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## Iran: U.S. Policy and Options

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## **ABSTRACT**

This CRS analyzes developments in U.S. policy toward Iran, including existing U.S. sanctions in force against that country. The report discusses changes in Iranian policy and in U.S. policy toward Iran since the May 1997 election of a relative moderate, Mohammad Khatemi, as Iran's President. The report analyzes the outstanding issues that divide the two countries, and conditions under which Iran might agree to U.S. overtures to improve relations with Iran's government. The report will be updated to reflect major developments in U.S.-Iran relations or in response to legislative developments. See also, CRS Issue Brief IB93033. Iran: Current Developments and U.S. Policy.

# Iran: U.S. Policy and Options

## Summary

Iran and the United States have been adversaries, and have sometimes engaged in low-level military hostilities, since Iran's Islamic revolution on February 11, 1979. During its first term, the Clinton Administration sought to build on earlier policies designed to contain Iran and moderate its behavior. The Clinton Administration initially placed its policy of containing Iran within a broader framework for keeping both Iran and Iraq weak, terming the policy "dual containment." The Administration maintained that dual containment was a necessary departure from past Persian Gulf policies in which the United States has alternately tilted toward either Iran or Iraq to maintain stability in the Persian Gulf.

In the absence of U.N. sanctions on Iran, as exist on Iraq, in 1995 and 1996, the Clinton Administration and Congress undertook a number of new measures to contain Iran. Foremost among these steps were expanded U.S. economic sanctions, including a ban on U.S. trade and investment in Iran and sanctions on foreign firms that make substantial investments in Iran's energy sector. U.S. military assets, in addition to those needed to deter Iraq, were sent to the Gulf to monitor Iran's growing naval capabilities and to help deter Iranian consideration of coercive maritime adventures. Similarly, U.S. arms sales and advice to the Persian Gulf states were designed to help the Gulf states defend themselves against potential attacks by Iran as well as by Iraq.

In late 1996, a debate began to develop over Clinton Administration policy toward Iran. Several prominent foreign policy experts maintained that the United States and Iran have some interests in common, such as containing Iraq and ending the continuing conflict in Afghanistan. Others noted that differences over how to deal with Iran had become a serious irritant in U.S.-European relations. This debate accelerated following the upset victory by a relative moderate in Iran's May 23, 1997 presidential election. By early 1998, following the unexpected election of a relative moderate as Iran's president, a consensus emerged within the Administration to try to engage Iran in a political dialogue or in mutual confidence-building measures that could eventually lead to normal relations. Administration officials maintain that discussions with Iran could yield progress in key areas of U.S. concern, which include: Iran's attempts to acquire weapons of mass destruction, its support for international terrorism, and its backing for groups opposed to the Arab-Israeli peace process.

The Administration's apparent policy shift has created concern among some groups and Members of Congress that the Administration will make substantive concessions to Iran in advance of clear changes in Iran's international behavior. Although some Members now appear to accept the concept of U.S. dialogue with Iran, some Members are concerned that Iran would try to take advantage of any easing of U.S. containment policy to accelerate a strategic buildup and fund Middle Eastern terrorist groups.

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# Iran: U.S. Policy and Options

## Introduction

The United States and Iran were allies when the Shah ruled Iran prior to the 1979 Islamic revolution, but there has been animosity between the two countries since Iranian radicals took over the U.S. Embassy in Tehran on November 4, 1979 and held 52 Americans there hostage for 444 days. Clinton Administration officials have articulated several areas in which Iran continues to challenge U.S. interests: (1) Iran's efforts to acquire nuclear weapons and other weapons of mass destruction; (2) its promotion of terrorism worldwide; and (3) its attempts to undermine the Arab-Israeli peace process, primarily by supporting groups that use violence to try to derail that process. In public statements prior to mid-1997, some U.S. officials mentioned additional U.S. concerns, including: efforts to subvert the Persian Gulf monarchies; a buildup of conventional weapons that threaten international shipping in the Gulf; human rights abuses; and its continuation of a death sentence against British author Salman Rushdie.<sup>1</sup> Several outside experts maintain that Mohammad Khatemi, after more than two years as Iran's President, has been unable to fulfill his apparent intention to improve relations with the United States because he has been prevented from doing so by hardliners led by Iran's Supreme Leader, Ali Khamene'i.<sup>2</sup>

