# International Economic Sanctions Are Not Zero-Sum Games: There Are Only Losers

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## Introduction

There are good laws and there are bad laws. The "Iran and Libya Sanctions Act of 1996," also known as D'Amato Act after its sponsor Senator Alfonse D'Amato, is a bad one. It is bad because it hurts American businesses and international standing of the United States government without delivering its stated objectives. One cannot deny that the law has and will continue to inflict economic costs on Iran. But the cost to Iran, while significant, has not been of the magnitude to cause a significant change in that country's posture or rhetoric. On the other hand, the costs to American companies and to America's international prestige are substantial.

The D'Amato law declares that "it is the policy of the United States to deny Iran the ability to support acts of international terrorism and to fund the development and acquisition of weapons of mass destruction and the means to deliver them by limiting the development of Iran's ability to explore for, extract, refine, or transport by pipeline petroleum resources of Iran."[1] To this end the congress directs the president to impose a number of sanctions on companies that make an investment of 20 million dollars or more or any combination of investment of at least 10 million each, which in the aggregate equals or exceeds 20 million in any 12-month period, "that directly and significantly contributed to the enhancement of Iran's ability to develop petroleum resources of Iran."[2]

The D'Amato law follows the Executive Order No. 12959 of May 6, 1995 issued by President Clinton which in turn reinforced the Executive Order of 1987. In 1987 imports of goods from Iran to the United States were prohibited. But foreign affiliates of American companies continued to buy substantial amount of Iran's oil. The Executive Order of 1995 prohibited export of American goods, services, and technology to Iran. It banned investment by American companies in Iran, and prohibited US persons from approving, facilitating or financing American owned companies to make transactions involving Iran, thus, closing the loophole of the Executive order of 1987. The D'Amato law is designed to extend these prohibitions, by the force of sanctions, to companies and nationals of other countries as far as the Iranian oil and gas industry is concerned. In particular, the President may impose a number of sanctions on companies who invest in Iran's petroleum industries.[3] These sanctions may include denial of assistance from Export-Import Bank, denial of permits to export goods and technology to the sanctioned persons, prohibition of United States financial institutions from making loans to the offending companies, and refusal of the U.S. government to procure goods and services from violators of these sanctions. If the violators are financial firms, they may not be designated as primary dealers in United States government debt instruments, or serve as her agents, or as repository for government funds.

These sanctions will be removed when the President determines and certifies to the congress that Iran has ceased its efforts to acquire nuclear, chemical, and biological weapons, and ballistic missiles, and has been removed from the list of governments supporting acts of international terrorism.

Ostensibly, the US sanctions have been enacted to bring pressure on Iran to abandon her support of terrorism and subversion of the region, efforts to produce weapons of mass destruction, and opposition to the Arab-Israeli peace process. But it is said that domestic politics, particularly, the 1996 presidential elections and the power struggle over foreign policy between the Congress and the President may have resulted in adopting the harsh measures.

In what follows we will argue that embargoes and sanctions outlined above are detrimental to the United State's leadership and harm American economic interests, and in all likelihood, they will not change Iran's behavior.

**International Sanctions and the United State's Leadership**

With the fall of the former Soviet Union, the United States has attained the status of the sole superpower in the world. She holds this position militarily, economically, and politically. Since the 19th century when the Great Britain ruled the waves and sun did not set on her empire, no nation has been in this position. To state the obvious, the time has changed and the condition of the United States as the world leader is quite different from that of Britain a century ago. The United States position rests, in addition to its economic and military power, on morality of its positions and her defense of certain principles. In particular, the United States advocates human rights, liberal democracy, free trade, independence and integrity of sovereign nations, and denunciation of the use of force in international affairs. The law in question is in conflict with these basic principles.

The only time the United States can legitimately and effectively exercise its power is when she has built an international consensus on the necessity and morality of her cause. Here lies the difference between the two centuries, the United States is the first among equals, by far the first. Consensus building has to precede any action by the United States government. The necessity and viability of this course of action was shown in the crisis over the invasion of Kuwait by Iraq. On the other hand, until President Clinton reversed the direction of the U.S. policy in Bosnia Herzegovina, the noninvolvement policy of his predecessor had brought worldwide criticism. Morality is not divisible and cannot be selective.

