

# UN Financial Sanctions on Iran: Political Confrontation, Iran's Response to US Threats

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Global Research, March 09, 2007

9 March 2007

Region: [Middle East & North Africa](#)

Theme: [United Nations](#)

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The UN Security Council 60 days' grace period for the sanctions imposed on Iran ended on February 21, 2007. The International Atomic Energy Agency reported on Feb 22, that "Iran has ignored the U.N. Security Council resolution 1737 to freeze its uranium enrichment program and has expanded the program by setting up hundreds of centrifuges." Iran argues that it produces low level enriched uranium for nuclear fuel use, but the West claims Iran plans further enrichment suitable for making atomic bombs.

Iran contends that it has "inalienable right" under Article IV of Nonproliferation of Nuclear Weapon Treaty to develop, research, and produce nuclear energy for peaceful purposes, and therefore the Council's resolution mainly pushed by the United States is not justified. Iran has indicated repeatedly that it will not suspend its uranium enrichment operation as a precondition for negotiations. As the Council resolution deadline passed on Feb 21, 2007, the US - Iran political observers wonder what will happen next. The Five permanent members of the council and Germany started a meeting on Feb 26, to discuss the course of action they will take regarding the nuclear standoff. It is expected that the US may push the Council members for further sanctions; however some Council members may oppose it. In that case the US will probably increase its own financial pressures on Iran.

## MEASURES BY THE US AND ITS ALLIES

Iran has been under US unilateral measures and sanctions more or less since 1979. In 1995, US imposed comprehensive trade and investment sanctions on Iran, which were followed by extra-territorial sanctions in 1996. The extra-territorial sanctions, which had not been seriously implemented, are now put to action in case by case basis. Coincided with the UN resolution, the US has increased its financial squeeze on Iran beyond the UN recommended measures. It has blocked American companies in dealing with several Iranian Banks, including Bank Saderat and Bank Sepah, which are accused of sending money to Hezbollah in Lebanon.

Until now US allies have had mixed reactions to the UN resolution. Germany, that is the largest exporter to Iran, is not apparent to put any economic pressure on Iran. Cutting its exports to Iran, which are mainly industrial machineries can worsen the already high rate of unemployment in Germany.

France also has major commercial ties with Iran and it is not expected to push for punishing the country. France is a major exporter of automobile and its accessories to Iran. Cutting export to Iran will add to unemployment in France. Furthermore, the French oil company Total, is engaged in a major oil project in Iran. The company substituted for the US's

Connoco that could not sign the intended Siri oil filed contract when the US sanctioned Iran in 1995. Moreover, France's banks, including BNP Paribas have about 20 percent share of Iranian foreign borrowings. Up to now, French companies have not shown any noticeable change in their dealings with Iran.

Meanwhile, the European Union and Japan announced few days before the UN's deadline that they will support the Council resolution. On February 12, the European Union released a draft resolution stating that it will adopt the UN resolution 1737. EU 25 member countries have over 30 billion euro exports per year to Iran and only very small portion of the exports could be curtailed due to the sanctions.

Stuart Levy, the Treasury's Undersecretary, has been shuttling Europe in the past few months to convince the European banks to cut their ties with Iran. Some major European banks such as USB AG based in Zurich, Credit Suisse Group, and Standard Chartered of the UK have indicated that they will curtail their financial dealings with Iran. However, it is not anticipated that the European banks will cut their ties with Iran, unless their home countries devise a concrete policy for financial sanctions on Iran, and that is not likely. At the same time, Japan announced that it will freeze the financial assets of 10 Iranian entities and 12 individuals who may be involved in Iran's nuclear program effective Feb. 17, 2007. Japan is the largest importer of Iranian oil, and has participated in the development of Azadegan oil field despite of US objection. Therefore, it is not expected that Japan will take any further measures to harm Iran.

Thus far, the UN resolution has been seen to be symbolic in nature and will not have any major impact that can damage the Iranian economy.

#### OTHER COUNTRIES' REACTIONS

Russia's Vladimir Putin in a speech at the Munich Security Conference in February this year strongly criticized the US unilateralism in the world international affairs. He said a unipolar world will lead to more wars and international conflicts. The theme of the speech indicated that Russia is worried about the US military build up in its backyard and will likely take measures to oppose it. Consequently, it is not anticipated that Russia will impose any pressure on Iran. Despite of US opposition, in the last two years, Russia has sold to Iran about 1 billion dollar worth of weapons, including the sophisticated Tor-M1 missile systems. Few days before the UN deadline, Russia that is completing the Bushehr nuclear power plant in southern Iran, indicated that the delivery of the plant may be delayed due to Iranian nonpayment. However, Iran said it has honored its contractual \$25 (19 euro) million monthly payments and the only problem was payment in euro instead of US dollar. Russia's action seemed to be a political gesture right before the UN deadline. Russia wanted to show that it is imposing pressure on Iran right before the UN ultimatum deadline.

China as well has very good economic relations with Iran. In the past few years, China has signed several oil contracts with Iran, and currently Sinopec, the Chinese oil company, is negotiating a \$16 billion contract to develop Iran's giant Yadavaran oilfield. Furthermore, China is ranked Iran's second exporter and importer. Because of its sizable trade relations with Iran, it doesn't seem that it will harm Iran under the United States pressures. Because both Russia and China have veto power at the Security Council, they will probably oppose any further Council's sanctions against Iran.