Even before the election of Khatemi, some experts believed the Administration was overstating the potential threat from Iran. These experts saw Iran weighted down by factional infighting and by outstanding debts to Western creditors that slowed its military modernization programs. They maintain Iran has acted to maintain stability on its borders by mediating such conflicts as the 1992-97 civil war in Tajikistan and the dispute between Armenia and Azerbaijan over the Nagorno-Karabakh region. Many analysts believe Iran is unlikely to take any actions that would threaten the free flow of oil on which Iran's economy depends, or scare away the foreign investment that Iran has tried to encourage in its energy sector. Some note that several International Atomic Energy Agency (IAEA) visits to Iran since

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<sup>1</sup> The late Ayatollah Khomeini issued a religious proclamation in February 1989 calling for Rushdie's death for writing the novel *The Satanic Verses*, which Khomeini and his aides believed blasphemed Islam. For further information on Iranian activities of concern to the United States, see U.S. Library of Congress. Congressional Research Service. *Iran: Current Developments and U.S. Policy*. CRS Issue Brief IB93033, updated regularly, by Kenneth Katzman. 15 p.

<sup>2</sup> Khamene'i was chosen to succeed the leader of the Islamic revolution, Ayatollah Ruhollah Khomeini, upon the latter's death on June 3, 1989. However, most experts believe that Khamene'i lacks the undisputed authority and religious credentials of his predecessor. Nonetheless, his position gives Khamene'i overall command of the armed forces and security services, and the ability to make key judicial, legislative oversight, and other appointments.

February 1992 have not turned up any evidence of a nuclear weapons program,<sup>3</sup> and that Iran was an original signer of the Chemical Weapons Convention (CWC) in 1993.

## U.S.-Iran Relations Under Previous Administrations

The close U.S. relationship with the Shah of Iran colored U.S. relations with the current regime. The United States assumed responsibility for defending Western interests, including the free flow of oil, in 1971, after Britain militarily withdrew from the Gulf. During 1971 - 1979, within the environment of a U.S.-Soviet Cold War, the United States sought to strengthen Iran, then led by the Shah, as a “policeman” of the Gulf. The effort to strengthen the Shah was partly a response to the 1968 coup in Iraq which brought the left-wing Ba’th (Arabic for renaissance) Party, in which Saddam Husayn was a senior leader, to power. The Ba’thist regime had turned to the Soviet Union for arms and political support, signing a treaty of friendship with the Soviets in April 1972. The Shah also maintained relatively good relations with Israel, which looked to forge alliances with non-Arab states in the region in order to keep its Arab neighbors contained.

The United States opted to preserve stability in the Gulf when it accepted a comprehensive understanding – the Algiers Accords – between Iran and Iraq in 1975. In those accords, both states agreed to share control of the Shatt al-Arab waterway and to refrain from interfering in each others’ affairs. However, the accords also required the United States to cutoff its support for the Kurds battling Baghdad for autonomy in northern Iraq.

Four years of relative stability in the Gulf were upset in February 1979, when the Shah was overthrown by the Iranian Islamic revolution, led by Ayatollah Ruhollah Khomeini. The fall of the Shah was viewed as a policy disaster by the United States, replacing a pillar of U.S. influence with an avowedly anti-Western clerical regime. The new regime came to power denouncing the United States as the “Great Satan.” The policy loss was confirmed on November 4, 1979, when radical “student” followers of Khomeini seized the U.S. Embassy in Tehran and held U.S. diplomats hostage. The setback was compounded in December 1979 by the Soviet invasion of Afghanistan, which prompted President Carter to articulate the “Carter Doctrine” – a U.S. threat to intervene militarily if the Soviet Union encroached on U.S. vital interests in the Persian Gulf. On April 7, 1980, after failing to make headway toward achieving the release of the hostages, the United States formally broke diplomatic relations with Iran. The U.S. Embassy remains occupied by Iran’s Revolutionary Guard Corps and Iran has not compensated the United States for the seizure of the Embassy. The possibility of freedom for the hostages receded further that month following the failed April 25, 1980 U.S. attempt to militarily rescue the hostages. Eight U.S. servicemen were killed when some of the operation’s helicopters collided upon departing the rendezvous point in Iran, following abortion of the mission.