Leading by consensus is a remarkable departure from the norm of conduct during the cold war era. Up until the end of the Soviet empire, the western world universally accepted the US leadership in the design and implementation of international relations and policies. Today, even though there is no world military or economic power of comparable strength to the United States, most nations tend to follow their own independent international policies. The United States' preeminence and hegemony is being challenged and undermined by friends and foes alike. This, from an American point of view, is an unfortunate phenomenon which, if it is not reversed before it takes hold in the international psyche, would have damaging long run effect. It could erode the United States' abilities to lead the world in the direction that enhances her interests. The United States cannot follow policies that ignore other countries sovereignty and interests which leads to the perception of US arrogance. Neither can she be oblivious to the growing strain and annoyance of other countries whose interest and sovereignty are being undermined by American foreign policies. This sentiment has succinctly been expressed by James Schlesinger:

> "It is essential for us [the United States], if we wish to continue to lead in the way we have, to avoid gratuitously antagonizing other nations. The

> tendency for others to bond together to cut the leader down to size is, of course, a variable. Clearly, if a leader fails to refrain from exasperating other nations, that process will inevitably be speeded up. Pride goeth before a fall."[4]

Perhaps the most damaging part of the sanctions to American prestige is in the international trade arena. The United States has consistently and forcefully advocated free trade. Sanctions are impediments to the free flow of goods, services, and capital. The main argument behind free trade is that it is beneficial to countries that adopt it regardless of other nations' action. Imposing sanctions on other countries in order to punish them contradicts the argument for free trade. If the idea behind the free trade is correct, then the country that adopts the sanctions is reducing her own people's welfare. Still a country may be on a firmer ground when restricting her own nationals from dealing with others. When sanctions take an extraterritorial character they are quite indefensible. Such unilateral actions violate the spirit if not the letter of the World Trade Organization. The idea behind GATT and WTO is to replace unilateral and bilateral ad hoc actions with rules and procedures accepted and followed by the community of nations. Unilateral sanctions on companies of other nations who deal with a third country can only be interpreted as the United States' belief that she is above and exempt from international rules and procedures.

The French government support of Total in her deal with Iran should be seen in this light. European economies are more dependent on international trade than the United States economy is. When the American government, without consulting her allies, decrees that European companies should not deal with Iran, Cuba, or Libya, the action will be seen as arrogant. They resist what they consider encroachment on their national sovereignty.

The argument for moral grounds in the American leadership cannot be exaggerated. Events of the last seven years, the Persian Gulf War, civil war in Bosnia Herzegovina, international concern over environment, and the Middle East peace process, to name a few, have underlined its importance. Nevertheless, the cost of sanctions to the United States is not restricted to intangibles of moral leadership and prestige. It can be measured in tangible commercial opportunity costs.

**2. The Economic Costs of Sanctions to the United States**

To assess the economic costs of the sanctions, we should consider the unique position of Iran in the energy map of the world.

Iran is sitting on the second largest reserves of natural gas in the world, estimated at 741 trillion cubic feet, and also has considerable oil resources. More important, the eye of oil companies are presently on the vast oil reserves of Caspian Sea which is estimated to be between 90 and 200 billion barrels. Exploitation of these resources as well as their transportation require cooperation from Iran. She is the strongest country after Russia that has a stake in the resources of the sea. Moreover, the safest and the most economical way of transporting oil passes through Iran. Indeed, Iran is almost indispensable for trade with the former Soviet Republics of Central Asia. To these advantages one should add the strategic location of Iran with regard to the Persian Gulf through which a large part of world crude oil passes en route to international markets. Iran is making her military presence felt in the Persian Gulf.

The unique position of Iran's energy resources has rendered her a potentially profitable market for international investors and an accessible market for exporters. The recent agreements with the French company Total can only be regarded as the tip of the iceberg. Moreover, revenues from oil and gas exports have turned Iran into a lucrative market for goods and services. In 1995, Iran imported more than 12.5 billion dollars in goods alone. She could have imported more than 18 billion dollars had it not been for the necessity to repay her foreign debts.

Potential trade and investment in Iran have been recognized by American companies. As mentioned above, before 1995 American companies continued trading with Iran through their subsidiaries. In 1995, the U.S. firm Conoco, Inc. had initialed and finalized a contract with Iran to develop oil fields in the Persian Gulf. President Clinton invoked the National Emergency Economic Powers Act, and Conoco had to withdraw from the deal. Conoco's loss was the French company Total's gain. The same could be said about the more recent deal worth two billion dollars that involves French, Russian, and Malaysian companies.[5] *Newsweek* (November 24, 1997) reported that "at a recent World Petroleum Congress in Beijing, Fereydoun Barkeshli of the Institute for

International Oil studies in Tehran, found unanimous US oil-firm support for an Iranian pipeline route for Caspian Sea oil." In general, given America's technological superiority and its financial might, there is no question that American firms would fare very well, should they be allowed to bid on Iranian projects. The embargo, and D'Amato Act are robbing American companies of the opportunity. Thus, the only tangible consequence of sanctions has been the loss of business and investment opportunities for American firms. They have been shut out of investment in Iranian gas projects, and are in a disadvantage regarding the exploitation of the Caspian Sea oil resources.

