A Nuclear Deal with Iran and the Perils of Sanctions Relief

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Western negotiators routinely explain that the purpose of the sanctions regime against Iran is to increase negotiating leverage against the Islamic Republic. Economic pressure, they reason, will force Iran into a suitable compromise at the negotiating table, and relief would accompany any final agreement. If a final agreement is ultimately signed, the sanctions relief architecture must be carefully crafted to ensure that Iranian attempts to procure dual-use technology and raw materials vital to a military program are met with the same stringent measure and vigilance now in place.

The regime's nuclear program unquestionably threatens international peace and security. The international community knows that if left unchecked, Iran's declared facilities and inventoried stockpile of nuclear materials would be enough for a straight and swift path to a nuclear bomb. But the current extent of Tehran's efforts is unclear. Western intelligence agencies are still learning what other investments the regime has made to support its nuclear program.

Iran's history of nuclear deception demands additional caution for the final stretch of nuclear negotiations. It also requires keeping Western leverage intact until full Iranian compliance is verified beyond any reasonable doubt. After all, twice since 2002, Iran was exposed as having massive nuclear facilities that Tehran had failed to report to the International Atomic Energy Agency. The existence of additional undisclosed facilities cannot be ruled out, nor can the possibility that Iran may seek to develop new sites in the future.

Iran is already benefiting from cracks in the sanctions regime. Though Western negotiators claim that economic concessions to Iran under the

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interim deal are both minor and fully reversible, there is ample evidence to suggest a more complicated picture. Iran's charm offensive, led by its new President, Hassan Rouhani, and his worldly Foreign Minister, Mohammad Javad Zarif, has created high hopes among global business leaders that Iran will soon again open its doors for profitable deals. Bolstering this perception is central to Rouhani's foreign policy strategy of changing the market psychology on sanctions – from a climate of fear that discourages even legitimate, unsanctioned business, to a climate of hope where business booms in anticipation of sanctions being lifted.

To elicit and strengthen this mood, Iran has unleashed its proxies in Europe and Asia to promote business visits to Iran, which have increasingly been reciprocated by Iranian visits abroad. Rouhani's appearance at Davos and an aggressive courtship of oil companies by his new oil minister, Bijan Zangeneh, have dovetailed nicely with the hopeful mood sustained by Western diplomats keen on lending a positive spin to the interim deal as well as the chances of a final diplomatic deal regarding Iran's nuclear program.

Particularly in Europe and Asia, the business community only grudgingly and reluctantly yielded to sanctions pressure late in 2010. Thus, their memories of business opportunities in Iran are still fresh; their partners in Iran still answer their calls; and the newly found atmosphere created by diplomatic negotiations encourages them to explore the possibilities of reopening lines of credit and reestablishing a foothold in Tehran. The lack of new sanctions and the partial freeze of existing ones strengthen their sense that with an impending deal, now is the time for companies to position themselves favorably with their Iranian counterparts so that business deals can be signed as soon as the veil of sanctions is lifted.

What is the problem with this approach? While one branch of the Iranian regime nods benignly at the business community offering assurances of openness and transparency, another branch plots how to exploit a newly relaxed trade environment to obtain the missing pieces of Iran's clandestine nuclear program. Indeed, Iran's entire power structure, as if in a nod to its Zoroastrian past, is based on dualism – two executive heads of state, one elected and one clerical; two judiciaries, one religious and one not; two armies, one regular and one revolutionary; and so on. So too is the nuclear program, part of which is declared and overt, while part has been kept concealed from the international community.

Understanding the history of Iran's procurement is critical, therefore, as the West prepares to offer additional sanctions relief in exchange for meaningful limitations on Iran's declared nuclear facilities, an intrusive inspection regime, and a cap on declared nuclear activities. Having a full accounting of Iran's clandestine procurement activities is important for uncovering potential undeclared nuclear facilities. It is also vital for those engaged in designing the pace and scope of sanctions relief to minimize the risk that Iran will be able to subvert its responsibilities under the Nuclear Non-Proliferation Treaty.

The Iranian system and nuclear program is unlike any the world has ever confronted. Foreign powers are reduced to acting nearly on intelligence alone to discern where decisions are made and how priorities are set. Internal conflict means that not all Iranian actions are necessarily directed by the regime's leadership. Certain activity, however, is clearly determined at the highest levels. This includes efforts to circumvent sanctions and develop procurement networks.