What's more, Italy and Spain also have good economic relations with Iran. They have signed oil contracts with Iran. India too signed a pipeline deal with Iran last month that gives Iran annual revenues of about \$10 billion per year. Although India has indicated that it will comply with the UN resolution 1737, but this is not a significant factor in its good trade relations with Iran. Furthermore, Iran's trades with other countries in the region, Latin America, and Africa have rapidly increased in recent months.

As it appears, further sanctions could be only imposed by the US and its Anglo Saxon allies. Such sanctions of course may put strains on the Iranian economy, but their impact will be mild. Iran is taking some counter measures of its own to deal with the expected economic pressures.

## IRAN'S RESPONSE

Due to long time US trade and investment sanctions, Iran has been able to adjust its economy to certain degree under the sanctions. Despite of the US extra-territorial sanctions, Iran has been able to attract about \$20 billion investment from other countries in its oil and gas development projects since 1995.

In order to absorb private investments in its oil and gas projects, Iran has recently relaxed the state control over its downstream oil development projects and has opened them to private sector. The upstream that includes the oil and gas reserves will remain under control of the government.

In the last several years, Iran has signed major contracts with international oil companies to lure their investment. According to an article in daily newspaper Kayhan, in just past year, Iran has awarded about \$4 billion worth of oil and gas contracts to domestic and foreign private sector.

To get better prices and sell its oil in non-dollar currencies, Iran plans to launch an international oil bourse (exchange) next month in the island of Kish located in the Persian Gulf. At this bourse, oil and its derivatives contracts will be traded in Iranian rial, euro and other major currencies. Iran's Economic and Finance Minister Davoud Danesh-Jafari believes that Iran's bourse will enhance competitive prices for oil and its derivatives. However, success of the bourse will depend on cooperation of other counties. At present, oil is traded in US dollar in New York Mercantile Exchange (NYMEX) as well as in London International Petroleum Exchange (IPE). Iran's oil bourse will threaten the supremacy of these exchanges. It is anticipated that some major oil producing countries will participate in this bourse, because NYMEX and IPE are not currently working in their favor. Also, Iran's petroleum bourse might be opened during Saturdays and Sundays, which are working days in the Middle East and its time zone is in the mid way between Europe and East Asia's time zones. The new petroleum bourse can create an oil market that is open 7 days a week around the clock. If the bourse is successful, it can reduce demand for Eurodollar (that is dollar deposits outside the United States) and can contribute to popularity of euro.

Furthermore, Iran has already converted most of its international dollar reserves to euro, other major currencies, and gold. According to the Head of Central Bank Ebrahim Sheibani, Iran's dollar reserves are down to less than 30%. So far Iran has not had any problems to open letter of credits for its imports in foreign banks. Also, Iran has pre-sold its petrochemical exports to foreign countries until 2009.

Iran's Supreme Leader Ali Khamenei has recently issued a directive emphasizing privatization of some of the state owned industries under Article 44 of the Iranian constitution. This article limits participation of private sector in basic industries, but leaves place for private sector in some industries when beneficial to the national economy.

The private banking industry growth is the most visible in the private sector. In the last couple of years, formation of private banks has been encouraged in order to increase deposits in the banking system. At present, Iran's private banks' deposits are about 10% of state banks but they are growing rapidly according to an article published on February 18 in the daily newspaper, Iran. Almost half of Iran's bank deposits are established in the greater Tehran. As a result, establishment of private banks throughout other regions is expected to attract more of people's savings and will facilitates liquidity in the country in the wake of international financial sanctions.

## POLITICAL CONFRONTATION

On the political front, the US has threatened Iran with possible use of military force if diplomatic and economic sanctions do not change Iran's decision to continue with its uranium enrichment.

In the past couple of weeks, the US has accused Sepah-e Ghods, a unit associated with Sepah-e Pasdaran, of supplying weapons to anti occupation forces in Iraq. The US so far has not directly targeted the clerical leaders of Islamic Republic namely Supreme Leader Khamenei and former president Rafsanjani. Instead, the US has pointed at President Mahmood Ahmadinejad who has stayed firm against US pressures. It appears US is building a case to justify use of military force against Iran. The US is trying to link Ahmadinejad and his affiliated Sepah-e Pasdaran with supplying weapons to anti-US militants in Iraq. Ahmadinejad has popularity among Iran's underprivileged class who were disappointed with former clerical presidents due to their inability to enhance economic welfare for the poor. It is unlikely that US can cause Ahmadinejad to be deposed by any means.

In the mean time, Iran has accused the US and Britain for supporting ethnic minority rebels such as Blotches and Kurds against the Islamic Republic. Iran has said that the explosives and arsenal used in a car bomb by the terrorists in Zahedan in late February came from the US. Experts believe, any use of military force against Iran could disrupt the flow of oil in the Persian Gulf and will cause a significant increase in oil prices. That will have a serious impact on the economies of oil importing countries and may shake the world financial markets. In fact, after the UN deadline, oil prices have increased. Some analysts believe, the collapse of the US stock market on February 27, 2007 was partly related to the concerns about possible US military action against Iran. After market close on the same day, Secretary Condoleezza Rice suddenly changed her position on Iran and said US supports Iran's participation in a conference that is planned in mid-march for stabilizing Iraq sectarian violence. Washington desire to attend the conference alongside Iran is a turnaround from previous position of no dialogue with Iran about the situation in Iraq.

How the two countries' conflicts will be resolved only time will tell.

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