strategy is meeting with partial success. A new route is developing from Afghanistan to Europe via Tajikistan, Uzbekistan, and Turkey. "Background to Iranian Drug Problem

are deployed at the Iran-Afghanistan border. Military, law enforcement, and Basij forces have all been mobilized in this effort. Over the last fifteen years, 3,000 Iranians have died fighting the flow of drugs from Afghanistan. In 2000 alone, 174 Iranians were killed in the fighting.

Iranian civilians have also been killed by drug traffickers, and there have been violent demonstrations because of a mounting sense of insecurity. Almost in desperation, the government decided to seal the border with Afghanistan by constructing a barrier 580 miles long.

Although Iran receives some assistance from European countries and from the United Nations Drug Control Program (UNDCP), the level of aid is minuscule when compared to Iran's own expenditure of \$1 billion per year: the UNDCP contributes \$13 million per year, and European countries collectively contribute another \$7 million. Iran also receives equipment donations from Europe but again the quantities are small compared to the dimensions of the problem. Iran received night-vision equipment and bulletproof vests from the United Kingdom and sniffer dogs from France. It cannot receive arms because of export control policies.

The domestic problems resulting from drug use in Iran are daunting. Estimates of the number of addicts range from 1 million to 2 million, out of a total population of 64 million. High unemployment contributes to the problem, as drugs are often a means of escape from difficult social conditions. Moreover, the prices are relatively low. Heroin is available at about 1 percent of the cost in the West. Drug abuse in Iran contributes to crime and, consequently, 70 percent of Iranian prisoners are being held for drug-related offenses. Possession of large quantities of drugs carries the death penalty. Possession of even small quantities is punishable by fines and lashes or both. These draconian measures, however, seem to have little deterrent effect.

U.S. NGOs can help Iran confront its drug abuse problem by sharing approaches that have proved effective in public awareness campaigns about the dangers of drug use. They can also provide advice about the efficacy of methods for curing addiction and rehabilitating addicts.

Trade and Investment

In a post-sanctions environment, U.S. companies will be able to participate in trade and investment in Iran, which Iran sorely needs. Groups like the Chamber of Commerce are well positioned to enter Iran once sanctions are lifted. Even now, the Chamber is exploring the idea of initiating contacts with Iranian business associations and would like to host meetings in which American and Iranian businesspeople could exchange information about their respective markets. Nongovernmental business groups could help Iranians learn about U.S. government programs that will be available once changes in existing U.S. legislation have been made.

PHASE TWO

Commercial Engagement

Lifting economic sanctions would make it possible for U.S. companies benefit from commercial engagement with Iran. There are hurdles, however, that must be overcome. One is the need for Iranian businesspeople to travel outside Iran to apply for U.S. visas, return to Iran, wait for 30

and Possibilities for International Cooperation," paper delivered at a conference on "US-Iran Relations: Narcotics Traffic Control" sponsored by the American-Iranian Council, October 2, 2000.

days, and then return to the country of application to pick up the visa. Consequently, only Iranians who are financially well off and politically well connected can get a visa. In addition, while the executive orders remain in place, Iranians cannot make the financial transactions required in the United States to participate in trade shows, contract for legal services, and otherwise participate in bilateral trade.

Early Diplomatic Engagement

The strand of engagement that involves U.S.-Iranian diplomatic interaction is one in which *reciprocity will be important, and its absence clearly apparent*. To date, the United States has made some minor diplomatic overtures to Iran, but they have not been reciprocated. For example, the United States requested but was denied permission to send representatives to inspect its interests section at the Swiss embassy in Tehran.¹²⁶ U.S. diplomatic personnel assigned to the interests section must be approved by Iran. Because Iran has not granted its approval, the United States has been unable to assign consular officers to process Iranian visa requests in-country. If the United States lifts economic sanctions and establishes a commercial presence in Iran, it would want to assign U.S. economic and commercial officers to the interests section so that they could assist U.S. companies doing business in Iran. Again, Iranian permission would be required.

For its part, the United States limits travel by Iranian diplomats and officials within the United States. In 2000, in a gesture of good will, the United States allowed Foreign Minister Kharrazi to travel beyond the 25-mile radius of New York City imposed on Iranian representatives to the United Nations. Kharrazi traveled to Los Angeles and other U.S. cities to deliver speeches to Iranian-American groups.

Iran could reciprocate by allowing U.S. officials to visit the interests section in Tehran. It could also permit U.S. officials to process Iranian visa applications in Iran.

Another test of the degree to which the United States and Iran have been able to engage diplomatically relates to the behavior of the officials of each country when they participate in international meetings. For example, in 1998, efforts were made at a symbolic thawing of relations by having Secretary of State Albright and Foreign Minister Kharrazi represent their countries at a meeting of the United Nations committee charged with addressing the situation in Afghanistan. Albright and Kharrazi planned to attend, but at the last minute Supreme Leader Khamenei canceled Kharrazi's visit. In 2000, both Kharrazi and Albright attended the UN meeting on Afghanistan and although they each sat at the conference table, they did not greet each other. Albright is reported to have been open to an exchange of greetings, but Kharrazi was not.

Symbolic progress on the diplomatic front was made during the September 2000 session of the UN General Assembly. Following a suggestion made by President Khatami the previous year, the United Nations held a conference on the Dialogue among Civilizations. Khatami gave the keynote address, and Albright made a special point of attending. In fact, she rearranged her schedule in order to be present. When the assembly session opened, and the heads of government delivered speeches, Presidents Clinton and Khatami responded positively to a UN request that they indicate mutual respect by arranging to be present at the others' speech.

¹²⁶ Switzerland acts as the Protecting Power for U.S. interests Iran, but the Iranian government controls the access of the United States government to the U.S. Interests Section at the Swiss Embassy.

Clinton departed from his usual practice and remained in the auditorium after his own presentation so that he could listen to Khatami's.

These gestures may seem small, but they are steps forward. Six months earlier, on March 17, 2000, Secretary Albright and Iranian Ambassador to the United Nations Nejad-Hosseinian addressed an audience convened by the American-Iranian Council, the Asia Society, and the Middle East Institute. It was on this occasion that Albright announced a partial lifting of U.S. sanctions against Iranian imports, while also taking note of several instances in the past in which the United States had acted in ways that had been harmful to Iran. Ambassador Nejad-Hosseinian spoke immediately after Albright completed her speech, but he was careful to schedule his arrival so that he and Albright would not be in the same room at the same time.

If the official policies of Iran and the United States were changed to permit contact between U.S. and Iranian diplomats at international meetings, further steps toward engagement could take place. At present, they are prohibited from substantive bilateral conversations and not allowed to engage in the type of informal conversations common on the sidelines of meetings.¹²⁷

It is always a possibility that the process of taking small steps toward increased diplomatic interaction will ultimately help in the establishment of full diplomatic relations. Until this happens, however, the process will continue to move at a gradual pace and there will be many points at which reassessments can be made.

Unofficial Parliamentary Exchanges

If the leadership in Iran acts on its seeming willingness to grant permission for exchanges between various members of Congress and their Majlis counterparts, the meetings would have both symbolic and practical value. They would break down barriers to communication and provide a corrective to mutually held negative stereotypes. Under ideal circumstances, such meetings could result in a genuine exchange of views that clarify positions, reduce tensions, and serve as a bridge to official government-to-government dialogue at some future date.

Although the Iranians have agreed in principle to parliamentary exchanges, they have been reluctant to follow through by setting dates and committing granting the necessary visas. Nevertheless, members of Congress should be encouraged to persevere in initiating dialogue with their Iranian counterparts.

PHASE THREE

Working-Level Government-to-Government Engagement

Given the distance that must be traveled before the normalization of diplomatic relations, an alternative approach to establishing government-to-government interactions may be in order. Although desirable, it is not necessary to have full diplomatic relations before government-to-government contacts can take place. What is being proposed here is a "bottom-up" approach that begins with low-level contacts on non-controversial issues.

¹²⁷ Diplomatic instructions change over time, as illustrated by the lifting of the prohibition against U.S. diplomats talking to representatives of the Palestine Liberation Organization. U.S. ambassador to the UN, Andrew Young was relieved of his position for violating this rule during the Carter administration. Now, of course, the president of the United States and the chairman of the PLO are permitted to talk directly.

A strategy of *disaggregating areas of potential government-to-government interaction* would enable the United States to approach a political rapprochement gradually, while evaluating the extent of Iranian interest and reciprocity. Limited working-level contacts would be pursued first, with contacts at the ministerial level the ultimate objective. Difficult issues would be postponed until a climate of trust is established.

Once such contact becomes routine, meetings at higher levels could be authorized. For example, assistant secretaries could be permitted to meet with their Iranian counterparts. An intermediate step might be to have such meetings take place in third countries. It would be hoped that at some point along this continuum, full diplomatic relations would be established and a full array of government-to-government contacts would take place.

This approach differs from the Clinton administration's policy in one important respect. Instead of starting dialogue at the highest level of government, with all issues on the table, it is suggested here that a more realistic approach would be to disaggregate government-to-government relationships so momentum can be built in areas where progress is possible. Thus, all forms of government-to-government interaction would not be held hostage until the United States and Iran are able to sit at the negotiating table to work out the outstanding issues of greatest concern.

Air Quality/Pollution

Given Iran's particular set of environmental problems and the need to reduce air pollution in Tehran and other urban centers, cooperative efforts could focus on the issue of air quality. Expertise available through the Environmental Protection Agency and in the Department of Energy would be helpful. Many of EPA's international programs involve working with in-country teams, providing training and "capacity building" as well as diagnosing environmental problems and pointing local officials in directions that will enable them to get more help.

The Department of Energy's National Renewable Energy Laboratory has a program to promote clean energy technology transfer through its Technology Cooperation Agreement Pilot Project. In addition, the department's Climate Technology Implementation Program helps developing countries attract private investment and international donor support for clean energy projects, as part of the UN Framework Negotiations on Climate Change.

The EPA's Office of International Activities has worked with the World Bank to develop a clean air initiative in Africa, Asia, and Latin America. If the program is extended to the Middle East, Iran could participate as well. The United States could also provide technical assistance if Iran decides to participate in UN programs that require developing countries to sign protocols committing themselves to lowering levels of pollutants. Adherence to such protocols helps give the issue salience in domestic political and economic contexts.

Drug Control

U.S. programs could be especially helpful to Iran in controlling the transit of drugs from Afghanistan. The United States could modify export control policies to provide Iran with technology and equipment for its drug control forces. For example, it could provide tracer chemicals to help Iran identify where seized drugs were processed. This would help expose transit routes.

If the United States proposed joining its European allies in approaching Iran, it might be able to persuade European governments to increase their transfers of material support to Iran beyond current levels. This would seem appropriate, given that most of the drugs transiting Iran are destined for European markets.

Trade and Investment

Both the Department of Energy and the Department of Commerce have well-established trade promotion programs that could be expanded to include Iran. The Department of Energy often sends its energy experts and independent contractors abroad to describe U.S. technology in the energy field. Once interest is generated overseas, U.S. businesses seek financial support from U.S. export-support agencies like the Export-Import Bank and the Overseas Private Investment Corporation (OPIC).

Unfortunately, however, even modest programs cannot now be undertaken officially because of legislation barring U.S. bilateral foreign assistance to countries – like Iran – on the Department of State’s Terrorism List. This legislation should be amended by “*carving out*” exceptions that permit bilateral assistance for programs that address issues concerning the *environment, drug control, trade and public health*.

Official U.S. Export Support

Lifting economic sanctions would make U.S. trade and investment possible. This, however, would solve only part of the problem. U.S. companies would still be at a disadvantage compared to their competitors because other legislation bars Terrorism List countries from receiving export assistance from the Export-Import Bank, OPIC and the Department of Commerce Trade Development Administration. Therefore, the United States should amend this legislation so that the programs of these agencies can be used to support U.S. businesses seeking to trade with Iran and invest in Iranian enterprises.

Confidence-Building Military Cooperation

Confidence-building measures can reduce tensions and promote regional stability. For example, the U.S. and Iranian navies have established common procedures for communications and interact regularly in the Persian Gulf. They provide notices-to-mariners about operational conditions, including naval exercises. The navies should be encouraged to pursue other means of cooperation, such as jointly mounting search-and-rescue efforts and working together on humanitarian assistance and disaster relief.

PHASE FOUR

Resolution of the Hague Tribunal Claims

More than 20 years have passed since the United States and the Islamic Republic of Iran signed the Algiers Accords ending the 1979-81 hostage crisis. At that time, Iran made a commitment to release all of the U.S. diplomats held as hostages and in return the United States agreed to release Iranian assets frozen in U.S. banks. The United States also committed not to intervene in Iranian internal affairs.

The Algiers Accords also provided for a claims tribunal to oversee binding third-party arbitration of both private and government-related claims involving the two countries. This process at The Hague moves slowly in part because complicated issues of fact and liability have to be resolved.

The tribunal has, however, been successful in resolving essentially all of the more than 4,000 claims involving private claimants, and most of the smaller government-to-government claims. Several large claims are still being arbitrated. The largest outstanding monetary claims relate to purchases that Iran made under the U.S. Foreign Military Sales (FMS) program. In keeping with FMS procedures, Iran deposited money in a Department of Defense FMS fund, and disbursements were then made to the contractors supplying the equipment and services. The Iranian claims relating to the FMS programs are two-fold:

- First, there is the FMS fund, itself. Iran alleges that at the time the FMS relationship was severed, it had deposited \$11.3 billion in the fund but had received only \$9.5 billion worth of military goods and services. Iran wants the balance of \$1.8 billion returned, with interest. The United States does not pay interest on FMS funds under normal circumstances. If the tribunal validates Iran's claim and decides to award interest, the sum owed would increase to \$3.6 billion.
- Second, Iran claims that it is owed \$1.4 billion for undelivered FMS equipment for which payment had already been disbursed from its FMS fund. If the tribunal validates this claim and interest is awarded, the sum owed would amount to \$2.8 billion.¹²⁸

Based on these numbers, Iran believes that it is entitled to a settlement of FMS claims of as much as \$6.4 billion. In addition, it has claimed compensation for costs it had to bear during the process of shutting down the FMS program. A related issue arises from controversy over which of the two countries should pay U.S. contractors for contract cancellations. The United States used funds in the Iranian FMS account to pay cancellation fees, which is one of the reasons why the account now has a balance of only \$400 million compared to the \$1.8 billion that Iran believes the account should contain. The work necessary to resolve the FMS claims is daunting. There are seventy to eighty cases involving sums exceeding \$250,000. Approximately 1,200 separate FMS contracts are at issue, and only 130 have been briefed.