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<sup>3</sup> These assessments were based on IAEA visits, not full fledged inspections. Inspections generally involve the systematic taking of samples and the performance of tests to account for the host country’s nuclear material. Reports about the IAEA visits to Iran suggest that only some of the standard IAEA procedures were performed, and only at some of the sites visited.

Some past Administrations have tried to improve relations with the Islamic regime, even though U.S. differences with Iran's radical Islamic ideology have remained. Although still unable to resolve the Iran hostage crisis, President Carter declared U.S. neutrality in the Iran-Iraq war, which began on September 22, 1980 when Iraq crossed the border with Iran in force.<sup>4</sup> The hostages were released minutes after President Reagan's inauguration in January 1981. In order to prevent an Iranian victory in the Iran-Iraq war, in 1982 the Reagan Administration began a "tilt" toward Iraq. The Reagan Administration opened export credits to Iraq in 1982 when it removed that Arab state from the list of state sponsors of terrorism; formal U.S.-Iraqi relations were resumed in 1984. The United States also undertook diplomatic efforts ("Operation Staunch") to persuade individual governments not to sell arms to Iran in the ongoing war, and the United States tacitly supported the arming of Iraq by other suppliers.

Despite this tilt, in 1985-86, the Reagan Administration sought to engage Iranian "moderates" in an effort to obtain the release of Americans held hostage by pro-Iranian groups in Lebanon and to promote a strategic opening to Iran. That initiative included 1985-86 U.S. arms shipments to Iran (TOW anti-tank weapons and HAWK anti-aircraft missiles) and hostage exchanges that developed into the Iran-Contra Affair.<sup>5</sup> After the abortive dealings, the United States and Iran skirmished in the Persian Gulf several times during 1987-88 in the course of a U.S. effort (Operation Earnest Will) to protect Kuwaiti oil shipments from Iranian attack. At the same time, Iraq began to gain the upper hand in the war, launching a series of ground offensives in 1988 that drove Iranian forces off Iraqi territory. Iraq's ability to modify Scud missiles and fire them at Tehran demoralized the Iranian population and undercut support for the war effort, as did Iraq's use of chemical weapons in the war.<sup>6</sup> The July 3, 1988 mistaken U.S. shutdown of an Iranian civilian aircraft (Flight 655), which Iran viewed as deliberate, apparently convinced Iran that the United States was committed to helping Iraq win the war. Two weeks after the shutdown, Iran accepted a U.N. cease-fire plan (Resolution 598, adopted the year earlier), and hostilities ended on August 20, 1988.

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<sup>4</sup> Analysts give several explanations for Iraq's decision to invade Iran. (1) Iraq wanted to gain complete control of the Shatt al-Arab waterway between the two nations; (2) Iraq sought to assume the "policeman of the Gulf" role played by the Shah until his downfall; and (3) Iran was weak and disorganized after its Islamic revolution and the Iraqi leadership felt its invasion could trigger an overturning of the Islamic revolution. Iraq hoped thereby to blunt the revolution's effects on Iraq's own Shiite population, much of which looks to Iran for inspiration. Iraq cited Iranian incitement efforts and border provocations as a justification for its military moves, although, in December 1991, a report by the U.N. Secretary-General formally determined that Iraq started the Iran-Iraq war.

<sup>5</sup> For further information on the Iran-Contra Affair and its implications, see CRS Report 92-870 F. Iran-Contra Affair: Questions and Answers. November 25, 1992. 24 p.