While U.S. companies have to watch from sidelines, European defiance [6] and resentment of American sanctions with its extraterritorial and big brother overtone are understandable. Iran is commercially important to Europe. America's unilateral measures requiring Europeans to give up a lucrative market and investment opportunities meets resistance. Perhaps the recent return of European ambassadors to Tehran best illustrates the importance of Iran for Europe. Some time ago a Berlin court found Iran's high government officials guilty of complicity in terrorist attacks on German soil. In the diplomatic struggle that ensued, European ambassadors left Iran. Their return to Tehran and their expressed enthusiasm for renewed economic ties with that country while a boon for the newly elected government of President Khatami, underlines the isolation of the United States in the sanctions game against Iran.

To sum up, sanctions hurt American firms, cause a rift between the United States and its European allies and, in return, increase the cost of doing business for Iran.

**3. The Effectiveness of Sanctions**

The arguments in favor and against sanctions can be summarized as follows. Those in favor of sanctions believe that the economic cost inflicted on the target country mobilizes the affected groups and force a change in the behavior of that nation. Those who oppose sanctions believe that by severing economic ties—be it disinvestment, denial of credit, or exports and imports embargo—the imposing countries would not have any leverage on the sanctioned country, simply because the latter has nothing left to lose. By keeping economic ties, the trading partner will have the leverage to affect the behavior of the target country. This is the essence of the so-called critical dialogue which Europeans have adopted with regard to Iran.

In general, the success of sanctions in altering a nation's behavior is doubtful. However, they do inflict economic costs on the sanctioned country. The magnitude of damage to the sanctioned country depends on the extent and severity with which the international community implements the sanctions. In addition, their effectiveness depends on the importance of the sanctioned sector(s) in the overall economy of the affected country, the availability of substitute markets for her exports and imports, duration of sanctions, dependence of the sanctioned country on the international capital, her ability to hoard and stockpile commodities before sanctions are in place, and the flexibility of her consumption and production structure.

Sanctions are more likely to be successful if they are imposed collectively by a group of nations rather than one county alone. Commitments by a reasonably large group of countries to engage in a collective action requires clear evidence that an important international norm of conduct has been violated by the offending nation. There has to be a villain before punishment can be meted out. It is not unusual, therefore, that in order to maximize the cost to the sanctioned country, the importance of the violated norm may be exaggerated and the extent of villainy of the target country magnified.

Proponents of sanction argue that sanctions need time to work themselves into the international business psyche and calculus. David Welsh, Assistant Secretary of State for Near East Affairs reported that, "many of the allies have been reluctant to grant Iran extensive credit and guarantees ... We have succeeded in raising the cost to Iran."[7] `On the other hand, it is argued that sanctions are not without cost to imposing countries. Therefore, the question is, on balance, which side is hurt more. That is, cost and benefits of sanctions do not represent a zero-sum game even in the sanctioning country. There is always a negative welfare loss associated with sanctions in both sanctioned and sanctioning countries.

In order to exact maximum economic cost on a country, at least two conditions must be present. First, the sanctioning countries must be able to control international trade of the sanctioned country. Second, other trading countries must not be capable of replacing the lost markets for sanctioned country's exports or become suppliers for her imports. If these conditions are obtained the sanctioned country is forced into autarky and she is denied all of the benefits of division of labor and international trade; her cost is maximized. However, if the sanctioning countries do not control the sanctioned country's international trade they can force the target country to trade at higher costs. Thus, a less favorable terms of trade is forced on the sanctioned country which means, she will export more in exchange for lesser amount of imports.

Even assuming that sanctions against a country are universally implemented, and further assuming that they have inflicted considerable economic costs on her, it is not clear that they would lead to a change of behavior. Cuba and Iraq come to mind. It is hard to imagine imposing a more restrictive set of sanctions than those imposed on these countries. No doubt the ordinary people of Iraq and Cuba have suffered immeasurably. Yet it is hard to discern any change in the posture of either country. If anything, the ruling click, who by no means are supported by their people, have hardened their position. Neither there is any logical reason to believe a nation or a person would change its beliefs or behavior because of economic hardship.