The outstanding Hague Tribunal claims complicate U.S.-Iranian relations. The Iranians tend to use the issue as a vehicle for expressing their sense of "grievance." Iranian officials have repeatedly claimed that the United States has been willful and unfair in refusing to return billions of dollars of frozen assets. The charge is played for maximum effect on public opinion, and inflated dollar figures are used. The rhetoric has been toned down recently, but Iran claimed in past statements that the amount owed it was in the neighborhood of \$20 billion.

In an attempt to respond to Iranian sense of grievance and wipe the slate clean, Secretary of State Albright, in her March 17, 2000 speech, proposed that the United States and Iran increase their efforts to conclude a "global settlement" of the outstanding legal claims. Such a settlement would require devising simplified legal mechanisms at The Hague, as well as mustering a considerable degree of political will on the part of both countries. If a global settlement is *not* reached, many more years will pass before the remaining claims can be resolved on a case-by-case basis.

¹²⁸ For a detailed description of the Iranian point of view, see the interview granted by Goodarz Eftekhari Jahromi, the Iranian representative to the Hague Tribunal, as quoted in Roozbeh Farahanipour, "Iran No Longer Possesses Deposits in American Banks," *Payame Azadi*, January 16-17, 2000.

It is significant that the Clinton administration did not move beyond the rhetoric of a global settlement before it left office. In other words, U.S. representatives to the tribunal were not authorized to broach the subject with their Iranian counterparts. This policy should be changed, and representatives to the tribunal should be allowed to inform Iranian negotiators of the U.S. willingness to pursue a global settlement.

The U.S. government has already paid some individual tribunal awards from the Treasury's Judgment Fund.¹²⁹ It is significant that the Judgment Fund is a *permanent and indefinite appropriation*. This means that Congress does not have to authorize disbursement of specific payments, and the Judgment Fund does not have a "cap" that would require it to be replenished by congressional authorization upon being exhausted.¹³⁰ Any Hague Tribunal awards, including a potential global settlement, are payable from the Judgment Fund – no matter how large the size of the award. Any resolution of remaining claims will require the expenditure of considerable amounts of money. For the most part, members of Congress and the public at-large are not aware of how much will have to be disbursed from the Treasury to settle the claims. As a matter of practical politics, it would be wise of the executive branch to consult closely with Congress in anticipation of the necessity of making a large payment to Iran at some future date.

Complications from the "Victims of Terrorism" Claims

On April 24, 1996, Congress passed the Antiterrorism and Effective Death Penalty Act. Section 221 amends the Foreign Sovereign Immunities Act by depriving Terrorism List states of sovereign immunity in instances in which private U.S. plaintiffs seek to sue such states for damages. Section 221 was designed to permit U.S. citizens and the families of deceased citizens to sue Terrorism List countries for "personal injury or death that was caused by an act of torture, extrajudicial killing, aircraft sabotage, hostage taking, *or the provision of material support or resources for such an act*" (italics added). The language of the legislation draws an explicit connection between the act in question and "the provision of material support or resources" for that act, but the evidentiary standards employed in subsequent court cases have not been strict.

The legislation removing Iran's sovereign immunity was enacted in 1996, a year before President Khatami's election victory. The full effect of stripping Iran of sovereign immunity was not felt until lawsuits were filed and decisions reached under the new dispensation. Since 1998, U.S. courts have awarded compensatory and punitive damages against Iran in several high-profile cases. Iran did not attempt to defend itself in these cases because it does not recognize the jurisdiction of the U.S. courts in which the cases were tried. In the absence of an adversarial proceeding, "default" judgments were rendered, and the size of the awards was especially generous. Five major cases were decided,¹³¹ with awards totalling \$208.4 million in compensatory damages and more than \$1.1 billion in punitive damages.

¹²⁹ This fund was established by the Automatic Payment of Judgments Act of 1956 and is codified at U.S.C. Section 1304.

¹³⁰ Instead, the claims paid from the Judgment Fund are charged against the entire U.S. budget. In other words, the total paid from the Judgment Fund in a given year is either subtracted from a budget surplus or added to a budget deficit.

¹³¹ The plaintiffs were the family of Alisa Flatow, who was killed by a bomb placed on an Israeli bus by the Palestinian Islamic Jihad; former U.S. hostages in Lebanon Joseph Cicippio, David Jacobsen, Frank Reed, and their families; former U.S. hostage and journalist in Lebanon Terry Anderson and his family; the families of Matthew Eisenfeld and Sara Rachel Duker, who were killed by a bomb placed on an Israeli bus by the

These awards complicate the ability of the U.S. government to fulfill its obligations in the Hague Tribunal process. Attorneys for plaintiffs Terry Anderson and the family of Alisa Flatow were successful in obtaining judicially approved writs of attachment enabling them to attach Iranian assets in the United States. The assets that they tried to attach included:

- monetary awards to Iran from the United States that had already been mandated by the Hague Tribunal and
- money in Iran's FMS fund under the jurisdiction of the tribunal pending a decision on its ultimate disposition.

The United States went to court and successfully quashed these writs by claiming that U.S. sovereign immunity protected money in the Treasury that had been earmarked for payment to Iran in compliance with the outstanding tribunal claims. When the plaintiffs confronted this roadblock, Sens. Frank Lautenberg (D-NJ) and Connie Mack (R-FL) introduced the Justice for Victims of Terrorism Act, which, among other things, deprived the United States of sovereign immunity in cases in which Terrorism List countries were at issue. After considerable negotiation with the Clinton administration, a compromise was reached and codified in Section 2002 of the Victims of Trafficking and Violence Protection Act of 2000.

This legislation is significant because it goes a long way toward protecting the Hague Tribunal process from domestic litigation. There are, however, aspects of the revised legislation that will introduce complications down the road. For example, it authorizes the government to pay damages awarded to plaintiffs, but to do so it transfers the claims for compensatory damages from the plaintiffs to the U.S. government. This subrogation of the claims is then used as a vehicle for requiring certain actions by the U.S. government. In the case of Iran, it involves the following:

- No funds shall be paid to Iran from property blocked under the International Emergency Economic Powers Act or from Iran's FMS account until the subrogated claims have been dealt with by Iran to the satisfaction of the United States.
- The president should not normalize relations between the United States and Iran until subrogated claims have been dealt with by Iran to the satisfaction of the United States.

Iran has already registered its disagreement with this arrangement and, in theory, could file a complaint against the United States with the Hague Tribunal or at the International Court of Justice.

Additionally, the Victims of Trafficking and Violence Protection Act seems to imply that Iran must admit to responsibility for the terrorist acts that gave rise to the judicial awards to the U.S. plaintiffs and, perhaps, pay compensation. Iran, however, not only does not recognize the jurisdiction of U.S. courts in this matter, it also argues that it is not complicit in the violent acts of organizations to which it has contributed funds for general purposes. Tit-for-tat, Iran passed legislation that permits Iranians to sue the United States in Iranian courts for injuries sustained at the hands of the U.S.-supported government of the Shah.

Palestinian group HAMAS; and the family of Marine Lt. Col. William R. Higgins, who was kidnapped and killed in Lebanon by the Lebanese Hizbollah.

With an eye toward the future, Congress should examine the possibility of rescinding the 1996 legislation depriving Iran and other Terrorism List states of sovereign immunity, in violation of widely recognized principles of international law. Meanwhile, in pursuing an expedited global settlement of the remaining Hague Tribunal claims, the United States should be fully aware of the difficulties that will have to be overcome because of the restrictions imposed by the victims of terrorism legislation.

PHASE FIVE: THE DIFFICULT ISSUES

One of the most difficult problems that the United States confronts in its current relationship with Iran emerges from the nexus that exists between the following issues:

- The U.S. government's belief that Iran wants to acquire nuclear weapons and is actively seeking them.
- Iran's repeated assertions that it is in full compliance with all NPT commitments and that it has no intention of pursuing a nuclear weapons program.
- Iran's insistence on exercising its right to peaceful nuclear technology and its assertion that the United States is trying to deny it this right in violation of Article IV of the NPT, which commits parties to the Treaty to:

“undertake to facilitate . . . the fullest possible exchange of equipment, materials and scientific and technological information for the peaceful uses of nuclear energy . . . and to [contribute] to the further development of the applications of nuclear energy for peaceful purposes, especially in the territories of non-nuclear-weapon States Party to the Treaty, with due consideration for the needs of the developing world.”

- Iran's legitimate national security concerns, given the nuclear weapons capabilities of nearby states and Iraq's potential to move quickly to a nuclear weapons capability in a post-sanctions environment.

There are two related ways for resolving these issues:

1. Devise a means by which Iran can exercise its NPT entitlement to build civilian nuclear power plants without raising weapons proliferation concerns.
2. Consider ways to help Iran address its legitimate security concerns without recourse to nuclear weapons or other forms of WMD.

A Civilian Nuclear Power Program with Additional Proliferation Controls

A New Approach

If an adequate and effective new safeguards regime could be established, it would be possible for the United States to change its current policy of attempting to deny Iran access to light-water nuclear power reactors for generating electricity. Under such a regime, *all* potential suppliers of such technology would first negotiate agreements with Iran whereby Iran (or any other NPT-covered non-nuclear weapons state) would

- sign and ratify the Model Safeguards Protocol¹³² of the IAEA.
- commit itself to forgo NPT-allowed civilian nuclear activities that raise weapons proliferation concerns, and
- agree to an IAEA inspection regime that would monitor and verify whether the joint commitments between Iran and the potential suppliers¹³³ were being met.

If such a regime could be negotiated successfully, the United States would be able to withdraw its objections to the sale of French, German, or Russian reactors to Iran and, with congressional approval, the United States would be able to sell Iran such reactors itself.

Adherence to the Model Safeguards Protocol of the IAEA

Close to two dozen countries have already signed the IAEA Model Safeguards Protocol. The Protocol was devised after the discovery of Iraq's clandestine nuclear weapons program and contains measures designed to permit IAEA inspection of *undeclared* nuclear sites, as well as declared sites, which are already the subject of the basic IAEA inspection regime.

In addition, the Protocol contains language that enables the IAEA to investigate the accuracy of suspicions brought to its attention by any IAEA member state. This means that, for example, if U.S. intelligence uncovered troublesome activity in Iran, it could ask the IAEA to go to Iran to ascertain whether its suspicions were well founded. Under the terms of the basic IAEA agreement and the safeguards Protocol, if the IAEA discovers that an NPT adherent is engaged in nuclear weapons activity, it is obligated to bring this fact to the attention of the Security Council. Although the NPT does not have a sanctions provision, the UN Security Council has the ability to impose sanctions or take other steps.

Iran is already in complete compliance with the Full Scope Safeguards program of the IAEA. If Iran were to adhere to the additional safeguards protocol, the extension of IAEA safeguards to undeclared nuclear facilities would provide a mechanism for preventing potential clandestine transfers of nuclear material from civilian to weapons-related purposes.

Iran has left the door open to signing the Model Safeguards Protocol. It has said that it would not be the first country in the Middle East to do so, but it would also not be the last. In informal conversations in a Track II setting, Iranian participants have said that Iran would be willing to sign the protocol in exchange for an ability to acquire civilian nuclear technology without U.S. opposition.

Commitment to Forgo Certain Kinds of Civilian Nuclear Technology

The NPT allows certain peaceful applications of the nuclear fuel cycle that particularly lend themselves to the eventual production of fissile material used in nuclear weapons. These permitted but troublesome capabilities are facilities that would permit

¹³² Sometimes referred to as the Enhanced Safeguards Protocol.

¹³³ While the IAEA possesses no such authority now, the countries that subscribe to the regime imposed by the Nuclear Suppliers Group have already committed to not supplying non-nuclear states with civilian nuclear technology that raises weapons proliferation concerns. France, Germany, Russia, and the United States are members of this group, but China is not.

- uranium enrichment;
- reprocessing of spent nuclear fuel;
- heavy-water production; and
- independent fabrication of nuclear fuel.

Thus, under current circumstances, if Iran (or any other non-nuclear party to the NPT) wanted to purchase a reprocessing plant or engage in any of the above activities, it need merely notify the IAEA of the location of the nuclear material involved and accept appropriate IAEA safeguards, and the IAEA would have no cause to fault the recipient or the supplier.

Contrast with Current U.S. Policy

The U.S. approach to preventing Iran from gaining a nuclear weapons capability has been to try to deny Iran *all* forms of nuclear reactors, including the civilian reactors permitted by the NPT for power generation. In doing so, the United States has created temptations for Russia, while frustrating its allies. U.S. policy includes prohibiting the building of civilian light-water nuclear power reactors (although the United States promoted the donation of light-water nuclear power reactors to North Korea).¹³⁴

In addition to prohibiting the sale by U.S. companies of light-water nuclear power reactors to Iran, the United States has been successful in persuading France and Germany to agree to a similar prohibition. This has left Russia as Iran's only supplier. The United States is putting pressure on Russia to stop providing Iran with civilian nuclear reactors once the two reactors at Bushehr have been completed. Russia has thus far been adamant in refusing to comply, and the combination of Russian recalcitrance and U.S. pressure has served to strain U.S.-Russian relations.

