The “Snapback” Sanction as a Response to Iranian Non-compliance

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There are serious flaws in the approach that the Obama administration is contemplating taking to respond to Iranian non-compliance in the event of a final nuclear deal with Iran. Based on press reports, it appears that the Obama administration will use a phased program of sanctions relief using “suspensions” and “snapbacks” where sanctions will be suspended and then re-imposed in the event of Iranian non-compliance.[1] This approach may also be adopted by the European Union. It may also potentially be used to deal with the U.N. Security Council resolutions and related sanctions.

Under current U.S. law, many of the most punitive financial and energy sanctions on Iran typically require a presidential certification that Iran has ceased its pursuit of and verifiably dismantled its nuclear weapons program, ceased its development of ballistic missiles, and ceased its support for international terrorism, among other criteria.[2] As the latter two issues are not on the table in the nuclear negotiations, President Obama is likely to use waivers to suspend sanctions. The sanctions could then be “snapped back” into place and re-implemented in response to Iranian non-compliance.

While legally feasible, the suspension and snapback of sanctions will pose political, economic, and psychological challenges. Instead, Congress should work with the administration to create a sanctions architecture that predicates any suspension of sanctions on verifiable, irreversible steps by Iran to dismantle its illicit nuclear infrastructure and cease its support for terrorism, as well as resolving international concerns about its money laundering and other illicit finance activities.

The Psychology Versus the Legalities of Sanctions

An overreliance on “snapback” sanctions can be problematic since the impact of the underlying sanctions is as much psychological as legal. The efficacy of sanctions is predicated upon a strategy of escalation and the perception of high risk. An ever-expanding web of restrictions effectively spooked foreign businesses from investing in, or

1. David Sanger, “Obama Sees an Iran Deal That Could Avoid Congress,” *The New York Times*, October 20, 2014. (http://www.nytimes.com/2014/10/20/us/politics/obama-sees-an-iran-deal-that-could-avoid-congress-.html?_r=1)
2. U.S. House of Representatives, 111th Congress, 2nd Session, P.L. 111-195, “Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010,” Section 401, Government Printing Office, 2010, page 40; (http://www.treasury.gov/resourcecenter/sanctions/Documents/hr2194.pdf) & U.S. House of Representatives, 112th Congress, 2nd Session, H.R. 1905, “Iran Threat Reduction and Syria Human Rights Act of 2012,” Government Printing Office, 2012. (http://www.gpo.gov/fdsys/pkg/BILLS-112hr1905enr/pdf/BILLS-112hr1905enr.pdf)

trading with, Iran. During the period of sanctions escalation, fear triumphed over profit motives as companies viewed Iran as an economic minefield, and Iranian investors and consumers lost confidence in their economy.

Unfortunately, the Joint Plan of Action (JPOA) began to reverse this phenomenon. As economic research has shown,[3] the Obama administration's estimates of the value of direct sanctions relief provided by the JPOA did not account for the psychological impact on markets, business, and investors and the broader impact on Iran's macroeconomic environment. A determined Iranian charm offensive has focused on opening business lines and welcoming trade delegations in order to prepare for the lifting of sanctions. This charm offensive has also had a psychological impact on markets.

Using a proprietary sentiment indicator, Roubini Global Economics and the Foundation for Defense of Democracies have tracked the economic impact of the following: the de-escalation of sanctions (since mid-2013); the optimism surrounding the election of President Rouhani (June 2013); the announcement of the JPOA (November 2013); the announcement of the JPOA implementation agreement (January 2014); and the subsequent direct sanctions relief.[4] The indicator identified a change in the perceptions of Iran globally and perhaps more importantly within Iran itself, where confidence in the rial's value increased, making Iranians more confident to hold domestic assets rather than hoarding dollars or fuelling domestic asset bubbles. This, in turn, gave breathing space to the Iranian government to put its economy on a stronger foundation by tightening fiscal and monetary policy to restrain inflation.

As a result, the Iranian economy has shown signs of modest growth and stabilization. There has been an undeniable shift in market psychology, both among Iranian businesses and those companies angling to do business with Iran. The change in Iranian consumer and investor sentiment has boosted Iran's economic performance, as reflected in modest GDP growth, a stabilization of Iran's currency, and a significant drop in inflation.[5]

Indeed, Iran has been on a modest recovery path since its *annus horribilis* of 2012 and the first half of 2013, when the Iranian economy was hit with an asymmetric shock from sanctions targeting: the Central Bank of Iran, Iranian oil exports, access to the SWIFT international banking system, the National Iranian Oil Company, shipping and insurance, key sectors of the Iranian economy, including energy, shipping and shipbuilding, and precious metals, among others. The poor economic management of the Iranian economy by the Mahmoud Ahmadinejad government further exacerbated these sanctions-induced shocks. Since the election of Hassan Rouhani as Iran's president in June 2013, a more competent economic team, under less severe sanctions-induced economic stress than its predecessor, has implemented more effective monetary and fiscal policies, which have increased the durability of Iran's recovery.