<sup>6</sup> U.N. investigators found that Iran had also used chemical weapons during the war. See: Report of the Mission Dispatched by the Secretary-General to Investigate Allegations of the Use of Chemical Weapons in the Conflict Between the Islamic Republic of Iran and Iraq. S/19823, April 25, 1988.

Although U.S.-Iran relations appeared to reach a new low point, U.S. conditions for future talks with Iran were established before the Reagan Administration ended. Under the policy formulation, which has held since, the United States welcomes an official dialogue with Iran as long as the talks involve no preconditions, can be openly acknowledged, and are conducted with an “authorized” representative of the Iranian government.<sup>7</sup>

President George Bush, in his January 1989 inaugural address, seemed to reach out to Iran. Referring to Iran, he said that “goodwill begets goodwill” — that Iranian help in gaining release of American hostages in Lebanon might earn some U.S. reciprocation. The June 3, 1989 death of the leader of the revolution, Ayatollah Ruhollah Khomeini, also created some international optimism that Iran’s policies might moderate under Khomeini’s successor, Ali Khamene’i, and Ali Akbar Hashemi-Rafsanjani, who was elected President in August 1989. Iran remained neutral during the 1990-91 Gulf crisis, although Iran, despite its long war with Iraq, criticized allied bombing of Iraq as unjustified aggression that was killing Muslim civilians. U.S. hostages in Lebanon were all released by the end of 1991, and the Bush Administration publicly thanked Iran for its intercession with the hostage holders — the Hizballah militia in Lebanon — in gaining their release. The stage seemed set for a U.S.-Iran thaw, but there was no overall improvement in U.S.-Iran relations. The Bush Administration might have feared that trying to improve relations would open the Administration to accusations that it was recapitulating the “search for Iranian moderates” that the Reagan Administration was criticized for in Iran-Contra. For its part, Iran remained steadfastly opposed to improved relations with the United States because of the U.S. support for the Shah, the U.S. tilt toward Iraq during the Iran-Iraq war, and the U.S. involvement in the 1953 ouster of nationalist Prime Minister Mohammad Mossadeq. Iran also accused the United States of backing groups seeking to overthrow the Islamic regime, although the United States refused contact with a key opposition group, the People’s Mojahedin, which had killed five Americans serving in Iran during the Shah’s reign.

## **Instruments of Containment Inherited From Previous Administrations**

Despite occasional dealings with or outreach toward Iran, previous Administrations established a broad package of economic sanctions, which served as a basis from which to implement containment of Iran. The purpose of the U.S. sanctions was to deprive Iran of the technology it needs to build up its strategic capabilities, as well as to signal — to Iran and to other countries — U.S. opposition to Iran’s policies.

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<sup>7</sup> Some U.S. statements set a requirement that Iranian representatives be “authoritative” rather than merely “authorized.” This condition was set to avoid the situation that characterized the Iran-Contra Affair, in which the United States initially dealt with intermediaries claiming to speak for the Iranian government.

A wide range of economic sanctions on Iran were imposed just after the November 4, 1979 seizure of the American hostages in Tehran.<sup>8</sup> The January 19, 1981 Algiers Accords that ended the hostage crisis required the United States to lift all previous sanctions. President Carter implemented that commitment in a series of executive orders in January 1981, but he did not restore diplomatic relations.

The resolution of the hostage crisis did not resolve all outstanding financial issues between the two countries. The Algiers Accords set up a process to arbitrate financial claims from the rupture in relations, called the U.S.-Iran Claims Tribunal, which meets at the Hague. At the tribunal, which convened for the first time on July 1, 1981, a panel of three Americans, three Iranians, and three neutral arbiters decide the conflicting governmental, individual, and corporate claims.

