

Testimony of
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Chairman Royce, Ranking Member Deutch, Members of the Committee, thank you for the invitation to appear before the Committee today. I am honored to appear before you today to discuss the impact of sanctions relief under the Joint Comprehensive Plan of Action, particularly with respect to Iran's regional influence and activities.

The JCPOA will entail enormous benefits for Iran's economy and, as a result, provide substantial additional resources available to the government of Iran. On "Implementation Day," which is anticipated to arrive sometime in early/mid-2016, Iran will be unshackled from the preponderance of the sanctions regime that halved its oil exports, crashed the value of its currency, and cost the country tens of billions — at least — in lost revenues and additional costs over the course of the past five years. The United Nations Security Council measures, which served as a platform for most of the actions undertaken by the rest of the world against Iran, will vanish with a few notable exceptions pertaining to conventional arms and ballistic missiles.

The totality of European Union sanctions, including the embargo on Iranian oil and prohibitions on energy investment, will evaporate. And nearly all of the American measures that had effectively severed Iran's economy from the international financial system will be waived, permitting somewhere in the realm of \$100 to \$150 billion in Iranian assets that had been held in overseas accounts to flow back into Iran.

The agreement also provides for the effective cessation of a number of American measures that were predicated on the full range of concerns about Iranian policies, re-opens a loophole that permits U.S. corporations to trade with or operate in Iran via foreign subsidiaries, and carves out a wider array of permissible U.S. business with Iran than at any time since the comprehensive embargo was put in place twenty years ago. Like the release of Iran's frozen assets, these new openings in the American sanctions architecture will go into effect immediately after Tehran's initial nuclear constraints have been certified.

This wide-ranging sanctions relief incorporated in the JCPOA has elicited considerable angst among some here in Congress, as well as other U.S. policymakers and allies. The sense of affront at the appearance of rewarding Tehran after decades of bad behavior is magnified by the irony that Washington is being forced to cede the most effective instrument in its policy toolbox, at the very moment when its efficacy has finally been confirmed, even as some of the most strategically relevant aspects of the Iranian challenge remain unabated. That inescapable reality underscores the importance of identifying and implementing new mechanisms for addressing Iran's problematic regional policies.

Sanctions Relief and the Iranian Economy: What Will Tehran Do with the Money?

The public discussion of the JCPOA and its provisions regarding sanctions relief has tended to emphasize the availability of new resources for Tehran's support for terrorist groups and other violent proxies as well as its assiduous efforts to extend its influence across the broader Middle East. However, it should be acknowledged that the most pressing needs facing the Iranian government are not those related to its regional posture, but rather to its domestic economy.

The sanctions regime erected between 2006 and 2015 has been viciously effective, halving Iran's oil exports, precluding Tehran from repatriating its hard-currency profits from the sales, and impeding Iranian banks from transactions with the rest of the world. They succeeded in shifting Iran's approach to the protracted nuclear impasse not because of these restrictions impeded its ability to sustain its regional policies, but rather because of the more immediate and potentially unsettling implications for the stability and ultimately the survival of the regime.

The sanctions were felt far more immediately and far more profoundly by the average Iranian than the average beneficiary of Tehran's terrorist subsidies, and it was the concerns about the long-term erosion of Iran's economic base and the legitimacy of the ruling system that generated a consensus decision among the political elite to relinquish its longstanding nuclear recalcitrance, elevate a more pragmatic elective leadership, and engage in a serious and, eventually, successful process of negotiations to end the impasse and the sanctions.

For this reason, it is important to appreciate that domestic requirements and priorities will indeed loom large in the allocation of the deal-related windfalls that will accrue to Tehran over the course of the next year. Iran's president, Hassan Rouhani, is keenly concerned with Iran's dire economic predicament. He has consistently articulated a national security perspective in which economic strength is an integral component of national power. He was one of the first public critics of the policies of his predecessor, Mahmoud Ahmadinejad, raising alarms about the dangers of the government's blithe disregard of the implications of intensifying sanctions and the 2008 global financial crisis.