Economic diplomacy, designed to weigh heavily on Iran's economy, has been the preferred tool of US and European powers to empower nuclear negotiators focused on containing and constraining Iran's declared nuclear activities. But Iran has managed to challenge the sanctions regime legally – and successfully. It has moved funds around the world, shipped sensitive technology and raw materials, found alternative ways of payment, and copied engineering marvels it could not import. Iran has exploited the EU legal system to mount court challenges against designations of Iranian entities. Once Iran called into question the legal grounds for designations and protested that the EU has based punitive measures on flimsy evidence, EU lawyers have balked at requirements to show evidence to both the court and Iran's lawyers. Revealing this sensitive material could jeopardize intelligence sources working with EU member states, so the EU has thus gone empty-handed to its judicial summons.

Predictably, the rulings have gone Iran's way and started the erosion of the once strong EU sanctions architecture. The Joint Plan of Action, the interim deal signed in Geneva in November 2013, bars the EU from passing new sanctions. Therefore, the EU cannot slap sector bans on entire areas of Iran's economy. Entities could be relisted, but only for a time. Winning in court is part of Iran's strategy to loosen sanctions – and it is a sure winner for whichever designation might remain on the books once a final nuclear accord is reached.

Key to continued court victories is the ability to obtain material or expertise that would be of use in furthering a clandestine nuclear program without attracting attention, and Iran has demonstrated a high level of ingenuity in developing its networks. In 2002, Iranian emissaries approached MCS International GmbH, a German producer of cylinders for hybrid cars, to buy a flow-forming machine. They succeeded in negotiating a purchase agreement, but before they could transfer the delicate equipment – which is used to rotate carbon fiber and other elements into cylindrical shapes, but can also produce centrifuges – the factory was caught in the hostile takeover of its erstwhile owner. In the process, MCS, at the time named Mannesmann Cylinder Systems, fell into bankruptcy. By the time its finances were settled, German authorities had caught up with the flow-forming machine and blocked its transfer to Iran.

Iran, however, did not relent. Iranian emissaries working for state-owned automotive industry companies established a new company, MCS International GmbH, and bought the factory with its machines. For the next 12 years, MCS International continued to operate under Iranian ownership – and eventually it became a subsidiary of a financial holding controlled by Iran's Supreme Leader. Though neither its machinery nor its carbon fiber could be transferred to Iran, its owners ensured periodic visits by delegations of Iranian engineers, who familiarized themselves with the technology on site. Eventually, a twin factory was built in Iran, at which point MCS International was left to go bankrupt.

The case of MCS International reveals two important aspects of Iranian procurement. The first is that Iranian emissaries have been scouting the global economy in search of distressed assets – factories and businesses in desperate need for cash injections. Robust purchases sometimes do the trick. Otherwise, the offer to buy a business, or at least a share of it, enables Iran to access technology that is hard to come by otherwise. Ownership enables heightened flexibility in arranging business deals with front companies that Iran operates elsewhere. Supplies of technology stream steadily as a result.

The second lesson has to do with how Iran covers its own tracks – and in the process, manages to build convoluted but effective routes for its illicit procurement efforts. Even as Iranian control over the German factory was revealed, European authorities were unable to block shipments of goods under the somewhat spurious notion that the end-user listed on sales was not in Iran, but in Dubai. Such matter highlights another weak point in the sanctions architecture, which Iran has exploited to circumvent both shipping and payment restrictions.

Most procurement efforts no longer go directly from the supply source to Iran. Iran has devised a complex web of intermediaries and middle points through which both shipments and payments can move without raising suspicion. Turkey, Dubai, Malaysia, and the Caucasus continue to feature prominently in these schemes, whereby locally incorporated businesses act as end-users, proceeding to fictitiously resell and reship prized dual use merchandise to Iran. Local banks are used for payments when possible. Otherwise, elaborate barter systems are utilized to ensure payments.

In the months since the JPOA was signed, there are no signs that such efforts are abating. After all, it is evident from the paucity of designations by the US Department of Treasury of Iranian entities since November 2013, and the total absence of new designations by Europe, that the West is reluctant to take action against Iranian proliferators. Western diplomats admit that though technically legal, new designations under existing sanctions are impolitic while negotiations continue. If anything, one must assume that a relaxed sanctions regime will involve less willingness, for practical as well as political reasons, to slap Iran on its wrist for violations if an agreement is reached.

Negotiators must make sanctions relief work without compromising Western ability to police Iranian procurement efforts and punish its regime for possible future misbehavior.

Iran's long experience in the art of procurement offers a cautionary tale. And it invites the question: can we ensure that, as sanctions are phased out, there will be no opening for Iran's temptation to complete its inventory on the path to nuclear weapons capability?