- Since the Tribunal began work, about 4,000 cases have been resolved, the overwhelming majority of which were in favor of U.S. claimants. The largest claims unresolved are by Iran for U.S. non-performance on about 1,200 Foreign Military Sales (FMS) cases. In addition to military services, these cases include military equipment — including Spruance-class destroyers, I-Hawk air defense batteries, CH-47 helicopters, F-16 aircraft, and Tong-class submarines — that Iran paid for but were not delivered because of Iran's revolution. One press report says that the United States, if found liable for these claims, might have to pay Iran \$10 billion plus interest since 1979.<sup>9</sup> Some of the military items were resold to other buyers or were incorporated into the U.S. arsenal. One military case was settled in November 1991 when the United States paid Iran \$278 million for Iranian-owned military equipment undergoing repair or testing in the United States at the time of the revolution, and not returned to Iran. In August 1992, Iran settled the last two (Atlantic Richfield and Sun Co.) of ten cases of U.S. oil companies whose properties in Iran were seized after the revolution. Each firm was paid \$130 million. In December 1999, the United States paid Iran

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<sup>8</sup> These sanctions included the halting of U.S. military spare parts shipments to Iran (November 8); a ban on imports of Iranian crude oil and unfinished oil or finished products made from Iranian crude oil (November 12); a declaration of a state of emergency against Iran, the blocking of all Iranian government property in the United States, and the freezing of Iranian deposits in U.S. banks and subsidiaries of U.S. banks (November 14). On April 7, 1980, the President imposed a ban on all U.S. exports, credits, performance of contracts, and most types of payments to Iran. On April 17, 1980, he banned all financial transactions with Iran, imposed an embargo on imports of Iranian goods, restricted the use of U.S. passports for travel to Iran, restricted travel by U.S. citizens and permanent residents to Iran, and revoked certain licenses for transactions with Iran Air, the National Iranian Oil Company, and the National Iranian Gas Company. The text of the executive orders cited in these sanctions are contained in U.S. Congress. House and Senate. Committee on Foreign Affairs and Committee on Foreign Relations. Legislation on Foreign Relations Through 1992. Joint Committee Print. Washington, G.P.O., June 1993. Pp. 1059 - 1087.

<sup>9</sup> Opall, Barbara. U.S. May Owe Iran Billions in Penalties. Defense News, February 22-26, 1998.

about \$6 million to settle a judgement in favor of Iran against the U.S. defense contractor Avco Corp.

- Iran also claims that it should receive the balances of letters of credit issued by U.S. banks to guarantee the performance of U.S. contractors and suppliers of the Iranian government prior to the revolution. Such performance guarantees were generally issued as so-called standby letters of credit. The U.S. position is that Iran is not entitled to any such monies unless the Claims Tribunal issues a judgement in favor of Iran in a particular case against a U.S. contractor or supplier. U.S. officials say the potential value of the disputed letters of credit is very small compared to the issue of undelivered military equipment.
- The United States government maintained control over about \$22 million worth of Iranian diplomatic property in the United States, including the former Iranian Embassy in Washington D.C., and associated operating accounts. The United States asserts that the property was confiscated in reciprocity for Iran's seizure of the U.S. Embassy in Tehran, for which Iran did not compensate the United States. The United States has insisted this issue remain outside the scope of authority of the U.S.-Iran Claims Tribunal.
- Iranian officials assert that Iran is entitled to the assets in the United States of relatives of the former Shah of Iran. Pursuant to section 535.217 of the Iranian Assets Control Regulations (31 CFR Sec. 535.217), the assets of the Shah's relatives in the United States are blocked as long as they are the subject of Iranian legal attempts to gain control of the assets.

Iranian actions against the United States since the hostage crisis prompted succeeding Administrations and Congresses to reimpose or add sanctions against Iran, to the point where Iran currently is subject to some of the strictest U.S. sanctions of any country in the world.<sup>10</sup> On January 19, 1984, based largely on evidence of Iran's involvement in the October 1983 bombing of the U.S. Marine barracks in Lebanon, then Secretary of State George Shultz designated Iran a state sponsor of terrorism (the "terrorism list"). That designation prohibits Iran from receiving U.S. foreign assistance and credits,<sup>11</sup> triggered (in 1986) a ban on U.S. sales of items on the Munitions Control List,<sup>12</sup> imposes strict requirements for the licensing of U.S. exports

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<sup>10</sup> For a further discussion of U.S. sanctions in place prior to the Clinton Administration, see the sections on Iran in U.S. Library of Congress. Congressional Research Service. Economic Sanctions Imposed by the United States Against Specific Countries: 1979 Through 1992. CRS Report 92-631 F, by Erin Day. Revised August 10, 1992. 654 p.