Ironically, U.S. policies against selling light-water reactors to Iran have contributed to Iran being completely dependent on Russia for its supply. This situation creates weapons proliferation implications in and of itself. During the construction of the plants Iranians are in contact with Russian nuclear scientists, some of whom have nuclear weapons expertise. Many of the latter are now unemployed because the Russian nuclear weapons program has been curtailed. The possibility that Russian scientists might have pecuniary motives that would lead them to participate in clandestine nuclear weapons programs in other countries has been a cause for concern among U.S. policy makers. The United States has been so concerned that it has given Russia financial assistance to train nuclear scientists in other lines of work to keep them employed.

The other problem arising from Russian-Iranian cooperation is that Russia wants to maximize its ability to earn money from its nuclear expertise. In doing so, Russia may be willing to provide Iran with some of the civilian applications of nuclear technology that have weapons proliferation

¹³⁴ As indicated earlier in this report, under the terms of the 1994 Framework Agreement between the United States and North Korea, the light-water reactors are to be provided to North Korea by South Korea. In exchange, there is a North Korean commitment to remain a party to the NPT and to halt construction of a research reactor of a type that would have produced of fissile material for possible weapons production. The light-water reactors have not yet been delivered because North Korea is still in the process of providing the IAEA with access to the information necessary to verify that it has accounted for all of its nuclear material.

potential but are allowed by the NPT. This would help Iran obtain an independent nuclear fuel cycle if it chose to do so. Again, this is a right to which Iran is entitled under the terms of the NPT, but it involves acquiring at a minimum reprocessing facilities, fuel fabrication capabilities, and most probably, uranium enrichment facilities. Russia is believed to be predisposed toward providing Iran with some of these capabilities and private discussions between Russia and Iran are thought to be underway.

Under these circumstances, U.S. weapons proliferation concerns would be eased to the extent that Iran is able to buy light-water nuclear power reactors from French, German, and U.S. firms instead of from the Russians. This would dilute Iran's strategic dependence on Russia, from whom Iran also receives most of its conventional weaponry. Most important, if Iran were to interact with French, German, and U.S. companies capable of selling light-water nuclear power reactors, its scientist and engineers would not be in contact with scientists tempted to assist Iran in a clandestine nuclear weapons program.

Moving Forward

If the United States decides to change current policy, the first order of business would be to reverse its opposition to the sale of civilian nuclear power reactors to Iran if the sales take place under the terms of an IAEA-monitored agreement whereby Iran would:

- sign and ratify the Model Safeguards Protocol and
- agree to forgo independent uranium enrichment, reprocessing, heavy-water nuclear reactors, and the acquisition of independent fuel fabrication capabilities.

The United States already has a legislatively mandated vehicle¹³⁵ for negotiating such an agreement, and it can invite other countries to do the same. Justification for the request would be the joint achievement of international non-proliferation goals.

As with any basic change in policy, there are likely to be misperceptions and repercussions from the way previous policy was pursued. Russia could fault the United States for trying to establish a system encroaching on its position in Iran's civilian nuclear power market. France and Germany, while likely to agree with the validity of U.S. non-proliferation motives, may express dissatisfaction with having forgone commercial nuclear power opportunities in Iran at the behest of the United States.

The most important question is whether Iran will agree to an expanded safeguards regime. It can be argued that Iran has no incentive to agree to new stipulations so long as Russia remains willing to sell nuclear technology without imposing the safeguards that the new regime would

¹³⁵ The Nuclear Regulatory Commission (NRC) regulates the export of parts, fuel, and major components of nuclear power reactors. If U.S. firms were to consider exporting civilian nuclear power plants to Iran, they would first have to receive NRC approval. Another requirement is that the export of U.S. civilian nuclear power reactors can only be approved if Section 123 of the U.S. Atomic Energy Act of 1954 has been fulfilled. This section stipulates that parts, fuel, and major components of nuclear power reactors can be directly exported from the United States only if an Agreement of Nuclear Cooperation is already in force between the United States and the recipient country. Agreements of nuclear cooperation have provisions that enable the United States and the IAEA to inspect whether stipulations made in the agreement are being carried out.

entail. On the other hand, Iran has been eager to prove that it is not engaged in a clandestine nuclear weapons program and that it is therefore in full compliance with the NPT.

By agreeing to go even further than required by the NPT in allaying suspicions that it is engaged in a nuclear weapons program, Iran would be reinforcing its nuclear non-proliferation bona fides. In addition, Iran might prefer having access to French, German, and U.S. civilian nuclear technology. Iran may well believe this technology to be superior in quality to the Russian's. At a minimum, competition among potential suppliers could reduce costs.

Congressional approval would be the most difficult problem to overcome if the United States agreed to allow the sale of U.S. nuclear power reactors to Iran under an expanded safeguards regime. The government-to-government agreements¹³⁶ that must be negotiated prior to the private sale of U.S. nuclear technology to foreign countries come into effect only if Congress has not registered its disapproval in a Joint Resolution that must take place within 90 days of the date of submission. These "Agreements of Nuclear Cooperation" are sent to Congress along with a Nuclear Nonproliferation Assessment of the recipient country prepared by the Department of State in conjunction with the CIA.

Presumably, any Nuclear Nonproliferation Assessment of Iran would include information on any clandestine attempts at weapons procurement. Congress would then have to weigh the balance between the non-proliferation progress represented by Iran's monitorable adherence to the proscriptions contained in the Nuclear Cooperation Agreement against any clandestine procurement practices. A case could be made, however, that the former would outweigh the latter. This is especially true because any procurements that were put together into usable nuclear weapons-related form would presumably be discovered by the joint IAEA-United States inspection and monitoring process.

Addressing Iran's National Security Concerns

Iran is a proud nation, with a history that has made it very sensitive to the importance of preserving its national sovereignty. Consequently, *the ability of the United States to influence a key national security decision such as whether to pursue a nuclear weapons or general WMD capability is limited, at best*, although it has had success with Japan and South Korea. It may well be that Iran will not back away from the pursuit of a nuclear weapons capability or, at a minimum, position itself so that it can move quickly toward a such a capability in the face of a serious threat. If so, the United States is unlikely to be able to persuade Iran to change course and instead will have to try to manage the issue.

It is important to note that the decision to pursue a nuclear weapons program is by no means unanimous among Iran's leadership.¹³⁷ Awareness remains that Ayatollah Khomeini ruled out pursuing nuclear weapons, even while Iran was keenly aware of its vulnerability to conventional missile and chemical weapons attacks during the Iran-Iran War. Khomeini argued that because nuclear weapons are by nature *indiscriminate* in the casualties they inflict, killing civilians and combatants alike, their use is counter to the teachings of Islam. This argument still has power in

¹³⁶ Such an agreement can be negotiated in the absence of diplomatic relations, although it would be preferable to have relations.

¹³⁷ See Gary Sick, "Managing Proliferation in Iran," presentation at a meeting hosted by The Atlantic Council of the United States, September 28, 2000.

Iranian society. In addition, many Iranian decision makers want very much to retain Iran's international respectability. This is, in part, Iran's reason for signing major arms control treaties and for cooperating fully with the IAEA inspection regime.

If Iran were to agree to IAEA-monitored agreements proscribing its acquisition of nuclear reactors and facilities that would enable it to reprocess spent nuclear fuel, enrich uranium, or independently fabricate nuclear fuel for its civilian nuclear power program, its progress toward acquiring a nuclear weapons capability would be slowed to a significant degree. This would give Iran time to consider whether to continue to pursue a nuclear capability in a quiet and deliberate manner. It would also give the United States and the international community time to consult with Iran about its national security concerns and to present Iran with non-nuclear defense alternatives.

Some military analysts argue that it is impossible to deter potential nuclear attack using conventional defense.¹³⁸ Nevertheless, Iran's religiously inspired view about the use of nuclear weapons, along with its desire to maintain its bona fides as a good international citizen, suggest that it may be worthwhile for the United States to explore non-nuclear solutions to Iran's national security concerns in bilateral discussions undertaken in the context of an already improved relationship.

One approach that has been recommended is for the United State to give quiet but effective support to the development of a regional security system in the Persian Gulf. This will take time to develop and, even upon bringing such a system to fruition, a regional security system would be as vulnerable as all collective security systems are: once a crisis ensues, there is no guarantee that each participant will fulfill its mutual defense obligations. This does not mean that a regional security system for the Persian Gulf should not be pursued, only that its limitations should be kept in mind and that it should be reinforced by simultaneous measures to maintain a military balance of power among potential combatants in the region.

Another factor that must be taken into account is the role that Israel plays in Iran's national security calculations. The Iranian leadership perceives Israel in a highly negative light. Some, like Supreme Leader Khamenei, give expression to the goal of ultimately driving Israel from the Middle East and reallocating the land that Israel now occupies to its former Palestinian inhabitants. The Iranian leadership is well aware of Israeli attitudes toward Iran and is consequently concerned about the possibility that Israel might use its undeclared nuclear weapons capability against Iran at some point in the future. Iran is also concerned about Israel's increasingly close defense cooperation arrangements with Turkey. Because Turkey falls within the NATO nuclear umbrella, Israeli military forces could use Turkish facilities to deploy in forward positions during a potential conflict.

It is possible that at some future date Israel and Iran will try to effect a *détente*. There is a minority within the Israeli defense establishment that believes that, in the long run, it will be impossible for Israel to deter possible aggression from Iran or mount a sufficient defense. Therefore, the reasoning goes, there is no alternative but to seek Israeli-Iranian rapprochement.

¹³⁸Anthony Cordesman, private conversation, October 17, 2000.

There is not much controversy about an eventual U.S. dialogue with Iran on its national security concerns. What is unclear is what the United States would be prepared to *do* to help Iran address them. Preliminary discussions can be held during a period of improvement in the U.S.-Iranian bilateral relationship, but addressing the problem in more concrete ways would have to wait for normal diplomatic relations – and perhaps for some time beyond their establishment.

If the United States thought about Iran in the same way that it thinks about countries like Saudi Arabia, it would be possible to speculate about a variety of defense alternatives. Based on the assumption that Iran's primary security concerns will be driven by Iraq for the foreseeable future, there are things that the United States could do. Just as the United States proved itself willing to share sensitive intelligence data about Iran with Iraq during the Iran-Iraq War, it could share intelligence data about Iraq with Iran. The United States will continue to closely monitor Iraq's military development in the post-sanctions period, so major movement toward an operational nuclear defense capability will be impossible for Iraq to hide. High-ranking U.S. defense officials have indicated that the United States would find a nuclear weapons capability under the control of Saddam Hussein intolerable.¹³⁹ The implication is that the United States would act preemptively to prevent an Iraqi nuclear weapons program from reaching an operational stage.

Finally, the most far-reaching way in which the United States can assuage Iran's national security concerns would be to extend a nuclear guarantee,¹⁴⁰ that is, commit itself to respond in kind against the perpetrator of any nuclear attack against Iran. A variant of this approach would be for the United States and Russia to issue a joint nuclear guarantee.

¹³⁹A point made by General Zinni, Atlantic Council presentation, May 1, 2000.

¹⁴⁰ By analogy, it has been argued that the United States should have given Pakistan such a guarantee following the Indian detonation of a nuclear device in 1974, thereby nipping a potential nuclear arms race between India and Pakistan in the bud.

APPENDIX A

Major U.S. Policies toward the Islamic Republic of Iran

The Carter Administration: 1979-January 1981

President Jimmy Carter responded to the takeover of the U.S. embassy in Tehran by taking two steps. First he issued Proclamation 4702 of November 12, 1979, imposing a ban on the import into the United States of Iranian oil. Second, he issued Executive Order 12170 of November 14, 1979, invoking the authority of the International Emergency Economic Powers Act (IEEPA) to block all property within U.S. jurisdiction owned by the Central Bank and government of Iran (including its instrumentalities and controlled entities).¹⁴¹ Although this step was already in the planning stages, its implementation was hastened when rumors that Iran intended to remove all of its dollar deposits from U.S. banks began to circulate in financial circles.

This was the first time that IEEPA had been invoked. Its provisions required a presidential finding that there was “an unusual and extraordinary threat to the national security, foreign policy and economy of the United States” of sufficient magnitude to justify the declaration of a national emergency. Another important aspect of the blocking of Iranian assets departed from the usual practice by having extraterritorial reach. Not only were Iranian assets held in the Federal Reserve Bank in New York and in private banks throughout the United States blocked, but the order also extended to Iranian deposits held in the foreign subsidiaries of U.S. banks.

When the United States severed diplomatic relations with Iran, President Carter issued Executive Order 12205 of April 7, 1980, instituting an embargo on U.S. exports to Iran.¹⁴² The order also imposed a variety of restrictions on U.S. financial transactions with Iran, including those involving private Iranian citizens. In anticipation of the April 25, 1980 hostage rescue attempt, Carter issued Executive Order 12211 of April 17, 1980 imposing further prohibitions on transactions with Iran, including the revocation of existing licenses for U.S. transactions with IranAir, the National Iranian Oil Company, and the National Iranian Gas Company.¹⁴³ This order also imposed a ban on all Iranian imports and prohibited U.S. citizens from traveling to Iran or conducting financial transactions there. One of the purposes of these regulations was to prevent U.S. citizens from being in Iran after the rescue attempt in case of reprisals, including the taking of more hostages.

On January 19, 1981, the Carter administration and Iran signed the Algiers Accords,¹⁴⁴ an agreement that provided for the release of the hostages and the establishment of a mechanism for resolving mutual claims. Accordingly, and “*to begin the process of normalization of relations between the United States and Iran,*” Carter issued Executive Order 12282 of January 19, 1981, revoking the prohibitions in the November 1979 oil import ban and in Executive Orders 12205 and 12211.¹⁴⁵

¹⁴¹ <<http://www.nara.gov/fedreg/codific/eos/e12170.html>>.

¹⁴² <<http://www.nara.gov/fedreg/codific/eos/e12205.html>>.