3. Paul Domjan, Mark Dubowitz, Jennifer Hsieh, & Rachel Ziemba, "Sanctions Relief: What Did Iran Get?," *Foundation for Defense of Democracies & Roubini Global Economics*, July 2014. (http://defenddemocracy.org/content/uploads/general/RoubiniFDDReport.pdf)

4. Mark Dubowitz & Paul Domjan, "New Sentiment Indicator Shows Positive Impact of Sanctions Relief on Iran's Economy," *Foundation for Defense of Democracies & Roubini Global Economics*, May 15, 2014. (http://www.defenddemocracy.org/content/uploads/documents/Final_Sentiment_Report.pdf)

5. Jennifer Hsieh, Rachel Ziemba, & Mark Dubowitz, "Iran's Economy, Out of the Red, Slowly Growing," *Foundation for Defense of Democracies & Roubini Global Economics*, October 2014. (http://defenddemocracy.org/content/uploads/publications/RoubiniFDDReport_Oct14.pdf)

As Iran's economic recovery becomes more durable and as Iran's economy in general becomes less susceptible to the impact of snapback sanctions, economic pressure will diminish as an effective tool to respond to Iranian nuclear non-compliance. This will make it more likely that the U.S. will be forced to choose between either tolerating Iranian cheating or using more coercive means, including military force, to enforce the deal and prevent it from unraveling.

The Psychology Versus the Legalities of "Snapbacks"

From a legal perspective, snapbacks are relatively simple. In the U.S., the Obama administration could decide unilaterally, on evidence of Iranian non-compliance, to immediately re-impose any of the suspended sanctions. In the European Union, the *imposition* of new sanctions (or the re-imposition of lifted sanctions) would require the support of all 28 members of the EU. In this case, sanctions could instead be suspended temporarily, for example for 180 days at a time, with an affirmative vote necessary to *renew the suspension*, and thus a veto by only one member state would automatically reinstate the sanctions. This could effectively give France, for example, a veto over renewal of the suspension of sanctions in the EU.

A similar mechanism could be used at the U.N. Security Council, where a renewal of the suspension of the U.N. Security Council resolutions could be blocked by one UNSC permanent member. This could give the United States, France, or the U.K. a veto over the continued suspension of sanctions at the UNSC.

The politics and economics of snapbacks are more complicated. Politically, at the U.S., EU, and UNSC levels, respectively, there would have to be agreement that there is sufficient evidence of Iranian non-compliance to warrant a decision to reinstate the sanctions. A fundamental question about the politics of a snapback is, who decides what constitutes a violation? There are bound to be significant disputes on the evidence, differing assessments of the seriousness of infractions, fierce debates about the appropriate level of response, and concerns about Iranian retaliation. Furthermore, if an issue of non-compliance arises, who has the burden of proof with regard to the alleged violation? Does the onus sit with Iran to provide evidence to verify that the violation has not occurred – the way that Iran is supposed to respond to IAEA concerns about possible military dimensions of its program? Or, must the P5+1 prove, using specific metrics and to a certain level of confidence, that the violation has indeed occurred?

The snapback is equally challenging to implement given the economic realities that will follow a nuclear deal. International sanctions took years before a critical mass of international companies terminated their business ties with Tehran. Once loosened, with so many international companies positioning to get back into Iran,[6] it will be difficult to persuade these companies to leave again, especially as

6. Jay Solomon, "Oil, Auto Companies Make Plans to Invest in Iran if Sanctions Ease," *The Wall Street Journal*, July 1, 2014; (http://online.wsj.com/articles/oil-auto-companies-make-plans-to-invest-in-iran-if-sanctions-ease-1404257812) & Saeed Kamali Dehghan, "Iranians and Multinationals Hungry For Nuclear Deal That Will End Sanctions," *The Guardian* (U.K.), November 14, 2014. (http://www.theguardian.com/world/2014/nov/14/iranains-multinationals-hungry-nuclear-deal-to-end-sanctions)

Western companies, and their lobby groups, will argue that Chinese, Russian, Turkish, and other less cooperative countries are bound to backfill if they do. As a U.S. official noted, "Suspension of sanctions will give Iran real value. … as the suspension takes hold contracts get signed and floodgates open."[7] These floodgates will be difficult to re-close.