<sup>11</sup> U.S. aid to and credits for terrorism list states are prohibited by Section 620 of the Foreign Assistance Act of 1961 (FAA), as amended (22 U.S.C. 2371).

<sup>12</sup> Section 40 of the Arms Export Control Act, as amended (22 U.S.C. 2780). Prior to 1986, Administration policies prohibited U.S. arms sales to the Islamic Republic.

of dual use items to Iran,<sup>13</sup> and requires that U.S. Executive Directors of international financial institutions vote against International Monetary Fund (IMF) loans to Iran.<sup>14</sup>

Several legislative and executive actions thereafter reinforced these restrictions.

- Since FY1985, the foreign assistance appropriations have contained a provision withholding the proportionate share of U.S. contributions to programs by international organizations for Iran (among other countries). No waiver is provided for. The restriction primarily affects U.N. humanitarian aid programs, such as the World Food Program. Aid organizations that receive U.S. funds can operate programs in Iran but, if they do so, U.S. contributions to the assisting agency are reduced by the amount of the U.S. share of that program. Following legislative history and congressional intent, the provision is not applied to disaster relief assistance. (In early 1997, the United States gave Iran \$125,000 in relief aid for two earthquakes that year. The funds were distributed through the International Federation of the Red Cross and Red Crescent Societies). The International Security and Development and Cooperation Act of 1985 (P.L. 99-83) amended the Foreign Assistance Act (Section 307) to incorporate this provision. Under that law, the restrictions do not apply to UNICEF or International Atomic Energy Agency programs.
- On February 28, 1987, Iran was first designated as a country that had failed to curb — or help the United States curb — drug trafficking through its territory. This designation, renewed for Iran every year until 1998, imposed “drug list” sanctions, including aid cuts and the requirement that the United States vote against multilateral loans to Iran. On December 7, 1998, based on U.S. assessments of areas in Iran under cultivation, the Administration removed Iran from the U.S. list of major drug producing countries. The removal exempted Iran from an annual certification review, and had the effect of lifting the “drug list” sanctions from Iran (although similar sanctions are in effect under other laws and Executive orders).
- On October 29, 1987, in retaliation for Iranian attacks (minings, small boat assaults) on U.S.-flagged Kuwaiti tankers in the Persian

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<sup>13</sup> Section 6(j) of the Export Administration Act of 1979, as amended (50 U.S.C. app. 2405(j)). The Export Administration Act provides for a presumption of denial of licenses to export commercial dual use items to military end users. Exports to non-military end users, or for clearly civilian exports to military end users, were to be evaluated on a case-by-case basis.

<sup>14</sup> Section 6 of the Bretton Woods Agreements Act Amendments of 1978, as amended 22 U.S.C. 286e-11, applies specifically to the International Monetary Fund. Section 327 of the Anti-terrorism and Effective Death Penalty Act of 1996 (P.L. 104-132) amended the Foreign Assistance Act to make permanent the requirement that the United States oppose all international lending to Iran. This provision had been included in yearly foreign assistance appropriations.

Gulf, President Reagan prohibited the import of Iranian-origin goods into the United States.<sup>15</sup> However, the petroleum products that are refined from Iranian crude oil in a third country<sup>16</sup> are considered a product of that third country, and imports of the refined oil are allowed. Until the May 1995 trade ban (see below), American oil companies were also allowed to continue buying Iranian oil and selling it outside the United States.