¹⁴³ <<http://www.nara.gov/fedreg/codific/eos/e12211.html>>.

¹⁴⁴ Warren Christopher et al., *American Hostages in Iran* (New Haven and London: Yale University Press, 1985) pp. 405-421.

¹⁴⁵ <<http://www.nara.gov/fedreg/codific/eos/e12282.html>>.

Executive Order 12170 of November 14, 1979, blocking Iranian government property in the United States was not rescinded. However, more than \$9 billion of Iranian assets that had been frozen in U.S. banks were returned to Iran. Of this amount, certain sums were placed in accounts for the repayment of Iranian bank loans and for payment of the claims to be resolved by the Iran-United States Claims Tribunal at The Hague. The Algiers Accords prohibited claims against Iran by the former hostages and halted private litigation against Iran in U.S. courts.¹⁴⁶

The Reagan Administration: 1981-1988

During the 1980s, Congress and the executive branch were united in their opposition to Iran, fearful that Iran would be able to spread its influence to neighboring areas with large Shia populations. In addition, the war in Lebanon that followed the Israeli invasion of 1982, caused the creation of the Lebanese Hizbollah, a group of Lebanese Shia supported by Syria and financed and trained by Iran. Hizbollah attacks caused U.S. casualties, the assassination of U.S. citizens, and the taking of western hostages, often with U.S. citizens as the primary targets.

Arms Embargo

On January 20, 1984, Secretary of State George Shultz designated Iran a sponsor of international terrorism¹⁴⁷ and actively pressured U.S. allies not to provide arms to Iran during its ongoing war with Iraq¹⁴⁸ in a policy code-named Operation Staunch. The rationale for the embargo was Iranian sponsorship of international terrorism and its unwillingness to sue for peace in the war with Iraq. On August 27, 1986, a new section was added to the U.S. Arms Export Control Act specifically prohibiting the export of U.S. arms to countries that the secretary of state designated sponsors of international terrorism.¹⁴⁹

Arms Sales

During 1985 and 1986, however, the United States engaged in an undisclosed effort to approach Iran in ways that it hoped would eventually lead to a strategic U.S.-Iranian relationship that would preempt any attempt by the Soviet Union to establish a strategic relationship of its own with Iran. In addition, the United States was told by Israeli and Iranian intermediaries that Iran could effect the release of U.S. hostages being held by Hizbollah in Lebanon in return for arms, notably TOW¹⁵⁰ and Hawk¹⁵¹ missiles. Some of the subsequent shipments were made by Israel, with U.S. replenishment, and others were sold directly by the United States. Only two hostages were released, Father Lawrence Jenco and David Jacobsen. During the period of the arms sales, three new hostages were taken: Frank Reed, Joseph Cicippio, and Edward Tracey. The arrangements with Iran were beset by miscommunications and broken promises.¹⁵²

By the end of what became known as the “arms for hostages” deal, U.S. representatives were negotiating with intermediaries reputed to be connected to a faction led by Majlis Speaker Ali

¹⁴⁶ Congress later awarded each hostage a stipend of \$50 for each day of incarceration.

¹⁴⁷ It is significant that Iraq was removed from the terrorism list in 1981. It was still harboring terrorists such as Abu Nidal, but it had begun to moderate its statements in support of terrorism. Once Iraq was removed from the list, it was no longer banned from purchasing Munitions List items.

¹⁴⁸ The Iran-Iraq war began when Iraq invaded Iran in September 1980 and was not ended until 1988.

¹⁴⁹ Subsequent secret shipments of arms to Iran by the Reagan administration violated this prohibition.

¹⁵⁰ TOWs are man-portable tube-launched, optically tracked, wire-guided missiles.

¹⁵¹ Hawks are ground-launched, anti-aircraft missiles.

¹⁵² Iran never effected the release of all of the hostages. On the other side of the ledger, the weapons in one of the Israeli shipments to Iran were obsolete and were eventually returned to Israel.

Akbar Hashemi Rafsanjani. Then, on November 3, 1986, the arrangements were made public in a Beirut newspaper. The next day, Rafsanjani publicly acknowledged the arrangement, and a firestorm of criticism erupted in the United States – especially when it was learned that a surplus created by overcharging Iran for the weapons had been used to fund the Contras in Central America,¹⁵³ in spite of a congressional prohibition against such sales.

Military Conflict

In 1983, U.S. forces deployed as part of a multilateral peacekeeping force in Lebanon exchanged fire with forces that included Iranian volunteers. Then, beginning in mid-July 1987 and continuing until the end of the Iran-Iraq War the following year, the United States began escorting Kuwaiti ships through the Persian Gulf to protect them against attack from Iranian forces. The United States also engaged in limited military action against Iranian targets in the Persian Gulf – including vessels and oil platforms – in reprisal for Iranian attacks on U.S.-flagged vessels transporting oil from Kuwait.

The Ban on Iranian Imports

The military skirmishes in the Persian Gulf and the holding of American hostages in Lebanon gave rise to President Reagan's Executive Order 12613 of October 29, 1987, forbidding the importation of Iranian goods or services into the United States because of Iran's active support of "terrorism as an instrument of state policy" and its "aggressive and unlawful military action against U.S.-flag vessels and merchant vessels of other non-belligerent nations" engaged in peaceful commerce in the Persian Gulf.¹⁵⁴ The order was designed to curtail financial support for these activities. The ban applied to direct imports of Iranian crude oil but exempted Iranian oil that had been refined in third countries.

Other Steps

In addition to these major measures against Iran, there had been a series of regulatory and legislative provisions that also impacted Iran, but with less severe consequences:

- When Iran was placed on the Terrorism List in 1984, following the bombings of the U.S. embassy and marine barracks in Lebanon in 1983, it became ineligible for various forms of U.S. foreign assistance, including programs of the Export-Import Bank, the Peace Corps, and assistance authorized by the Agricultural Trade and Development Act.
- In 1985 legislative changes were made mandating the withholding of U.S. funding of international organizations in an amount proportional to the assistance that they provided to Iran (and certain other countries).
- In 1986, legislative changes prohibited the export of Munitions List items to countries on the Terrorism List and, separately, instructed the Department of Defense to deny contracts of \$100,000 or more to firms that were owned or controlled by Iran.
- Also in 1986, regulations in the internal revenue code were changed to deny tax credits to U.S. businesses paying taxes in Terrorism List countries.

¹⁵³ See the Report of the President's Special Review Board (the Tower Report), chapter 3, for details. (Washington, DC: Government Printing Office, February 26, 1987),

¹⁵⁴ <<http://envirotext.eh.doe.gov/data/eos/reagan/19871029.html>>.

- In 1988, legislative changes required U.S. executive directors of multilateral financial institutions to vote against loans to Iran. Legislative changes were also enacted to prohibit bilateral foreign assistance to Terrorism List countries.

The Bush Administration: 1989-1992

The most significant piece of legislation during the Bush administration was the Iran-Iraq Arms Non-Proliferation Act signed into law on October 23, 1992.¹⁵⁵ The act prohibited the export of missile technology; U.S. government sales; commercial arms sales; sales of dual-use items; and sales of nuclear material, equipment, or technology to either Iran or Iraq. When this legislation was first introduced, the lessons learned during the successful prosecution of the Persian Gulf War 1991 were very much in mind. The goal of the legislation was to make certain that if future U.S. military engagements in the Persian Gulf were necessary, U.S. forces would not face significantly enhanced military capabilities from Iran or Iraq.

By equating the military threat posed to U.S. interests by Iran and Iraq, this legislation was conceptually similar to the Clinton administration's "Dual Containment" strategy that was introduced months later. Concern about Iraq was not surprising, in view of its invasion of Kuwait. The same degree of concern about Iran's capabilities was motivated in part by a simultaneously issued CIA report estimating that Iran was allocating up to \$2 billion for the acquisition of weapons of mass destruction.

The Iran-Iraq Arms Non-Proliferation Act was also significant in its imposition of secondary sanctions against foreign countries that supplied Iran or Iraq with the prohibited items. In this respect, the act provided a model for the Iran and Libya Sanctions Act of 1996. Although aimed at the export to Iran and Iraq of items that could have military uses, the non-proliferation act has resulted in implementing regulations that have a bearing on the possibility of future normalized commercial activity between the United States and Iran. By barring the export of items controlled by the Commerce Control List, the regulations simultaneously prohibit many items that would be needed to support U.S. commercial initiatives or investments in Iran.¹⁵⁶ In addition, the statutory scheme in the act requires the secretary of state to ask Congress for waivers on a case-by-case basis, a very cumbersome process that has had a chilling effect on use of the waiver authority.

The First Clinton Administration, Part One: 1993-1994

Shortly after Bill Clinton took office, a new policy toward Iran was articulated in the Dual Containment doctrine put forth by Martin Indyk, then special assistant to the president for Near East and South Asian Affairs at the National Security Council.¹⁵⁷ The policy applied equally to Iraq and Iran. It was argued that in the aftermath of the Persian Gulf War a severely weakened Iraq could no longer be thought of as a counterweight to Iran. Thus, the United States could no longer follow a policy of tilting toward Iraq or toward Iran depending on the predominance of either country. Instead, both countries had to be contained simultaneously.

¹⁵⁵ Hossein Alikhani, *Sanctioning Iran: Anatomy of a Failed Policy*. (London: I.B. Tauris Publishers, 2000) pp. 171-176.

¹⁵⁶ Oil well perforators are one example among many.

¹⁵⁷ Martin Indyk, "Clinton Administration Policy toward the Middle East," special report of the Washington Institute for Near East Policy, May 21, 1993.

The basic assumption underlying Dual Containment was that it could operate in the tradition of the containment policy toward the Soviet Union that had been articulated by George Kennan in 1950. When applied to Iran, the goal was to “increase the strains”¹⁵⁸ under which Iran must operate, and thereby generate “the break-up or gradual mellowing”¹⁵⁹ of Iranian power. The belief was that pressure would cause the Iranian leadership to moderate its behavior abroad and open itself up to greater democracy at home.

The First Clinton Administration, Part Two: 1995-1996

The U.S. measures toward Iran that constitute the greatest barriers to reformulating U.S.-Iranian relations were put in place during 1995-1996. There was a confluence of events that caused this to happen. Republicans in Congress had been energized by their takeover of the House and Senate and were poised to take a more active role in setting the foreign policy agenda. This occurred against a backdrop of events that increased public anxiety about international terrorism and enhanced negative perceptions of Iran.

Beginning in the spring of 1994, there had been a series of bombings in Israel by members of HAMAS and the Palestinian Islamic Jihad (PIJ), each of which were recipients of financial assistance from Iran and moral and logistical support from Syria. These attacks accelerated in 1995 and were designed to frighten the Israeli public, with the hope that this would undermine the Peres candidacy in forthcoming Israeli national elections and ensure the victory of his hard-line opponents. The latter could be expected to derail the Middle East peace negotiations by staunchly opposing compromise, and this is exactly what happened under the Netanyahu government.

In some instances, American citizens were among the killed and wounded. The level of concern, among members of the Jewish-American community was understandably high. U.S. concern about international terrorism reaching its own shores was amplified by several events: the April 20, 1995 bombing of the Alfred P. Murrah Federal Building in Oklahoma City; the (then) mysterious July 18, 1996 downing of TWA flight 800 off Long Island, New York; and the July 26, 1996, bombing at the summer Olympics in Atlanta, Georgia. None of these events proved to have been caused by foreign agents, but before investigations were concluded television news programs and other media had paraded forth a series of former intelligence community commentators articulating theories of international terrorist involvement.

At the same time, concerns were raised about Iran’s pursuit of a nuclear weapons capability. Israel presented the United States with intelligence that pointed to Iran acquiring components for nuclear weapons. Upon being briefed by the Israelis, the Clinton administration initiated a review of the effectiveness of its Dual Containment policy toward Iran. Shortly thereafter, in early February 1995,¹⁶⁰ the Russian government announced that it had permitted a contract to be signed for completion of a civilian nuclear power reactor in Bushehr, Iran.¹⁶¹ This raised U.S.

¹⁵⁸ *Ibid.*

¹⁵⁹ *Ibid.*

¹⁶⁰ See, for example, Thomas Lippman, “Russian-Iran Atomic Deal Irks U.S.,” *Washington Post*, February 11, 1995.

¹⁶¹ The reactor had been started by a German firm but was severely damaged during the Iran-Iraq War. Until the Russian announcement, the United States had been successful in deterring European firms from undertaking to complete the project.

anxieties, especially in Congress. The American Israel Public Affairs Committee (AIPAC) began to formulate a plan for dealing with Iran, and took its case to Capitol Hill. This was the climate in which a number of sanctioning events took place.

Economic Sanctions against Iran

AIPAC produced a detailed report advocating a policy of comprehensive U.S. sanctions against Iran and used it as the basis of an energetic congressional lobbying campaign. The plan was noteworthy both in promoting a total U.S. trade and investment embargo and in advocating a secondary boycott of foreign companies trading with Iran. Shortly afterward, Sen. Alphonse D'Amato (R-NY) introduced the Comprehensive Iran Sanctions Act on January 25, 1995, followed by his introduction of the Iran Foreign Sanctions Act on March 27, 1995. To compete with the proposed D'Amato legislation and to head off some of its more far-reaching aspects, the Administration issued Executive Order 12957 on March 15, 1995,¹⁶² banning U.S. contributions to the development of petroleum resources in Iran, and Executive Order 12959 on May 6, 1995,¹⁶³ imposing a total trade and investment embargo. Provisions were made, however, to allow U.S. licenses to be granted for swaps of crude oil from land-locked Azerbaijan, Kazakhstan, and Turkmenistan for Iranian crude oil that could be exported through the Persian Gulf.

While D'Amato's Comprehensive Iran Sanctions Act listed Iran's transgressions as being violations of human rights, efforts to acquire a nuclear explosive device, and support for acts of international terrorism, the Clinton administration's rationale for its executive orders did not include human rights but was described as being a response to "Iran's support for international terrorism, including support for acts that undermine the Middle East peace process, as well as its intensified efforts to acquire weapons of mass destruction."