His campaign for the presidency was grounded in the argument that Ahmadinejad's policies had devastated Iran's economy, and after taking office Rouhani has insisted that the situation was even worse than he previously understood. On his 100th day in office, he gave an address to the nation in which he described food shortages, epic inflation rates of 46 percent, and massive state debts of at least 2 trillion rials. He conceded that "the government that had the most revenues during its two terms" – Ahmadinejad presided over eight years in which Tehran earned more in petroleum exports than the previous century of production – "left the most debts as well."

In practice, economic rehabilitation has ranked at the top of Rouhani's agenda, in parallel with the nuclear file. He has installed an experienced group of technocrats and experienced economic planners to manage Iran's rehabilitation, most of who had been forced out of government by Ahmadinejad. They have sought to revive the economy without imposing strict austerity budgeting, imposing fiscal and monetary discipline to control and reduce inflation while attempting to avoid triggering a deeper recession.

Rouhani's government has also sought to abandon or significantly modify several of the headline economic initiatives of his predecessor, and to cultivate greater transparency and accountability within the economy. His officials and allies have been sharply critical of what they describe as incompetent, corrupt, and ultimately destabilizing stewardship of the country by Ahmadinejad and his cronies. And they have endeavored to curtail or even reverse the array of makeshift mechanisms for coping with sanctions that were intended to mask the dramatic exodus of foreign investors that facilitated the creeping sway of the Revolutionary Guard throughout Iran's economy.

One of Rouhani's most significant, and widely appreciated, domestic accomplishments since taking office in August 2013 is the reduction in the inflation rate, from 42 percent at the time of his inauguration to more recent figures of 15 percent. His policies have also reversed the dangerous involution of Iran's economy that transpired during Ahmadinejad's final years in office – stabilizing to minimal levels of growth after a contraction of more than 8 percent.

But he has promised the Iranian people more than just a halt to the crisis; Rouhani has pledged to generate growth, development, and jobs. He acknowledged in February 2015 that “at the moment we are just paving the way and filling up those potholes that were created earlier... We should reach a stage where the ground is paved, after which the machine [of economic growth] will speed up.” And he emphasized, in contradistinction to Iran's supreme leader and some hard-line supporters of the Islamic Republic that “those who think the country can develop without relations with the outside world are absolutely wrong.”

The JCPOA and its attendant sanctions relief will greatly facilitate Iran's economic rehabilitation, but Rouhani and his advisers are particularly aware that it will not be a magic bullet. Based on their experience during the early 1990s, when a moderate Iranian president sought to reconstruct Iran's economy after a decade of revolution and war, Iranian technocrats appreciate all too well that even the expeditious lifting of all international sanctions will only create new dilemmas for the country's economy.

For this reason, one of the key aspects of Rouhani's economic strategy is an attempt to avoid some of the pitfalls that undermined its previous attempt to rebuild and restore its economy. Then, initial economic improvements were undercut by rapid growth in imports, which contributed to inflation as well as government struggles to stay current on a quickly-expanding foreign debt burden. The potentially counterproductive ramifications of a massive injection of new capital explains in part the conservative estimations by Iran's Central Bank of the prospective repatriation of frozen funds in the aftermath of sanctions relief.

Rouhani and his team will instead seek to deploy the JCPOA economic boost toward job creation and sustainable growth. Masoud Nili, Rouhani's senior economic advisor who has long experience in devising Iran's economic plans, has warned that if Tehran does not invest in its own capabilities and citizens, “in view of the unemployment situation we have, conditions in the economy will become deadly.”

As with all issues in Iran, Rouhani's economic policies have generated fierce debate within the engaged political class within the Islamic Republic. However, like the nuclear diplomacy, the

president clearly benefits from the support of Iran's supreme leader and, by extension its hard-liners, to advance this agenda.

This isn't simply a matter of policy preferences for Rouhani and his team: Iran has real politics, including elections for its parliament and the body that selects its supreme leader early next year. And its population is impatient to reap the peace dividend that they were promised more than two years ago, when they elected Rouhani to the presidency by a surprising margin. Rouhani's initial stabilization efforts have been greeted positively, but the wait for real results has proven to be a long and frustrating one for Iranians.