- Since FY1988, Congress, in successive foreign aid appropriations, has prohibited the use of any U.S. foreign assistance funds to finance directly (direct aid) any assistance or reparation to Iran (among other named countries). Since FY1990, the legislation has included a prohibition on Export-Import Bank credits, guarantees, and insurance. No waiver is provided for.
- Since FY1989, Iran (among other countries) has been named in a separate provision of the foreign assistance appropriations that bars indirect U.S. aid. (U.S. contributions to multilateral development banks or international organizations that loan to or work in Iran.) However, Presidents Bush and Clinton have routinely waived this provision every year on the grounds that withholding U.S. contributions to multilateral development banks and international organizations — even if they benefit Iran or other U.S. adversaries — would be contrary to the national interest.
- In October 1992, Title XVI of the FY1993 National Defense Authorization Act (P.L. 102-484), entitled the Iran-Iraq Arms Non-Proliferation Act, required denial of all U.S. applications to export dual use items to Iran (and Iraq), and imposed penalties on violators. It also provided for mandatory sanctions against foreign persons (U.S. Government procurement and U.S. export sanctions) and mandatory (same as above) and discretionary sanctions against countries (suspension of U.S. aid, military sales, codevelopment and coproduction agreements and military and dual use technical exchanges, and U.S. votes against international loans) that transfer “destabilizing” advanced conventional arms to Iran. Section 1408 of the FY1996 defense authorization act (P.L. 104-106, February 10, 1996) amended this law to apply to the transfer to Iran (or Iraq) of technology that can be used in weapons of mass destruction programs.

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<sup>15</sup> Congress specifically authorized the President to ban imports from terrorist countries in Section 505 of the FY1986 foreign aid authorization (P.L. 99-83).

<sup>16</sup> An additional exemption to the ban came about in 1991 as a result of U.S.-Iran negotiations at the Claims Tribunal. To address Iran’s difficulties in maintaining the required \$500 million in the U.S.-Iran Claims Tribunal security account, the two countries agreed that U.S. oil companies could import Iranian crude oil on a case-by-case basis if the proceeds were deposited in the security account or if the imported oil was accepted as settlement in a claims tribunal decision in favor of an American claimant.

## The Clinton Administration's "Dual Containment" Strategy

Upon taking office, the Clinton Administration stressed that it would contain Iran within a broader policy framework that casts both Iran and Iraq as "rogue regimes" and seeks to keep both weak.<sup>17</sup> On May 19, 1993, at a speech in Washington, former National Security Council Senior Director for the Near East Martin Indyk first described the Administration's policy as one of "dual containment" of Iran and Iraq.<sup>18</sup> The Clinton Administration presented dual containment as a departure from previous U.S. Gulf policies that have relied on Iran or Iraq to restore or maintain stability in the Gulf. The past policies, according to the Administration, had contributed to the downfall of the Shah and the Iraqi invasion of Kuwait.

There was speculation among observers that the policy was intended to result in the overthrow of regimes in Iran and/or Iraq, but, if this was the intention, the Administration did not state it explicitly.<sup>19</sup> In response to initial doubts among many observers that both countries could be contained simultaneously,<sup>20</sup> Administration officials maintained that the new policy did not ignore balance of power considerations, but, rather, sought to maintain that balance at a low level of Iranian and Iraqi capability. Administration officials added that dual containment did not mean "duplicate containment" — that U.S. policy toward Iran would be exactly the same as it was toward Iraq. Iraq is contained by international implementation of very strict U.N. sanctions<sup>21</sup> resulting from the August 2, 1990 invasion and occupation of Kuwait, but Iran is not subject to any U.N. or international sanctions. Therefore, to contain Iran, the United States has acted unilaterally and bilaterally.

The Iran policy of the first two years of the Clinton Administration relied largely on stepped up attempts to elicit cooperation from U.S. allies and other countries in isolating Iran. The Administration's objectives were to persuade U.S. allies not to export arms or dual use items to Iran, not to reschedule any credits they have issued

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<sup>17</sup> The rationale for the dual containment policy is discussed in Anthony Lake. *Confronting Backlash States*. Foreign Affairs, Volume 73, No. 2, March/April 1994. Pp. 45-55; and Symposium on Dual Containment: U.S. Policy Toward Iran and Iraq, in *Middle East Policy*, Volume III, No. 1, 1994. Pp. 1-26.