Radio Free Iran

On May 15, 1995, Senator D'Amato introduced the Radio Free Iran Act, citing Article 19 of the Universal Declaration of Human Rights and the objective of communicating accurate information to the people of Iran. The station was patterned after Radio Free Europe, Radio Free Asia, and the broadcasts to Cuba by Radio Marti.

Reports of Plans for Covert Action

On December 22, 1995, the *Washington Post* published a story entitled "White House Agrees to Bill Allowing Covert Action against Iran." The text described the Clinton administration as having bowed to pressure from House Speaker Newt Gingrich (R-GA), who was said to have held up approval of an intelligence community spending bill pending inclusion of a covert program targeting the Iranian government. According to anonymous sources quoted in the article, the administration resisted providing funding for any program aimed at overthrowing the Iranian regime, but agreed to provide up to \$20 million for a small covert program that would "cultivate new opponents to the regime, . . . try to blunt the regime's extremist policies, and encourage it to move – even slowly – toward becoming a democracy."

¹⁶² <<http://envirotext.eh.doe.gov/data/eos/clinton/19950315.html>>.

¹⁶³ <<http://envirotext.eh.doe.gov/data/eos/clinton/19950506.html>>.

Economic Sanctions against Foreign Companies

Senator D'Amato's proposed Iran Foreign Sanctions Act of 1995 reemerged in somewhat altered form as the Iran and Libya Sanctions Act of 1996 (ILSA).¹⁶⁴ Libya had been added to the bill at the behest of Sen. Ted Kennedy (D-MA), who had constituents who had been engaged in attempts to vindicate the victims of the bombing of PanAm Flight 103 over Lockerbie, Scotland. ILSA was passed with overwhelming support and signed into law on August 5, 1996 (just 10 days after the Atlanta Olympics bombing and less than one month after the then-unsolved crash of TWA 800).

Passage of ILSA was delayed by congressional negotiations with the administration, during which it was able to insert language narrowing the scope of the proposed sanctions and giving the president the ability to waive the terms of the act on national security grounds. There were also negotiations between the United States and the European Union because the EU opposed ILSA's extraterritorial application of U.S. law. European countries enacted domestic legislation preventing their nationals from complying with ILSA's terms. The EU also threatened to take the issue to the World Trade Organization (WTO).

Fingerprinting Iranian Visitors

On September 5, 1996, one month after the passage of ILSA, Attorney General Janet Reno directed the Immigration and Naturalization Service to register and fingerprint "certain non-immigrants bearing Iranian or Libyan travel documents who apply for admission to the United States."¹⁶⁵ The order was justified as a response to national security concerns resulting from terrorist attacks and uncovered plots directed by nationals of Iran and Libya. (A similar regulation had been issued for the nationals of Iraq and Kuwait on January 16, 1991, at the outset of the Persian Gulf War; it was lifted on December 23, 1993.)

The attorney general had been given the authority to issue such orders with the passage of the Alien Registration Act of 1940,¹⁶⁶ which provides for the registration and fingerprinting of all aliens seeking to enter the United States. The stipulation covers foreign visitors as well as intending immigrants. The process of fingerprinting non-immigrant aliens (i.e., foreign visitors) has been waived as a matter of practice. In ordering the fingerprinting of entering Iranians and Libyans, Attorney General Reno was merely making use of a power that she already possessed. There was no legislation that made it *mandatory* for her to do so.

Removal of Iran's Sovereign Immunity from Private U.S. Litigation

On April 24, 1996, Congress passed the Antiterrorism and Effective Death Penalty Act of 1996,¹⁶⁷ many aspects of which bear upon Terrorism List states. Section 221 is especially important because it amends the Foreign Sovereign Immunities Act by depriving Terrorism List states of sovereign immunity in instances in which private U.S. plaintiffs seek to sue them for damages. This part of the act, often called the Lautenberg Amendment, after Senator Frank R. Lautenberg (D-NJ), was designed with the particular purpose of permitting U.S. citizens and

¹⁶⁴ <<http://usinfo.state.gov/regional/nea/gulfsec/irnsanc.htm>>.

¹⁶⁵ Federal Register: September 5, 1996 (Volume 61, Number 173).

¹⁶⁶ The provision is described in Title III, Section 30 of the act. The purpose of the act was to protect the United States from subversion and sedition during the period immediately preceding its entry into World War II.

¹⁶⁷ P.L. 104-132.

families of deceased U.S. citizens to sue Terrorism List countries for “personal injury or death that was caused by an act of torture, extrajudicial killing, aircraft sabotage, hostage taking, *or the provision of material support or resources for such an act.*” (Emphasis added).

Although the language of the legislation draws a connection between the act in question and the provision of material support or resources for that (presumably specific) act, the evidentiary standards employed in court cases brought under the act have not been strict. For example, an attorney in a victims of terrorism lawsuit against Syria was successful in arguing that, “the law does not require his plaintiffs to show that Syria *carried out* or *encouraged* the specific bombing that killed [the deceased relative of his clients], but only that it provided ‘material support’ to the group whose members carried out the act.”¹⁶⁸

Prohibition against Financial Transactions with Iran

The Antiterrorism and Effective Death Penalty Act of 1996 also contained language that prohibited U.S. financial transactions with Terrorism List states. Under Section 321 of the act, and *except as provided in existing regulations*: “[if] a United States person, knowing or having reasonable cause to know that a country is designated . . . as a country supporting international terrorism, engages in financial transactions with the government of that country, [he or she] shall be fined under this title, imprisoned for not more than 10 years, or both.”

At first glance, this legislative provision would seem to override any potential modifications of the 1995 executive orders barring U.S. trade and investment in Iran. The provision excluding existing regulations, however, also applies to the ability to *revise* those regulations. In other words, because the 1995 orders were already on the books when the 1996 Antiterrorism and Effective Death Penalty Act was passed, they can be revised without reference to the act. Revision can include lifting the terms of the orders altogether.

In addition, when the Department of the Treasury’s Office of Foreign Assets Control (OFAC) wrote the regulations necessary to implement Section 321 with respect to countries like Syria – which had not been the subject of “grandfathered” regulations – the language used was much more narrow than the framers of the act probably intended. The only prohibitions were that U.S. citizens could not accept donations from a Terrorism List country’s government, and they could not engage in financial transactions with such a government if they knew or had reason to believe that the particular transaction would further terrorist activity.

The Second Clinton Administration: 1997-January 2001

A dramatic change in Iranian politics occurred during the first year of President Clinton’s second term of office. In May 1997 the reform candidate, Mohammad Khatami received a dramatic victory in Iran’s presidential election. Nevertheless, U.S. policy toward Iran showed no change.

Executive Order 13059 of August 19, 1997,¹⁶⁹ was issued so that the prohibitions against the re-export of U.S. goods contained in the trade and investment embargo of May 6, 1995 could be tightened. In the letter to Congress that accompanied the order, President Clinton again authorized swaps of Iranian and Caspian oil.

¹⁶⁸ Judith Miller, “Syria Is Sued by Family of Man Killed by ’96 Bomb in Jerusalem,” *New York Times*, August 2, 2000.

¹⁶⁹ <<http://www.ustreas.gov/ofac/legal/eo/13059.pdf>>.

Separately, the proposed legislation for Radio Free Iran became law on November 13, 1997, as part of the Appropriations Bill for the Departments of Commerce, Justice, State, the Judiciary, and Related Agencies for the Fiscal Year Ending September 30, 1998.

ILSA waiver

On May 18, 1998, Secretary of State Albright waived the application of ILSA sanctions in response to a contract signed by companies Total, Gazprom, and Petronas for the development of the South Pars Iranian gas field. This was the first violation of ILSA that the United States had confronted. The sanctions were waived on national security grounds because the European Union and Russia had enhanced their cooperation with U.S. efforts to inhibit Iran's ability to develop weapons of mass destruction and support terrorism.

Albright also indicated that future waivers could be expected in similar cases involving EU countries.¹⁷⁰ The EU issued a simultaneous statement indicating its own expectation that ILSA waivers would be granted to EU companies and committing itself not to call for a WTO Panel against the United States in response to ILSA so long as such waivers were granted.¹⁷¹

Victims of Terrorism Lawsuits

The most important changes in U.S. policy toward Iran resulted from private lawsuits against Iran made possible after passage of the Antiterrorism and Effective Death Penalty Act of 1996.

Although the legislation removing Iran's sovereign immunity for terrorism-related suits had been enacted in 1996, the full impact of this change in policy was not felt until specific lawsuits were filed and decisions reached under this new dispensation. The cases took time to wend their way through the courts but during 1998 to 2000, U.S. courts awarded both compensatory and punitive damages against Iran in several high-profile cases:

- On July 18, 1998, the family of Alisa Flatow was awarded \$247.5 million (\$22.5 million in compensatory damages to Flatow's estate and the individual members of her family and \$225 million as punitive damages meant to deter future Iranian support of terrorist groups). Flatow had been a passenger on an Israeli bus when the PIJ Shaqaqi faction detonated an explosive on April 9, 1995. Flatow died during surgery to remove a piece of shrapnel from her brain.
- On August 27, 1998, Joseph Cicippio, David Jacobsen, Frank Reed, and their families were awarded \$65 million in compensatory damages. These men had been abducted and held hostage in Lebanon by a Hizbollah faction. The judge's reading of the law was that he could not impose punitive damages. Later, in a separate case, the same judge did award punitive damages.
- On March 24, 2000, former U.S. hostage and journalist Terry Anderson and his family were awarded \$341.2 million (\$41.2 million in compensatory damages and \$300 million in punitive damages). Anderson had also been abducted and held hostage in Lebanon by a Hizbollah faction. As in the Flatow case, the level of punitive damages awarded Anderson was a

¹⁷⁰ Iran and Libya Sanctions Act (ILSA): Decision in the South Pars Case," Department of State, May 19, 1998. <<http://secretary.state.gov/www/statements/1998/980518.html>>.

¹⁷¹ EU Unilateral Statement, May 18, 1998. <<http://presid.fco.gov.uk/news/1998/may/18/unilat.txt>>.

multiple of an estimate of Iran's yearly expenditure to support terrorism. Because oil prices had risen since the Flatow case was decided, and Iran was therefore believed to be spending more in support of terrorism, the level of punitive damages was also higher – by \$75 million.

- On July 11, 2000, an award was made to the families of Matthew Eisenfeld and Sara Rachel Duker in the amount of \$324.7 million (\$24.7 million in compensatory damages and \$300 million in punitive damages). Eisenfeld and Duker were killed by a bomb placed on an Israeli bus by HAMAS.
- On September 21, 2000, an award was made to the family of marine lieutenant colonel William R. Higgins in the amount of \$355 million (\$55 million in compensatory damages and \$300 million in punitive damages). Higgins had been kidnapped by Hizbollah forces in February 1988, while he was part of a United Nations peacekeeping mission in Lebanon. After 16 months of captivity, he was killed by his captors.

Taken together, the awards in these five cases amount to more than \$1 billion. The awards in each case were relatively high largely because they were default judgments; the evidence adduced was never questioned in an adversarial proceeding. Iran did not defend itself in the suits because, citing the principle of international law that grants states sovereign immunity, it did not recognize the jurisdiction of the U.S. district courts in which the lawsuits were brought.

The plaintiffs in the Flatow suit tried to attach money that was owed to Iran by the United States as the result of an award granted by the Hague Tribunal. This attempt was quashed after the U.S. government went to court and asserted its right to sovereign immunity over funds still in the Treasury. Later, both the Flatow and Anderson plaintiffs tried to attach money held by the U.S. government in Iran's FMS account. This account represents one of the sums of money currently under arbitration at The Hague. Again, the claim of sovereign immunity over funds held by the U.S. government prevented the monies from being attached without an expressed U.S. waiver of that immunity.

The Justice for Victims of Terrorism Bill

On October 26, 1999, Senator Lautenberg joined with Senator Connie Mack (R-FL) in introducing the Justice for Victims of Terrorism Act.¹⁷² Senator Lautenberg represented the state in which the Flatow family resides, and the bill was designed to facilitate the attempts of victims of terrorism to attach Iranian assets deposited in the United States. Two aspects of the bill (as originally drafted) had significance for U.S.-Iran relations.

- First, it deprived the United States of sovereign immunity against the attachment of assets of Terrorism List states. This means that, had the act been passed in its original form, the U.S. government would no longer have been able to protect money under arbitration at The Hague. If the cases before the tribunal continued to be decided separately – or if a global settlement was reached – the monetary awards to Iran could have been attached by the victims of terrorism plaintiffs before the United States had a chance to transfer them to Iran.

¹⁷² The Clinton Administration was able to negotiate a compromise with the sponsors of the bill before the bill came up for a vote. The compromise legislation is described below, along with an assessment of the likely impact of the revised legislation on U.S.-Iranian relations.

- Second, the Justice for Victims of Terrorism Act stipulated that “all assets of any agency or instrumentality of a foreign state shall be treated as assets of that foreign state,” meaning that normalization of U.S.-Iranian trade relations could not take place without both importers and exporters facing writs of attachment from victims of terrorism plaintiffs in instances in which an Iranian “agency” or “instrumentality” is involved. (This would apply, for example, to an Iranian government agency’s payment to a U.S exporter for the purchase of grain, as well as to a hypothetical shipment of oil to the United States from the National Iranian Oil Company).