The November 2013 interim nuclear agreement sparked new interest in Iran, but it generated little new investment and only modest new avenues of trade for Tehran. To date, the nuclear diplomacy has provided no meaningful 'trickle-down' effect for Iran's economy or its population at large. Expectations have been elevated by the maximalist rhetoric that Iranian leaders have utilized in describing the benefits of the JCPOA.

For this reason, expectations for Implementation Day are sky-high at home among Iranians, and Rouhani will be risking his mandate and his presidency if he does not deliver on real results: the generation of jobs, growth, new vitality and opportunities for Iranians beyond the inner circle of regime elites, whose proximity to power has enabled them to thrive under even the most stringent periods of international economic pressure. (Of course, the *aghazadeh* and crony capitalists of the Islamic Republic are at least as eager for their own piece of the sanctions-relief pie, and the competition for resources among privileged constituencies and state institutions will also place domestic pressure on the regime.)

These priorities do not negate the legitimate concerns about the potential for additional regional troublemaking as a result of the inevitable boost to Iran's economy that will derive from the deal. Rouhani is not Iran's ultimate authority, and the influx of previously inaccessible revenues will magnify the challenge facing the U.S. and the international community with respect to Iran's regional influence.

Still, both the contemporary balance of power in Iran and the historical track record highlight the importance of domestic priorities for Tehran. The internal expectations and urgent demands on the regime's expanding coffers is a more complicated environment than simply a blank check to terrorist groups, and the continuing U.S. capacity to isolate those entities and individuals within Iran who remain engaged in terrorist activities will be crucial to shaping the decisions of its leadership (and the trajectory of its economic recovery.)

How Will Sanctions Relief Impact Iran's Regional Policies?

Unfortunately, the long-term track record is clear: Iran's support for terrorism has never been driven primarily or even substantially by resource availability. In fact, Iran's most destructive regional policies have been undertaken and sustained even at times of epic constraints. These policies were initiated in the early post-revolutionary period, when Iran's economy was suffering the consequences of revolutionary upheaval and continuing internal unrest, and they continued

and actually significantly intensified after the September 1980 Iraqi invasion of Iran and throughout the long, brutal, and costly war that followed. In fact, many of Iran's worst regional abuses took place during this first decade: the cultivation of Hezbollah and that group's 1983 bombing of the U.S. Marine barracks in Beirut and the direct and often deadly assistance to subversive groups in its southern Gulf neighbors throughout the war with Iraq. In fact, economic constraints may have energized and legitimized Tehran's investment in unconventional warfare against its neighbors as well as American interests and allies by virtue of the limitations on Tehran's ability to resupply its conventional war effort vis-à-vis Iraq and the cultivation of its leadership's innate sense of suspicion.

These same trends have held over the course of the past decade, as externally-imposed economic pressures on Tehran, as a result of both sanctions and the more recent decline in oil prices, reached or even surpassed the heights of the hardships during the war. These pressures provided no remedy to Iran's efforts to extend its influence through nefarious activities and allies, or its substantial investment in fueling and fighting conflicts in Iraq and Syria. Even since 2010, when the world has applied unprecedented financial pressure on the regime including measures that have directly targeted the institutions and assets related to Iran's regional power projection and its support for terrorist proxies beyond its borders, there is little evidence that sanctions impeded Iran's most destabilizing policies.

The relative consistency of Iran's relationships with terrorist organizations and extremists across the region makes it impossible to discern much, if any, remedial relationship between the economy and the adoption of more responsible regional policies. This is in part a function of the relatively low funding threshold for these activities; the expense associated with sustaining Hezbollah's massive rocket arsenal or fueling Bashar Al Assad's barrel bombs is relatively easily absorbed even at times of relative scarcity. More importantly, the persistence of these policies is further confirmation that they tend to reflect opportunism on the part of Iranian leaders rather than budget priorities.

The few episodes in which Iran's support for terrorism has been mitigated, if only partially and ultimately temporarily, have been undertaken when the risks appear to be too high. During the late 1990s, Tehran appeared to curtail its previous policies of assassinating dissidents abroad as well as reign in its longstanding support to some subversive elements in the Gulf states; these shifts transpired after the 1996 Khobar Towers bombing and the 1997 Mykonos verdict, both of which posed brief but very serious jeopardy to Tehran's efforts to secure a durable rapprochement with its neighbors, reopen its economy to the world, and attract a steady flow of new foreign investment.