The cornerstone of Iran's financial isolation has been the reputational and legal risk of dealing with an Iranian government, economy, and entities that have consistently engaged in deceptive and other illicit conduct to try to mask the involvement of designated proliferators and other illicit actors. The question of risk and the integrity of Iran's economy and financial dealings cannot be turned on and off quickly. Repeated reversals of sanctions are likely to raise the question about how markets will respond and about the premature rehabilitation of the Iranian financial sector after a deal. As discussed in a previous Iran Task Force memo,[8] ***waiving or otherwise lifting sanctions without Iran addressing the underlying concerns about illicit financial activities undermines the stated purpose of the sanctions to protect the integrity of the international financial system. The snapback of financial sanctions in response to nuclear violations may send a message that such sanctions are political rather than tied to specific, discrete, illicit conduct.***

The recent drops in the price of oil present a new variable to the global market which is now facing a demand shortage. This market situation allows for the maintenance of current levels of Iranian oil exports virtually "cost-free" for energy consumers and impacts Iran's budget and overall economic conditions. In the event of an Iranian violation of a nuclear agreement, some may argue that oil prices alone will cause sufficient pain to the Iranian economy such that no snapback sanctions are necessary. However, violations that do not receive a response create a dangerous precedent of allowing Iran to engage in cost-free violations, and additional sanctions at a time when Iran is vulnerable as a result of low oil prices will provide important signaling to the markets.

The Iranian regime is also likely to take steps to minimize its economic exposure when it anticipates that it will violate any nuclear agreement. For example, it may move its oil revenues out of Western bank accounts into accounts held in jurisdictions less exposed to U.S. pressure; this will diminish the impact of a snapback of the oil-revenue escrow restrictions, which may be a preferred way for the Obama administration to maintain some economic leverage. Finally, Iran will enjoy substantial psychological benefits from the deal that will translate into improved macroeconomic conditions – as it already has under the JPOA.[9]

7. "Iran Nuclear Talks: The Fog Recedes," *International Crisis Group*, Middle East Briefing N°43, December 10, 2014, page 9, footnote 40. (http://www.crisisgroup.org/~/media/Files/Middle%20East%20North%20Africa/Iran%20Gulf/Iran/b043-iran-nuclear-talks-the-fog-recedes)
8. "Smart Sanctions Enforcement and Relief," *Iran Task Force*, July 2014; (http://taskforceoniran.org/pdf/Smart_sanctions_Memo.pdf)
9. Paul Domjan, Mark Dubowitz, Jennifer Hsieh, & Rachel Ziemba, "Sanctions Relief: What Did Iran Get?," *Foundation for Defense of Democracies & Roubini Global Economics*, July 2014. (http://defenddemocracy.org/content/uploads/general/RoubiniFDDReport.pdf)

Conclusion

Since sanctions snapbacks will be difficult to implement politically and economically, Congress needs to defend the sanctions architecture in a way that is not overly reliant on mechanisms to re-impose sanctions; the snapback has a role to play but only in the context of a comprehensive sanctions relief program where core elements of the sanctions are maintained. To preserve economic leverage against Iranian non-compliance, Congress should consider adopting the recommendations outlined in a previous Iran Task Force memo, "Smart Sanctions Enforcement and Relief," and an accompanying report, into a sanctions defense, enforcement, and relief bill.[10] This economic leverage will be critical to the enforcement of a nuclear deal with an Iranian regime that has a decades-long track record of nuclear mendacity and a long "rap sheet" of terrorist activities and financial crimes.

The Iran Task Force's goal is to lend expertise on Iran's internal politics, nuclear science, and sanctions regime to the legislative branch. By providing the necessary intellectual capital, this group can help to strengthen Congress's role in a potential final nuclear agreement with Iran. This group of former government officials and nuclear, legal, and sanctions experts provides advice and recommendations to policymakers in order to ensure that any final deal prevents Iran's uranium and plutonium pathways to a nuclear weapon.

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10. "Smart Sanctions Enforcement and Relief," *Iran Task Force*, July 2014; (http://taskforceoniran.org/pdf/Smart_sanctions_Memo.pdf) & Mark Dubowitz & Richard Goldberg, "Smart Relief after an Iran Deal," *Foundation for Defense of Democracies*, June 2014. (http://www.defenddemocracy.org/content/uploads/documents/Final_Smart_Sanctions_Report.pdf)