Revised Justice for Victims of Terrorism Legislation

On October 11, 2000, compromise legislation for addressing the issues raised in the Justice for Victims of Terrorism bill was passed as an amendment to the Victims of Trafficking and Violence Protection Act of 2000. Section 2002 of the act contains the relevant provisions:

- Plaintiffs in victims of terrorism lawsuits that have already been filed as of the date of the act have the option of receiving either 100 percent or 110 percent of their court awards of compensatory damages, *with payment being made directly by the U.S. government*. Plaintiffs who agree to accept the award of 110 percent of compensatory damages are eligible to do so only if they agree to relinquish all rights and claims to punitive damages that have been awarded them. Plaintiffs who wish to maintain their right to pursue payment by Iran of punitive damages can receive 100 percent of their compensatory damage awards if they agree to relinquish their rights to “execute against or attach property that is at issue in claims against the United States before an international tribunal.”
- The U.S. government will fund its payments to the plaintiffs from money derived from rental proceeds from Iranian diplomatic and consular property in the United States that had accrued as of the enactment of the act; funds in the Treasury of an amount not to exceed the total amount in Iran’s FMS program account on the date of the enactment of the Act; and additional funds from the Treasury as needed to fulfill the obligations set forth by the legislation.
- The court-awarded rights of the plaintiffs to compensatory damages from Iran will be subrogated¹⁷³ to the U.S. government to the extent of the payments made by the Treasury in connection with Iran’s FMS account. The U.S. government will pursue these rights with the government of Iran. No funds shall be paid to Iran from property blocked under IEEPA or from the FMS fund until the subrogated claims have been dealt with by Iran to the satisfaction of the United States.
- In addition, the legislation stated that it was the sense of the Congress that *the president should not normalize relations between the United States and Iran* until the subrogated claims have been dealt with to the satisfaction of the United States.

¹⁷³ Subrogation is the substitution of one entity for another as a creditor so that the new creditor receives the former’s rights.

Iran has already registered its unhappiness with this arrangement and, in theory, could try to file a complaint against the United States with the Hague Tribunal or at the International Court of Justice (ICJ).

- If each of the plaintiffs agrees to accept payment from the United States of 110 percent of their compensatory damage awards, then all punitive damages will be forfeited. This means that the formerly outstanding sum of close to \$1 billion would no longer exist as a complicating factor in future U.S. payment of Hague Tribunal awards to Iran or future normalized U.S.-Iranian trade relations.
- Alternatively, if each of the plaintiffs agrees to accept at least 100 percent of their compensatory damages, the Hague Tribunal awards process will be protected but other Iranian assets would still be subject to attachment by those plaintiffs unwilling to forfeit their punitive damage awards.

If the Hague Tribunal continues to render its decisions on a case-by-case basis, Iran will not suffer any adverse effects from this legislation, because the U.S. government would still be responsible for paying the Hague award(s). The legislation does not permit the plaintiffs to attach awards rendered to Iran.¹⁷⁴ Assuming that the subrogated claims have not been dealt with by Iran to the satisfaction of the United States, the United States would not be able to withdraw any money from Iran's FMS account for payment of an award rendered in Iran's favor by the Hague Tribunal. The money instead would come from the Treasury.¹⁷⁵

If, on the other hand, a global settlement of the outstanding U.S.-Iranian claims is reached, in accordance with a proposal made by Secretary of State Madeleine Albright in a major speech on U.S.-Iranian relations that was delivered on March 17, 2000, the situation would be more complicated. The United States first would have to "be satisfied" that Iran had dealt appropriately with the subrogated victims of terrorism awards. Satisfaction, however, does not necessarily depend on receipt of a monetary payment from Iran and can be derived from the totality of the terms of the agreed-upon global settlement.

It is important to be aware that the compromise legislation only relates to victims of terrorism cases that have been filed thus far. As long as the Antiterrorism and Effective Death Penalty Act of 1996 remains in effect in its original form, future victims' lawsuits can be brought against Iran for the time that Iran remains on the Terrorism List. For example, if further investigation of the Khobar Towers bombing reveals that the government of Iran was involved,¹⁷⁶ relatives of the victims can file lawsuits against Iran in U.S. courts. Once awards are granted in these lawsuits, Iranian assets in the United States again will be subject to attachment. Therefore, a future situation of normalized U.S.-Iranian trade would be fraught with the danger that both Iranian

¹⁷⁴ If they abide by its terms by forgoing their rights of attachment in exchange for payment of their compensatory damages by the U.S. government.

¹⁷⁵ The money would probably be disbursed from the Judgment Fund. Its rationale and the way in which it operates are described in Appendix C in the section entitled "Payment of a U.S. Award to Iran."

¹⁷⁶ Statements by the Departments of State and Justice have been at variance on this issue, with Justice having reached a more definite conclusion about Iranian government involvement. Saudi Arabia is also unwilling to make a definitive statement about Iranian government involvement. The Saudi foreign minister Prince Saud al-Faisal has stated that it is premature to reach such a judgment at this stage of the investigation. See Associated Press, "Saudi Arabia Criticizes U.S. Report," May 13, 2001.

exports to the United States and Iranian prepayments for the purchase of U.S. imports could be subject to court-ordered attachment.

Currently, this issue is moot because the regulations of the Treasury's Office of Foreign Assets Control have required that financial institutions of third countries process the financial transactions that are necessary for otherwise-permitted trade between the United States and Iran. In a fully normalized trade relationship, such arrangements may have to be perpetuated.

Modest Sanctions Liberalization

In April 1999, the Clinton administration modified existing sanctions regulations to allow the export of U.S. food and medicine to sanctioned countries, including Iran. Later, on March 17, 2000, the administration went further by lifting the prohibition on the importation of Iranian carpets and certain foodstuffs, namely caviar and pistachio nuts. This latter lifting of sanctions was meant to represent a reward to Iran for the reform faction's victory in parliamentary elections the month before. In fact, it was expected that Iran would respond to the U.S. gesture in an identifiably positive manner, but such a response was not forthcoming. The conservative backlash that subsequently thwarted implementation of the reform agenda was not foreseen.

Proposals to Roll Back Sanctions Liberalization¹⁷⁷

U.S. public and legislative opinion still does not discriminate between Iranian policies that can be influenced by President Khatami and the reform movement and those that are under the control of the Supreme Leader and his conservative supporters. The September 21, 2000, conviction of 10 Iranian Jews on charges of spying for Israel is a case in point. Various aspects of the trial gave credence to the widespread belief in the West that the accused were being tried on trumped-up charges. It appeared implausible that the suspects could have had access to state secrets. In addition, the long period of imprisonment before trial, doubts about due process, televised "confessions" by the suspects, and the length of the prison terms handed down led to a surge of renewed U.S. hostility toward Iran. The judiciary in Iran has always been under the control of the Supreme Leader. President Khatami's influence has not extended to the judiciary, although he is trying to influence it in a more moderate direction.

In her March 17, 2000 speech, Albright had warned the Iranian government that the outcome of the trial of the Jews would be a barometer of the prospects for improved U.S.-Iranian relations. Four months later, Iran tested a Shahab-3 missile on July 16, 2000, a time when the United States was engaged in a high-profile attempt to promote a final peace agreement between Israel and the Palestinians. The range of the missile, 1,300 kilometers, would allow it to reach Israel. While it could carry a conventional warhead, many defense analysts argue that its only purpose is to eventually carry a nuclear or chemical warhead.

This is the context in which legislation was introduced on July 27, 2000, to immediately end the importation of all Iranian goods into the United States. The legislation was introduced in the Senate by Senator Charles Schumer (D-NY). Similar legislation was introduced in the House by Rep. Brad Sherman (D-CA). Meanwhile, Representative Peter Deutsch (D-FL) introduced an amendment to the Treasury and General Government Appropriations Act of 2001 that would

¹⁷⁷ These proposals have not resulted in any legislation, but could be revived in the future if international events cause a new surge of Congressional hostility toward Iran.

deny the use of any of its appropriated funds “to allow the importation into the United States of any product that is the growth, product, or manufacture of Iran.”

As presently drafted, the Schumer-Sherman legislation disallows the importation into the United States of Iranian goods until the president is able to certify that Iran has:

1. Shown substantial progress in respecting the rights of ethnic and religious minorities.
2. Ceased support for international terrorism.
3. Terminated its weapons of mass destruction and ballistic missiles programs.

Even if the first two conditions could be met at some time in the future, *it is highly unlikely that Iran would terminate its ballistic missile program in order to sell carpets, caviar, and pistachio nuts in the United States.* Also, because Iran’s weapons of mass destruction programs are clandestine in nature, it would be impossible to certify that they had been terminated, even if there is a change in Iranian policy. There is such a strong predisposition to be suspicious of Iran that a future absence of evidence that Iran continues its weapons programs would be countered by skeptics asserting that Iran had merely become more successful in hiding its efforts from U.S. intelligence.

The George W. Bush Administration: January, 2001-
Proposals to Renew ILSA

Introduction of legislation for the Iran and Libya Sanctions Act of 1996 was in part an attempt by the Republican congress to embarrass the Clinton administration. Once the May 1998 ILSA waiver was granted and commitments were made to grant similar waivers to the companies of EU countries, it was generally believed that the legislation would not be renewed when it expired on August 5, 2001. Circumstances changed, however, when violence between Israel and Palestinians accelerated after leading Israeli politician (and now Prime Minister) Ariel Sharon declared Israeli sovereignty over the Temple Mount in Jerusalem in late September 2000. During the ensuing violence, Iran was still giving material support to HAMAS, the PIJ, and the PFLP-GC and many of its leaders engaged in harsh rhetoric against Israel. In addition, Supreme Leader Khamenei urged Palestinians to follow the example of Hizbollah’s successful ending of the Israeli occupation of southern Lebanon to also end the Israeli “occupation” of Palestine.

Consequently, by the time AIPAC held its annual meeting in March 2001, renewal of ILSA for another five-year period had become a primary legislative objective and a vigorous lobbying campaign was mounted.

House hearings on ILSA renewal were held on May 9, 2001 by the Committee on International Relations, Subcommittee on the Middle East and South Asia, under the chairmanship of Rep. Benjamin Gilman (R-NY). ILSA renewal became so popular in Congress that its cosponsors in the Senate, Senators Schumer and Gordon Smith (R-OR), were able to gather sufficient support to override a possible presidential veto.

The Bush administration responded by proposing that the extension of ILSA should be limited to a two-year period. During that time it plans to complete separate internal reviews of its policies toward Iran and toward the general use of economic sanctions as an instrument of foreign policy. If this were done, however, U.S. policy toward Iran would be subject to the same kind of periodic scrutiny as U.S. policy toward China, for which Congress is required to give annual

authorization of China's Most Favored Nation (MFN) status.¹⁷⁸ In spite of the Bush administration's preference for a two-year extension of ILSA, the extension is expected to be for a five-year period because of overwhelming support from both houses of Congress.

¹⁷⁸ China will be able to attain Permanent Normal Trade Relations (PNTR) status once it enters the World Trade Organization (WTO). Meanwhile, the Bush administration will have to seek annual congressional approval for continuing normal trade status for China.

APPENDIX B

Analysis of the *Patterns of Global Terrorism Reports*¹⁷⁹

Importance

Some of the most significant barriers to improved U.S.-Iranian relations can be traced to legislation that references the Terrorism List used for export control purposes in accordance with 50 U.S.C., Section 2405(j). Such legislation either denies Terrorism List countries the benefits of various forms of U.S. assistance or deprives them of general benefits that they would otherwise enjoy.

- Terrorism List countries, as noted earlier in this report, cannot participate in the Peace Corps program, Export-Import Bank initiatives, or Agricultural Trade and Development programs. They also cannot receive bilateral U.S. assistance. U.S. taxpayers cannot receive foreign tax credits in instances in which they are permitted to invest in these countries. Export of Munitions List items are prohibited to these countries and export financing is supposed to be denied to third countries selling them lethal equipment.

The prohibition against bilateral U.S. assistance to Terrorism List countries means that many of the *modest first steps* toward Iran that have been suggested by analysts and former government officials cannot be implemented. Not only is the U.S. government prohibited from assisting Iran in matters like narcotics control and the protection of the environment, but such programs as educational exchange through the U.S. Agency for International Development programs are also impossible under current legislative circumstances.

- Terrorism List countries are denied sovereign immunity from lawsuits filed by U.S. plaintiffs in U.S. courts. This exception to the Foreign Sovereign Immunities Act subjects countries like Iran to the possibility of having their assets seized in order to satisfy the awards granted in such lawsuits. *This legislative stipulation may prove to have the most dramatic long-term negative impact on relations between Iran and the United States.* As already noted, the victims of terrorism lawsuits that are made possible by depriving Iran of a long-standing right will, at the very least, complicate the ability of the United States to pay Hague Tribunal awards to Iran.

To the extent that they are still outstanding at the time of a future normalized trading relationship between the United States and Iran, the writs of attachment that U.S. courts have validated in victims of terrorism lawsuits will allow liens to be placed on the assets of Iranian government “entities,” when they become involved in trading relationships with the United States.

In addition to legislation linked to the Terrorism List, perceptions of Iran as a supporter of terrorism also affect other legislation and executive branch regulations. As noted, the executive orders of 1987, 1995 and 1997 referenced Iranian support of international terrorism as a key reason for their promulgation. The Iran and Libya Sanctions Act of 1996 declares that “the Government of Iran’s . . . support of acts of international terrorism endanger the national security and foreign policy interests of the United States and those countries with which the

¹⁷⁹ <<http://www.state.gov/www/global/terrorism/1999report/sponsor.html>>.

United States shares common strategic and foreign policy objectives.” This legislation will expire in August 2001, but a strong campaign for its renewal for another five years has been launched by the American Israel Public Affairs Committee, with strong support from its allies in Congress.¹⁸⁰

Definition of Terrorism

When Congress required the Department of State to produce annual country reports on terrorism, it imposed a requirement for “detailed assessments” of the terrorism-relevant activities of each of the Terrorism List countries. This requirement applies not only to currently identified Terrorism List countries, but also to any country that has appeared on the Terrorism List during the preceding five years.