What is also plainly evident is that there is a powerful correlation between the intensification of multilateral sanctions on Iran and the expansion of the political and economic influence of the Revolutionary Guards within the power structure of the Islamic Republic. Indeed, during the same years that the Iranian nuclear impasse intensified, and economic pressure mounted, the political and economic role of the Revolutionary Guards expanded markedly.

The Guards' ascendancy had been long in the making, and it certainly reflects other factors well beyond sanctions themselves, including the coming-of-age of Iran's war generation and the

inability of the reformist movement to sustain its initial momentum and efficacy. Still, it can be no coincidence that the IRGC and its affiliated organizations managed to secure new primacy after sanctions and concerns about political and reputational risks had sent most of Iran's Western investors running.

The Role of Residual Sanctions in Shaping Iran's Regional Posture

The deal leaves intact a significant array of restrictions for Iran's economy. The U.S. Treasury Department remains the long pole in the international sanctions architecture, and even residual American measures will pose a powerful deterrent against business in Iran. Iran's worst actors, including those associated with the Revolutionary Guard Corps, will remain sanctioned by the United States — tainting, by extension, any foreign company that does business with them after the deal.

For American firms and individuals, the embargo on U.S. trade and investment in Iran criminalizes even the most tangential involvement in the Iranian economy outside the specific sectors exempted under the deal.

These measures will compound other complications for new and returning investors in Iran. A decade of increasingly wide-ranging restrictions and consistently rigorous enforcement, including numerous multimillion dollar penalties, has created a culture of compliance by major firms around the world. In fact, the legal and reputational risks have been so thoroughly reinforced that the impact of the openings provided to Iran's economy under the November 2013 interim agreement has proven to be less, not more, valuable than originally anticipated. The same could prove true with respect to the relevant provisions of the JCPOA.

Congressional opposition to sanctions termination means that the Obama administration will have to rely on waivers and other inherently temporary mechanisms for reversing existing measures; that alone entails sufficient uncertainty to give major investors around the world significant qualms about committing to the kind of multi-year, multi-billion dollar projects that Iran's energy sector requires.

And of course the deal incorporates the threat of “snapping back” other sanctions, something the Obama administration fought for and has trumpeted in its defense of the agreement. Even if these provisions are not perfect guarantees that the current level of multilateral restrictions on Iran can be readily reinstated, they reinforce a sense of uncertainty about the medium or long-term context for investing in Iran — a time horizon that will be directly relevant for the scale and duration of major investments.

There is no doubt that the perpetuation of economic restrictions will have a continuing, albeit modest, dissuasive impact on Iran. It seems highly unlikely, however, that U.S. penalties against the Revolutionary Guards and related organizations can provide sufficient disincentives to alter Tehran's longstanding patterns of regional power projection or revise the broad calculus of opportunism and insecurity that underlies these policies and relationships.

Where U.S. sanctions may play the most constructive role is in diminishing the advantages that the Guard and its affiliates have enjoyed within Iran's economy.

Sanctions Worked, So Why Are We Ceding Our Most Effective Tool?

Three decades of indifference to American penalties had inculcated an illusion of invulnerability among the Iranian leadership. With the help of Congress and the world, Washington has tested and ultimately shattered that illusion. Authorities put in place in the aftermath of the 9/11 attacks to curtail terrorist financing provided a platform for assembling an unprecedented campaign that access to the international financial system to individual Iranian banks and eventually most of its economy. Changes in energy markets made it possible for the first time to target Iran's oil production without blowback to the global economy or domestic price at the pump. And Iran's internal regression – its conveniently cartoonish then-president Mahmoud Ahmadinejad and the suppression of 2009 pro-democracy protests – facilitated newfound and profoundly valuable cooperation from Europe and much of the rest of the world.

Analysts have often argued that Iranian policies are shaped by varying degrees of pragmatism and a rational assessment of the costs and benefits of its options. On the nuclear program, however, Tehran's uncompromising stance over a dozen years fueled the perception that its leadership would pay any price for the program. That is disproved by this deal. The sanctions instituted over the course of the past five years forced Iran to alter its uncompromising approach.

