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THE IRANIAN NUCLEAR CRISIS: THE IMPLICATIONS OF ECONOMIC SANCTIONS

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Iran has ignored the deadline set in the UN Security Council's ultimatum and continues to reject any suspension of uranium enrichment. Although the Security Council is now required to decide on next steps, the United States is the only Council member supporting early political and economic sanctions. If no agreement is reached in the Council, Washington may try to create some mechanism for sanctions that bypasses the Council.

The sanctions potentially available to the international community range from a freeze on financial transactions and cooperation agreements of various sorts through restrictions on trade in sensitive materials and freezing of Iranian assets abroad all the way to a total economic embargo. The first and second types of sanctions would seem to have limited impact and would probably be adopted mainly to serve notice on Iran of serious intentions. By contrast, a total embargo would inflict a heavy cost.

If such an embargo were imposed, Iran could withstand the sanctions for some time, but the price would be very high. An embargo would reverse the growth trend Iran has been enjoying for several years, cause hundreds of millions of dollars in damage, and bring about a sharp drop in living standards.

Iran currently has a population of about 68 million and is richly endowed in natural resources. Its oil fields hold about 133 billion barrels of oil, about 11.5% of the world's proven reserves. In 2005, Iranian exports were estimated at about \$55 billion. Oil accounted for about 80% of that, with the rest consisting of chemicals and petrochemical products, agricultural produce, and carpets. The main export markets were Japan (17.3%), China (11.4%), Italy (6.2%), South Africa (5.5%), South Korea (5.2%), France (4.5%), Turkey (4.5%), Taiwan (4.3%) and Netherlands (4.3%). Iran exports about 2.4 million barrels of oil per day of its total production of 4 million. At current prices (about \$70 per barrel), exports now bring in about \$60 billion per annum, as opposed to \$45 billion in 2005 and \$20 billion in 2001. Oil revenues are the main source of funds to finance Iranian imports and a central item in national income. In 2005, imports amounted to about \$43 billion (equivalent to 23% of domestic income at official exchange rates). The main imports are raw materials, industrial machinery, refined oil products, food, consumer goods and defense items. Although Iran is a major oil exporter, it needs to import gasoline because its refinery capacity is too small to satisfy local needs. An embargo would force Iran to cut back

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on gasoline consumption by about 37%. The main sources of imports are Germany (14.2%), China (8.3%), Italy (7.5%), United Arab Emirates (6.7%), South Korea (6.4%), France (6.2%) and Russia (5.3%).

Technically, it would be possible to embargo exports from Iran without constraining exports to it, or vice versa. An embargo on exports from Iran would allow it to continue to import goods and to pay for them with its foreign currency reserves (estimated at \$45 billion in late 2005). An embargo on exports to Iran would harm it without disrupting the international oil market, although Iran might well retaliate by unilaterally restricting its own exports.

Iran could withstand economic sanctions for some time if it managed to remain determined and united internally, but the cost would be high. In recent years, Iran has enjoyed a significant improvement in its economic situation, reflected in rapid and constant growth in per capita income. This has been largely due to rises in world oil prices and a drop in the rate of natural increase in population. But if an economic embargo were imposed, all this would change. National product would drop (industry, which accounts for about 40% of GNP, would be particularly hard hit), imports would nose-dive, foreign currency inflows would decline by tens of billions of dollars per year, and the government would have to implement huge budget cuts and cancel many projects. As a result, standards of living would decline precipitously. Moreover, sanctions would help prevent the import of raw materials and equipment for the development of non-conventional weapons and surface-to-surface missiles and would limit Iran's ability to export weapons. Iran would also be left with far fewer resources to support terrorist organizations and finance the export of the Islamic revolution to other countries, including Lebanon.

Of course, an embargo on Iranian oil exports would also have an adverse impact on the global economy. Iranian oil only accounts for about 3% of global consumption (and about 5% of the international oil trade), but most oil producers are now stretched to the limit of their production capacity and oil prices are highly sensitive to any changes in supply. Consequently, a cutoff of Iranian exports would result in additional price rises that would moderate the pace of world economic growth. Moreover, an embargo would harm Iran's trading partners, particularly China (which objects to any sanctions on Iran).

To round out the picture, however, it should also be noted that a nuclear Iran could threaten the global economy even more than would sanctions. The Persian Gulf currently holds about two-thirds of the world's proven oil reserves and until some real alternative to oil is developed, the world will remain dependent on the Gulf as its main source of energy. Iran is known as a "price hawk" in the oil market, in contrast to Saudi Arabia and other Gulf producers, who believe that aggressive pricing alienates the major oil consumers with whom they would like to preserve friendly ties and would also encourage the development of alternative energy sources, which would harm their own interests in the long term. For example, at a meeting of OPEC oil ministers in Vienna on 31 January 2006, Iran demanded a cutback in production quotas of one million barrels per day (about 3.3% of OPEC's total production). Only Venezuela supported the Iranian demand, which was ultimately rejected. But if and when Iran acquires nuclear weapons, it could well try to dictate new and more expensive rules for the world oil market.

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