One aspect of *Patterns of Global Terrorism* that has a bearing on how Iranian policies are assessed derives from the basic definitions that it employs. International terrorism is defined as “terrorism involving citizens or the territory of more than one country,” a non-controversial assumption, but “terrorism” is defined as “premeditated, politically motivated violence perpetrated against noncombatant targets by *subnational* groups or *clandestine* agents, usually intended to influence an audience” (emphasis added).

This definition is drawn from Title 22 of the United States Code, Section 2656f(d) and is part of the legislation that mandates the annual country reports. It is important to note, however, that *this definition focuses attention on only one strand of the whole spectrum of politically motivated violence that occurs on a worldwide basis*.¹⁸¹ Moreover, the definition of a subnational group as being terrorist is biased toward the perspective of the nation-state. Most terrorist groups are operating in a context in which a nation-state attempts to blunt their impact through police and military action. Such a situation usually devolves into a cycle of violence and counterviolence. Because of the analytic restriction focusing only on the activities of the subnational or clandestine group, only one side of the cycle of violence is examined.

The phenomenon considered by the Department of State as “terrorism” is often called asymmetrical warfare by military analysts. From this latter perspective, it is taken as given that because insurgent and nationalist groups generally cannot match the conventional military forces of their nation-state adversaries, they rely instead on sabotage and clandestine attacks on official and noncombatant targets. As pointed out in the *New York Times* coverage of the release of *Patterns of Global Terrorism 1996*, “If a nation’s air force bombs civilians, that is not terrorism; if civilians blow up a plane, it is.”¹⁸² This observation is not meant to absolve separatist and

¹⁸⁰ Hearings on ILSA renewal were held by the Subcommittee on the Middle East and South Asia of the House Committee on International Relations on May 9, 2001. The hearings were somewhat skewed. Three witnesses were invited to argue the case for ILSA renewal: former senator Alphonse D’Amato, who introduced the original ILSA legislation in 1996; Howard Kohr, the executive director of AIPAC; and Patrick Clawson of the Washington Institute for Near East Policy. The only witness presenting an opposing position was William A. Reinsch, president of the National Foreign Trade Council, Inc. and vice chairman of USA*Engage.

¹⁸¹ For example, it absolves nation states from being judged for “politically motivated violence perpetrated against noncombatant targets and intended to influence an audience.”

¹⁸² Tom Weiner, “Terrorism’s Worldwide Toll Was High in 1996, U.S. Report Says,” *New York Times*, May 1, 1997.

nationalist insurgencies of opprobrium for the destructive actions that they undertake, but to put these actions in a broader political and military perspective.

The introductory sections of recent *Patterns of Global Terrorism* reports take note of this problem, pointing out that “terrorist acts are part of a larger phenomenon of politically inspired violence, and at times the line between the two can become difficult to draw.” The reports, however, fail to inform the reader of the larger context of politically inspired violence when it lists allegations of terrorism under country headings.

Suggested Improvements

In the course of preparing *Patterns of Global Terrorism*, the Department of State has latitude to improve the analytical categories that it employs. The most important improvements relate to statements of comparison and the advisability of distinguishing between different kinds of terrorism. Such changes would facilitate an evaluation of the extent to which the record of each Terrorism List country changes over time. The factors described below should be applied across the board, but they will be discussed here in terms of their impact on the assessments made about Iran.

Statements of Comparison

The most misleading aspect of the approach that the Department of State takes in *Patterns of Global Terrorism* is that the reports do not compare Iran’s actions to international terrorism in its totality. The reports instead produce a narrow view by assessing Iran’s support of international terrorism only as it exists in comparison with the records of other “state sponsors” of terrorism.

The emphasis on state-sponsored terrorism dates back to 1981 and the beginning of the first Reagan administration. This administration came into office with the intention of making the point that past international political relationships had changed to the extent that nation-states had begun to engage in terrorism themselves and to assist terrorists by providing sanctuary, arms, training, logistical support, financial backing, or diplomatic facilities. Almost twenty years have passed since this observation was made and *Patterns of Global Terrorism 1999* points out that there is now a trend in international terrorism *away* from state-sponsored groups. Instead, most international terrorism is now caused by “loosely organized, international networks,” like the group headed by Osama Bin Laden.

Nevertheless, Iran’s record is evaluated exclusively within the category of state sponsors of terrorism. Thus, in recent years *Patterns of Global Terrorism 1996* described Iran as “the premier state sponsor of terrorism in 1996”; *Patterns of Global Terrorism 1997* described Iran as “the most active state sponsor of terrorism in 1997”; *Patterns of Global Terrorism 1999* described “certain state institutions...[as making] Iran the most active state sponsor of terrorism”; and *Patterns of Global Terrorism 2000* stated that “Iran remained the most active state sponsor of terrorism in 2000.”

By the time these conclusions reach newspaper headlines, the qualifying phrase “state sponsor” is usually dropped, and Iran is depicted being *the* primary source of worldwide terrorism, as in the following examples:

- “U.S. Report Calls Iran No. 1 Terror Sponsor, Despite New Leader.”¹⁸³
- “Iran Still Leading Terrorism Sponsor, Report Says.”¹⁸⁴
- “Iran Ranked No. 1 Terrorist Country by State Department.”¹⁸⁵

Headlines like this affect the perception of Iran held by the public at large and they also affect views of Iran held by members of Congress and by officials in the executive branch.

Under current circumstances, it makes little sense to compare Iran’s behavior to that of most of the other designated state sponsors of terrorism: Cuba, Iraq, Libya, North Korea, the Sudan, and Syria. North Korea and Cuba remain on the Terrorism List because they continue to provide asylum for a small number of foreigners who committed acts of terrorism many years ago. Iran’s record is described as outweighing that of Iraq, Libya, and the Sudan largely because of Iran’s support of groups that oppose the current modalities of the Middle East peace process by means that include violence.¹⁸⁶

Ironically, Iran’s record in this respect is described as outweighing that of Syria. While Iran gives financial support to groups like Hizbollah, HAMAS, the PIJ, and the PFLP-GC, it is Syria that gives these groups political direction and support. Consequently, it is expected that Syria would have the ability to restrict the activities of these groups in the context of a potential Syrian-Israeli peace agreement.

It is surprising that Iran is annually described as the perpetrator of more acts of state-sponsored terrorism than Iraq. Yet there is convincing evidence that links Iraq to a number of high profile incidents:

- the February 26, 1993, World Trade Center bombing in New York City;
- plans to bomb the United Nations building and other New York targets (before the arrests of some of the conspirators on June 24, 1993);
- plans to bomb U.S. commercial airliners flying Pacific routes on January 17, 1995 (the fourth anniversary of the beginning of the Persian Gulf War);
- the November 13, 1995, bombing of facilities of the U.S. training mission for the Saudi National Guard in Riyadh, Saudi Arabia; and
- the June 25, 1996, bombing of the Khobar Towers housing complex for U.S. pilots in Saudi Arabia enforcing the no-fly zone over southern Iraq.¹⁸⁷

In addition, since the outbreak of the al-Aqsa Intifada in late September 2000, Iraq has provided considerable rhetorical and financial support to Palestinian rejectionist groups.

¹⁸³ Philip Shenon, *New York Times*, May 1, 1998.

¹⁸⁴ R. Jeffrey Smith, *Washington Post*, May 1, 1998.

¹⁸⁵ Associated Press, George Gedda, May 1, 2001.

¹⁸⁶ *Patterns of Global Terrorism 1999* states that Libya may still have ties to the PIJ and PFLP-GC.

¹⁸⁷ See Mylorie, *Study of Revenge: Saddam Hussein’s Unfinished War against America*.

Instead of comparing state sponsors of terrorism to each other, a different approach could be taken. *Patterns of Global Terrorism* reports are now required by Congress to provide a list of terrorist acts of major significance. Consequently, in addition to the brief sketches of each Terrorism List country, *Patterns of Global Terrorism 1999* presents a chronology of the year's major terrorist incidents. In each instance, the country in which the attack occurred is noted, along with the identity of the suspected perpetrators, but no analytical linkage is drawn between the country reports and this chronology.

If Iran's annual record were evaluated in terms of its contribution to that year's "significant terrorist incidents," a very different picture would emerge. One hundred sixty major terrorist incidents were listed for the year 1999, and Iran was not associated with any of them. If the Department of State had chosen to make use of this more meaningful comparison, the headlines in the press might have read: "Iran Not Responsible for Major Terrorist Incidents."

Distinguish Between Different Kinds of Terrorism¹⁸⁸

Assertion: "Iran's security forces conducted several bombings against Iranian dissidents abroad."

Iranian attacks against dissidents abroad at first appear to fall within the category of *direct action*,¹⁸⁹ but on closer examination they may more appropriately be identified as *self-defense* against terrorism.¹⁹⁰ The identity of the people described as "dissidents" is important. The dissidents are not identified, except in a reference to a truck bombing of a Mujahedin-e Khalq (MEK) terrorist base near Basra, Iraq, that killed several MEK members and non-MEK individuals.

While it is true that members of the MEK are dissidents in the sense that they are Iranians opposed to the current government, they also receive support from Iraq, and as such are engaged in a low-intensity military conflict between the two countries. Because Iran is a sovereign state, it can be expected to attempt to defend itself against cross-border MEK attacks by means of retaliatory and preemptive actions. Viewed in this light, Iran is not engaged in attempted assassinations of dissidents but in national self-defense against terrorism. In fact, the Department of State's *Patterns of Global Terrorism* reports define the MEK as a terrorist organization.

In the past Iran has been linked to attacks against former Iranian officials, such as Shapour Bakhtiar, the prime minister of a transitional government appointed by the Shah, and members

¹⁸⁸ The suggestions presented below are illustrated by referencing the four assertions about Iran's support of international terrorism presented in the State Department's report and restated in a subsequent report on terrorism requested by the Congress: *Countering the Changing Threat of International Terrorism*. Report of the National Commission on Terrorism pursuant to Public Law 277, 105th Congress, June 16, 2000, p. 20. <<http://w3.access.gpo.gov/nct.html>>.

¹⁸⁹ The term direct action refers to terrorist acts that are planned and perpetrated by the country whose behavior is being examined. In contrast, indirect actions would cover general financial support to an organization like HAMAS or the PIJ where the decisions on targets and the terrorist acts themselves are undertaken by their own members.

¹⁹⁰ The United States cited this principle of international law to justify its bombing of Libya on April 14, 1986. The bombing was ordered in response to an April 5, 1986, attack on a Berlin discotheque attributed to Libya. The club was frequented by U.S. servicemen. One serviceman was killed and approximately 50 others were among the 230 people wounded.

and officials of the opposition Kurdish Democratic Party of Iran (KDP) (as occurred at Berlin's Mykonos restaurant in 1992). There have also been allegations linking Iranian intelligence agents to the murder of leaders of an anti-Shia sectarian group in Pakistan in 1998. Therefore, if the 1999 anti-terrorist, quasi-military Iranian cross-border retaliations against the MEK in Iraq were in fact the only instances in which "Iran's security forces conducted . . . bombings against Iranian dissidents abroad," then – in comparison to its previous record of undertaking terrorist direct actions against dissidents – Iran can be said to have *improved* on its record with respect to support of international terrorism.

Provide Political Context

Assertion: "Iran has increasingly encouraged and supported – with money, training and weapons – terrorist groups such as Hizbollah, HAMAS, the PIJ and Ahmed Jibril's PFLP-GC."

Because the country assessments for state sponsors of terrorism do not describe the political motivations of rejectionist groups, it is necessary to go to other parts of *Patterns of Global Terrorism 1999* for this information. The only reason the information appears at all is that the secretary of state is now required to designate and describe "Foreign Terrorist Organizations" (FTOs), pursuant to Section 219 of the Immigration and Nationality Act as amended by the Antiterrorism and Effective Death Penalty Act of 1996.

In the description of FTOs, Hizbollah is called a radical Shia group formed in Lebanon that is foreign to that country. In fact, Lebanon is criticized for giving Hizbollah safe haven. Yet the Lebanese Shia are one of the major ethnic groups in the country and Hizbollah has elected representatives, now serving in the Lebanese parliament. These facts and Hizbollah's opposition to the 20-year Israeli occupation of southern Lebanon are not mentioned.

Hizbollah's political goals are described in terms that are, however, more informative than the usual "opposition to the Middle East peace process by violent means." Instead, Hizbollah is said to seek the creation of an Iranian-style Islamic republic in Lebanon and the removal of all non-Islamic influences from the area. Similarly, HAMAS is described as seeking an Islamic Palestinian state in place of Israel and as receiving external aid not only from Iran, but also from Palestinian expatriates and private benefactors in Saudi Arabia and other moderate Arab states. The PIJ is said to seek an Islamic Palestinian state and to destroy Israel through holy war. The PFLP-GC is described as an offshoot of the Palestine Liberation Organization that is violently opposed to Yasir Arafat. Hizbollah, the PIJ, and the PFLP-GC are all said to receive logistical and organizational support from Syria in addition to the assistance they receive from Iran.

Assertion: "Iran continues to provide a safehaven to elements of the PKK, a Kurdish terrorist group that has conducted numerous terrorist attacks in Turkey and against Turkish targets in Europe."

Allegations that Iran provides safe haven to PKK forces have been a constant in *Patterns of Global Terrorism* over the years. The only information adduced in *Patterns of Global Terrorism 1999* to provide a reason for this assertion is that the brother of imprisoned PKK leader Abdullah Ocalan lived in Iran "at least part-time . . . even though he is a senior member of the PKK leadership whose arrest is being sought by the Turkish authorities." Again, it is necessary to go to the FTO section of the report before any political context for PKK activities is provided. There, the PKK is

listed under its name, the Kurdistan Workers' Party, and is described as "a Marxist-Leninist insurgent group primarily composed of Turkish Kurds . . . [who seek] to establish an independent Kurdish state in southeastern Turkey." The politically motivated violence that Turkey uses to contain the Kurdish separatist movement is not described.