Iran's president has acknowledged as much. Rouhani has consistently cited the economy in his criticism of the foreign policies of his predecessor, Mahmoud Ahmadinejad, as well as in his public case for the nuclear negotiations, arguing in May 2015 that “the lives, the economy, the market, the money, the value of the national currency of the people depend on the nuclear negotiations.”

So, after 36 years, pressure worked, imperfectly and incompletely perhaps, but it worked nonetheless. And now, just as one aspect of the Iranian challenge appears to have been mitigated, the deal relinquishes the very tool that made that success possible despite the fact that Iran's destabilizing regional policies persist.

The fundamental impediment is this: the United States does not have, nor is it likely we could instigate, anything close to the level of multilateral consensus surrounding Iran's regional policies that was built, slowly and through the fortuitous confluence of facilitating circumstances, on the nuclear issue.

Russia clearly does not share our interests in ending the Syrian conflict through the removal of the vicious Assad government; Beijing will not readily jeopardize its energy security to punish Iran for its financial and material assistance to Hamas or Palestine Islamic Jihad. And even our European allies have traditionally exhibited ambivalence on Iranian support to groups such as Hezbollah.

The most recent period of Iran sanctions has been the exception to the rule of the past 36 years; throughout most of the history of the Islamic Republic, Washington found little support even among its closest allies for the application of any economic pressure toward Tehran whatsoever. Some of the conditions that facilitated the more recent consensus, such as historic shifts in the global energy market, remain true today. However, Iran has effectively dispelled some of the other factors, such as the international abhorrence toward its former president, Mahmoud

Ahmadinejad, and the outrage generated over his contested 2009 reelection and the repression of the protests that followed in its wake.

Rouhani's election launched Iran's rebranding, and this alone had begun to undermine cohesion on the strategy toward Tehran. Ultimately, the nuclear agreement will accelerate a process of reintegration into the global economy that likely would have gained momentum even without a resolution to this crisis.

Washington could have sought to thwart this process until or unless Tehran had fully transformed itself into a responsible actor at home and in the region. The uniquely dominant U.S. role in the international financial system affords formidable leverage, and refusing to dismantle the blockade on Iranian banks would have curbed at least some of the world's sudden enthusiasm for opportunities in Iran. Such a scenario may yet transpire, if Congress can muster a veto-proof majority to reject the nuclear deal.

However, the history of U.S. policy since the Islamic Revolution offers little reason to be sanguine about a go-it-alone approach on Iran. Trying to sustain Iran's economic isolation without the participation, or at least the acquiescence, of the rest of the world's major powers would inevitably pose fewer costs for Tehran and greater expenses for Washington in terms of transatlantic relations and American influence around the world. And, based on the track record of the nuclear negotiations since 2002, it almost surely would generate an even less favorable resolution to Iran's nuclear ambitions.

What Can Washington Do?

Sanctions relief under the JCPOA will undoubtedly complicate and likely exacerbate the challenges posed by Iran across the Middle East. However, the nuclear deal mitigates, in a meaningful fashion and for a reasonable duration, one of the most urgent aspects of the Iranian threat, and should facilitate a new and more serious effort to generate a similar multilateral effort to curtail Iranian terrorist financing and materiel support. There are a number of steps that Washington can and should consider:

- 1) Clarify in advance with our allies how we will respond to a range of potential issues with implementing the deal, including but not limited to clear-cut Iranian noncompliance with its obligations under the deal. This should include a robust European endorsement of the notion of reinstatement of European Union and individual state sanctions adopted after the 2010 United Nations Security Council Resolution 1929.
- 2) Make certain through both private and public communications that Tehran appreciates the inevitability of continuing enforcement of those residual American sanctions related to counterterrorism, in an effort to preclude or undercut likely Iranian impulse to use this enforcement as a pretext for any failure to adhere to its own obligations.
- 3) Intensify efforts to enforce existing Security Council prohibitions on the transfer of conventional weapons and ballistic missile technology to Iran, step up efforts to interdict illicit shipments to and from Iran. In addition, the United States should seek to generate new cooperation with Europe and U.S. regional allies on preventing Iranian arming and financing of proxy groups in the region and around the world.