Despite their dismal record of success, the frequency of imposing international economic sanctions has increased. It may be that they are the best substitute for military intervention and war. Sanctions are somewhere between diplomatic effort and outright war. They portray of decisiveness on the part of the leadership and since they do not require military force and bloodshed, they are less objectionable by the world community as well by the domestic interest groups. Outcomes of public policies depend on the relative influences of interest groups in generating political pressures and by exerting these pressures, they help determine "the extent and types of sanctions selected." According to the public choice theory, "Political efficiency prevails when the marginal utility to the groups benefiting from a given regulation or policy, weighted by the group's political influence, is equal to the influences-weighted marginal disutility to the loser group ... [but], in general, the losers will lose more than the beneficiaries gain."[8]

**4. The Effects of Sanctions on Iran**

In the case of Iran, the sanctions are not universally applied. Thus, while Iran has undergone economic costs, the damage is not substantial. It is true that Iran needs American market, capital, and technology. As Conoco deal showed Iranians' first choice would have been an American company. But both Western and Eastern European countries, as well as Japan and Southeast Asian countries have been too happy to oblige. Iran earns close to 20 billion dollars annually from its exports and it is difficult for many countries to give up on such a market.

If the purpose of the sanctions is to force Iran to drop her quest for weapons of mass destruction and support for terrorism, then a critical dialogue would be a more effective tool. Iran, unlike Iraq, has never used chemical[9] or biological weapons and its nuclear facilities have been open to international inspection. Her support for terrorist acts has waned over the years and, to be sure, trading partners have a much greater leverage in persuading Iran to seek her goals through diplomatic channels.

It may be that the objective is to force Iran to publicly denounce its past policies and make a pledge not to seek biological weapons and other weapons of mass destruction. And to make such statements in a way that leaves no doubt she is seeking reprieve from economic sanctions. In other words, the purpose may be to avenge her hostage taking and the defeat of President Carter in the 1980 elections. Such statements would not be forthcoming regardless of economic costs.

First, the government of Iran is founded on ideological principles that prohibits submission regardless of the cost. This point was well illustrated during the eight year war brought by the Iraqi invasion of Iran. Second, it should be noted that despite the well-known and well-documented human rights infractions of the regime, particularly in the early years of the Islamic Republic, Iran's political system is the closest to a democracy of any country in the Middle East, with the exception of Israel. Political differences are freely aired in the Majlis (Parliament)and in the media.[10] If the faction that controls the executive branch makes a move in the direction of an apology, it will be exploited by the opposition as giving in to the enemies of the revolution.

**Conclusions**

The election of Mohammad Khatami to presidency, if he succeeds in controlling all organs of the government, heralds a new era in the political life of Iran. Khatami campaigned on a platform of tolerance, human rights, particularly for women, rule of law, civil society, peaceful coexistence, and dialogue rather than confrontation. He won by a landslide of two thirds majority. The intransigence of the United States in imposing economic sanctions weakens Khatami's position vis-à-vis his opponents. Removal of the sanctions would strengthen him against his rivals without giving the appearance that somehow he is playing the American game.

Perhaps sometime governments and nations behave like individuals, that is, they decide on the basis of emotions rather than cool mathematical logic. Imposing sanctions on a "rogue" state would make everyone feel good. But if economic benefits of the United States, and her international standing are considered, and the objective is to bring about a change in policies and international conduct of the Iranian government, removal of sanctions and repeal of D'Amato law are clearly indicated.

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[1] Sec. 3 (a) of Public Law 104-172 [H.R. 3107]; August 5, 1996.

[2] Ibid. Sec. 6. The law stipulated a limit of $40 million, but in August, it was lowered to $20 million.

[3] Ibid. Sec. 8 (a).

[4] James Schlesinger, "Fragmentation of Hubris," The National Interest, Fall 1997, pp. 3-10.

[5] Iran has just announced its intentions to accept bids for 13 new oil projects on land to foreign companies as soon as these projects are approved by the Iranian Majlis. Another lost opportunity for American oil companies. See Iran Times, November 28, 1997, page 1.

[6] In a recent statement, French President and Malaysian Prime Minister, rejected the D'Amato law as extraterritorial and expressed their support for investment in Iranian oil industries again. See Iran Times, November 28, 1997, page 1.

[7] For a more detailed discussion of these point see chapter five of William H Laempfer and Anton D. Lowenberg, International Economic Sanctions: A Public Choice Perspective, Westview Press, Boulder, Colorado, 1992; or see Gary Clyde Hufbauer

and Jeffrey J. Schott, Economic Sanctions Reconsidered: History and Current Policy, Institute for International Economics, Washington, DC, 1985, appendix A.

[8] Ibid., page 42.

[9] Iran just became a signatory to the international chemical weapons treaty which prohibits production and stockpiling of this class of weaponry. This means that Iran's facilities are open to legitimate international inspections.

[10] This is not to imply that Iran has a democracy comparable to that of the United States or Western Europe. As recent clashes over the absolute powers of the Supreme Guide (Rahbar) showed, certain subjects are not to be questioned. Nevertheless, in an area of the world where some countries have never elected the mayor of their village, Iranians enjoy freedom of choice, albeit restricted, in determining their President.