Provide More Information

It would be helpful if there were a prominent caveat at the outset of each year's *Patterns of Global Terrorism* to alert readers to the absence of material that cannot be revealed publicly.¹⁹¹ The Department of State relies heavily on such material to make its rank-order judgments about the relative contribution that each state sponsor of terrorism makes to international terrorism during that year. The examples described below reflect the effect of the absence of such information.

Assertion: "Iran has increasingly encouraged and supported – with money, training and weapons – terrorist groups such as Hizbollah, HAMAS, the PIJ and Ahmed Jibril's PFLP-GC."

In *Patterns of Global Terrorism 1999*, Iran was especially criticized for increasing its support for these groups after the election of Israeli prime minister Ehud Barak in May 1999 and the resumption of peace talks between Israel and Syria. Iran was charged with encouraging these groups to use violence designed to undermine the peace process, especially in Israel. Yet the narrative in the country assessment for Iran only mentions that President Khatami met with the leadership of the Palestinian rejectionist groups during his visit to Syria in May 1999, and Supreme Leader Ali Khamenei sponsored a major rally in Tehran on November 9, 1999 to demonstrate Iran's opposition to Israel and the peace process. At the rally, Hizbollah representatives and Palestinian rejectionists reaffirmed their support for a holy war against Israel.

Bearing in mind that Iran was described as being the "most active" state sponsor of terrorism in 1999, largely on the basis of its increased support for groups opposed to Israel and the peace process, it is interesting to note that this support seemed to have had little practical effect during that year. In the report's Chronology of Significant Terrorist Incidents, more than 160 incidents are described by location, and none of them occurred in Israel.¹⁹² Elsewhere in the report, Egypt, Israel, and Jordan are described as having enjoyed a period of comparative respite from international terrorism during 1999.¹⁹³

Assertion: "Iran also provides support to terrorist groups in North Africa and South and Central Asia, including financial assistance and training"

In *Patterns of Global Terrorism 1999*, examination of the section "Background Information on Terrorist Groups" reveals no information detailing Iranian support for terrorist groups in South and Central Asia. Regarding North Africa, it is not clear whether the allegation refers to current Iranian activities. Algeria is described as having accused Iran of supporting Algerian extremists

¹⁹¹ Much of the information on which the country assessments are based is highly classified in order to protect intelligence sources and methods. If the reports are to be convincing, however, further attempts should be made to declassify information that would be more persuasive in justifying the summary judgments reached.

¹⁹² *Patterns of Global Terrorism 2000* was released on April 30, 2001, after *Thinking Beyond the Stalemate* was compiled. The 2000 report notes that Iran increased its support of Palestinian rejectionist groups in the context of increased Israeli-Palestinian violence after the outbreak of the al-Aqsa Intifada.

¹⁹³ Judith Miller, "South Asia Called Major Terror Hub in a Survey by U.S.," *New York Times*, April 30, 2000.

and as having severed diplomatic relations with Iran in March 1993.¹⁹⁴ (During the period covered by the report, however, Iran and Algeria had already improved their relationship and were close to resuming diplomatic relations.) Similarly, the Egyptian government is described as believing that Iran is among the external supporters of an Egyptian terrorist organization called al-Gama'at al-Islamiyya, but the reasons for this belief are not provided.

Distinguish Between Relevance of Past and Current Events

It would be useful to distinguish between terrorist activity that occurs in the particular year that is being reviewed in each volume of *Patterns of Global Terrorism* and events that are linked to terrorist acts that occurred in previous years. For example, more than one-quarter of the description of Iran's support for terrorism in *Patterns of Global Terrorism 1997* was devoted to an account of the Berlin trial of the perpetrators of the Mykonos murders. The trial was concluded in April 1997, but the murders occurred in 1992. Similarly, when the activities of the PKK are described, mention is made of past attacks mounted against Turkish targets in Europe, but it is not clear whether the attacks are ongoing.

Place Casualties from Terrorism in Broader Context of Political Violence

Patterns of Global Terrorism 1999 raises the conceptual issue of the relationship between international terrorism and other forms of politically motivated violence, but it does not attempt to present the relationship in either quantitative or qualitative terms. Like its predecessors, the report provides statistics describing the number of international terrorist acts recorded for the year, the number of people killed and wounded, and the number of U.S. citizens killed and wounded in these attacks:

- In 1998, international terrorist incidents killed 741 people and wounded 5,952.
- In 1999, international terrorist incidents killed 233 people and wounded 706.
- In 2000, international terrorist incidents killed 405 people and wounded 791.¹⁹⁵

The reports do not put these figures in context by comparing them with available statistics for the number of people killed and wounded each year in *all forms* of politically motivated violence, including civil wars. Such data would, at best, be an estimate, but it would be more meaningful than alternative comparisons that, for example, cite the number of murders that occur each year or the number of injuries and deaths that are caused by automobile accidents.

¹⁹⁴ This statement also falls within the category below that calls attention to passages of the annual reports that fail to distinguish between the relevance of past events and those under scrutiny in the most recent report.

¹⁹⁵ In 2000, there were 200 attacks against U.S. installations, and 19 U.S. citizens were killed. See *Patterns of Global Terrorism 2000* <<http://www.state.gov/s/ct/rsl/pgtrept/2000/index.cfm?decid=2420>>.

APPENDIX C

Issues Relating to Potential Settlement of the Outstanding Hague Tribunal Claims

Substantive Issues

The United States has filed claims against Iran for failing to pay its proportion of the Hague Tribunal expenses in a timely manner and for failing to maintain its security account at the agreed level of \$500 million.¹⁹⁶ Otherwise, virtually all of the unresolved claims between the two governments are claims that Iran has registered against the United States. These claims are very complicated and involve difficult problems of fact and liability.

There are two categories of claims: those that involve issues relating to past sales and purchases of goods and services, and those in which one government challenges the other government's interpretation of the Algiers Accords. In the latter category, for example, are the following:

- Iran has accused the United States of alleged *covert action* in violation of its Algiers Accords commitment not to interfere in Iran's internal affairs. (The tribunal has accepted jurisdiction in the matter.)
- Iran claims that the United States did not adequately fulfill its Algiers Accords commitments to help identify and recover assets of the Shah and his family within U.S. jurisdiction.
- Iran contends that the United States violated the Algiers Accords by refusing to permit the export to Iran of military and civilian goods that had already been purchased from private U.S. contractors. These claims involve more than 50 private companies and hundreds of thousands of separate items and large sums of money are involved.¹⁹⁷

The claims that involve the largest amounts, however, relate to past sales to Iran of U.S. goods and services. Most of these claims relate to the purchases that Iran made under the terms of the U.S. Foreign Military Sales (FMS) program. During the reign of the Shah, this was a robust and flourishing vehicle for satisfying his desire for large quantities of highly sophisticated military weaponry. To U.S. policy makers, the FMS program was an important means of cementing the U.S.-Iranian strategic relationship. U.S. defense contractors benefited financially from the Iranian orders, and the Department of Defense benefited because Iran's purchases made it possible to keep specific production lines open.

In keeping with FMS procedures, Iran deposited money in a Department of Defense FMS fund and disbursements were then made to the contractors supplying the equipment and services. The Iranian claims relating to the FMS program are two-fold:

¹⁹⁶ The Hague Tribunal has ruled that Iran has been in non-compliance of its replenishment obligation since 1992 but that it still expects Iran to meet its obligation.

¹⁹⁷For a detailed description of the Iranian point of view see the interview granted by Goodarz Eftekhari Jahromi, the Iranian representative to the Hague Tribunal, in Roozbeh Farahanipour, "Iran No Longer Possesses Deposits in American Banks," *Payame Azadi*, January 16-17, 2000.

- First, there is a claim relating to the FMS fund itself. Iran alleges that at the time the FMS relationship was severed, it had deposited \$11.3 billion in the fund but had received only \$9.5 billion worth of military goods and services. Iran wants to be paid the balance of \$1.8 billion, with interest. The United States does not pay interest on FMS funds under normal circumstances. If the tribunal validates this claim and decides to award Iran interest, the sum owed would be approximately double, or \$3.6 billion.
- Second, Iran claims that it is owed \$1.4 billion for undelivered FMS equipment (for which payment had already been disbursed from Iran's FMS account).¹⁹⁸ If the tribunal validates this claim and interest is awarded, the sum owed would amount to \$2.8 billion.

Based on these numbers, even the relatively straightforward FMS claims indicate that Iran believes it is entitled to a possible settlement in an amount that could be as much as \$6.4 billion. These figures do not, however, take into account U.S. challenges to Iranian claims. U.S. counterclaims in the FMS cases amount to more than \$800 million.

In addition, Iran has claimed that compensation is owed because of FMS overbilling – not only of the items in process at the time of the revolution, but also going back to earlier purchases by the Shah. The tribunal has accepted jurisdiction over this type of claim.

Iran has also filed for compensation for costs it had to bear during the process of shutting down the FMS program. This includes its having to restructure its military program once the expected FMS equipment was no longer available. A related issue involving U.S. and Iranian counterclaims concerns which of the two countries should pay the costs owed to contractors for the cancellation of contracts aborted when the FMS relationship ended. The United States has used the Iranian FMS account to pay contract cancellation fees, one of the reasons why the account now has a balance of only \$400 million compared to the \$1.8 billion that Iran believes it should contain.

The work necessary to resolve the FMS claims is daunting. There are 70 to 80 FMS “large” claims or those involving sums exceeding \$250,000. The remaining cases involve some 1,200 separate FMS contracts, only 130 of which have yet been briefed by the lawyers working on the cases. The briefings, in turn, involve scrutinizing contracts on a billing line-by-billing line basis. One of the 130 contracts already briefed includes 17,000 separate transactions and, in another example, one of the remaining 1,070 “unbriefed” contracts involves more than one million billing lines. The complexity of the legal briefs themselves can be illustrated by the fact that one U.S. filing was 35,000 pages long.¹⁹⁹

The Hague Tribunal has resolved complicated cases before, albeit ones that did not reach the level of complexity of the Iranian-U.S. FMS and blocked export cases. Prior to the revolution, U.S. companies had been heavily involved in the Iranian oil industry and in various banking, insurance, and industrial ventures. The extent and variety of U.S. private assets in Iran was

¹⁹⁸ This claim is listed separately from that relating to the FMS account, because Iran has claimed at the Hague Tribunal that the use of U.S. export controls to prevent the equipment from being sent to Iran represents a violation of the Algiers Accords.

¹⁹⁹ See Ronald J. Bettauer, “A Progress Report on Government Cases before the Iran-U.S. Claims Tribunal,” *International Arbitration Report*, January 1996.

significant. Subsequently, these assets were confiscated by Iran's Revolutionary Courts or nationalized by the post-revolutionary government.

The Algiers Accords stipulate that private claims for restitution or compensation for seized assets must be resolved by the Hague Tribunal's arbitration process, not in U.S. courts. The major cases in which U.S. companies have filed claims against the government of Iran have now been resolved and compensation totaling more than \$2 billion has been disbursed.²⁰⁰ Iran also lodged tribunal claims against U.S. companies for failing to fulfill contractual obligations in force before the revolution. Many U.S. companies declared *force majeure* and pulled out of Iran because of the political instability that preceded the revolution. Iran received approximately \$530 million after these claims were arbitrated by the tribunal.²⁰¹

Despite these instances of successful resolution by the Hague Tribunal process, it is clear that simplifying legal mechanisms will have to be devised to meet the goal of reaching an expedited settlement of the remaining government-to-government claims. Moreover, during a bilateral U.S.-Iranian negotiation (albeit within the Hague Tribunal framework), a considerable degree of "political will" will be required from each side before a global settlement is reached.

Payment of a U.S. Award to Iran

The U.S. government has been paying its tribunal awards to Iran with money from the Judgment Fund, established by the Automatic Payment of Judgments Act of 1956 codified at U.S.C. Section 1304. It is significant that the Judgment Fund is a *permanent and indefinite appropriation*, meaning that Congress does not have to authorize the disbursement of payments and there is no "cap" requiring it to be replenished by congressional authorization once it is exhausted. Instead, the claims paid from the fund are charged against the entire U.S. budget. In other words, the total amount of claims paid from the Judgment Fund in a given year is either subtracted from a budget surplus or added to a budget deficit.

The Judgment Fund was established to eliminate the need for Congress to pass specific appropriation bills for the payment of court judgments against the government not otherwise provided for in the budgets of individual government agencies. (Most of the judgments that result in payments from the Judgment Fund arise from decisions by U.S. courts.) The Judgment Fund is also available to pay settlements with foreign countries and awards mandated by foreign tribunals.²⁰²

Any Hague Tribunal awards that require payment by the U.S. government to the government of Iran are payable from the Judgment Fund *no matter how large the award*.²⁰³ Before a Judgment Fund

²⁰⁰ *Ibid.*

²⁰¹ Jahromi in Farahanipour, "Deposits."

²⁰² In a separate legal decision, the U.S. government ruled that the Hague Tribunal qualifies as a "foreign" tribunal even though, technically speaking, it is the forum for an *international* arbitration.

²⁰³ The highest single payment from the Judgment Fund thus far is \$324,629,300. A hypothetical Hague Tribunal global settlement award to Iran could be many times this amount. But there are U.S. domestic cases currently in litigation that could also result in Judgment Fund payments of the same order of magnitude as a potential U.S.-Iran lump-sum settlement at The Hague. If settled in the plaintiffs' favor, these cases could create precedents for drawing multibillion-dollar amounts from the Judgment Fund.

payment can be made in connection with an award made by a foreign court, however, the attorney general must certify that it is in the interests of the United States to do so.

As a matter of practical politics, the administration in office at the time of a possible global Hague Tribunal award might choose to ask Congress to make a specific appropriation for that purpose. The rules of the Judgment Fund would then not apply because there indeed would be an availability of funds otherwise provided for. In any event, it would be wise for the executive branch to consult with Congress in anticipation of the necessity of making a large payment to Iran from the Treasury at some future date.

About the Author

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