<sup>18</sup> Text of Martin Indyk's speech can be found in the proceedings of the Soref Symposium, *Challenges to U.S. Interests in the Middle East: Obstacles and Opportunities*, May 18-19, 1993. Washington, Washington Institute for Near East Policy. Pp. 1 - 8.

<sup>19</sup> The United States is obliged by Point 1 of the January 19, 1981 Algiers Accords that settled the hostage crisis "not to intervene, directly or indirectly, politically or militarily, in Iran's internal affairs." See text of the Algiers Accords, formally titled the "Declaration of the Government of the Democratic and Popular Republic of Algeria," in *State Department Bulletin*, February 1981. Pp. 1-5.

<sup>20</sup> See, for example, Gause, Gregory. *The Illogic of Dual Containment*, in *Foreign Affairs*. Volume 73, No.2, March/April 1994.

<sup>21</sup> Analysis of U.N. sanctions and Iraq's compliance can be found in CRS Issue Brief IB92117, *Iraqi Compliance With Ceasefire Agreements*, by Kenneth Katzman.

to Iran or to issue any new credits, and not to support loans to Iran by international or multilateral banks. The Administration said it did not seek to persuade its allies or other countries to cut off political dialogue or routine trade with Iran, but only to refuse to conduct normal relations with Iran unless or until Iran modified its unacceptable behavior.<sup>22</sup>

Differences in approaches to Iran between the United States and its allies proved difficult to bridge. The allies of the United States in Europe and Japan maintained that trade and contact with Iran, rather than isolation, would succeed in moderating Iran's international behavior by helping promote moderate elements in Iran who want greater international contact. In December 1992, the European Union (EU) countries formally adopted a policy termed "critical dialogue," consisting of political and economic engagement with Iran coupled with criticism of Iran's objectionable behavior. Some European governments maintained that the United States was excessively critical of the Islamic regime in Iran because of the fall of the Shah, a key U.S. ally, and the 1979-1981 hostage crisis. On the other hand, some observers held that U.S. allies may have overemphasized the political benefits of engagement to cover a pragmatic calculation of the economic necessity of dealing with Iran and its 65 million people. Most of Iran's external debt — about \$30 billion at its height in 1993 — was held by creditors in European countries and Japan, and these countries wanted to ensure that Iran was able to service this debt. (As of September 1999, and despite a sharp temporary drop in oil prices during 1999, Iran had reduced its external debt to about \$11.7 billion, not including an additional \$10 billion in future interest payments and outstanding commercial debt.)

Over U.S. opposing votes and diplomatic objections, U.S. allies voted with other countries in early 1993 to authorize \$463 million in World Bank loans to Iran for power, irrigation, and health projects. Also over U.S. bilateral protests, the allies rescheduled about \$14 billion in Iranian debt during 1994-5, reaching bilateral agreements with Iran rather than adhering to Paris Club rules that specify multilateral rescheduling with International Monetary Fund (IMF) involvement. Administration and congressional pressure succeeded in persuading the World Bank to suspend new loans to Iran in 1994.<sup>23</sup> Bilateral U.S. pressure, although with no threat of sanctions, led Japan to withhold the remaining \$1 billion of a total \$1.4 billion official loan program for Iran to construct a hydroelectric dam over the Karun River. This program, which was partially resurrected in 1999, has been the only bilateral assistance program for Iran; no European countries have given development aid to Iran.

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<sup>22</sup> U.S. Congress. House. Committee on Foreign Affairs. Subcommittee on Europe and the Middle East. Developments in the Middle East: July 1993. Hearing, 103<sup>rd</sup> Congress, 1<sup>st</sup> Session. Washington, G.P.O., July 27, 1993. P. 8.

<sup>23</sup> The FY1994 Foreign Assistance Appropriations (P.L. 103-87) stated that U.S. officials must vote to oppose multilateral lending to Iran. Title I of that law cut U.S. funding to the World Bank by the amount the Bank had agreed in 1993 to lend Iran (\$463 million) and added a new provision that the U.S. share of a portion of the Bank's capital increase would be withheld if the Bank made any further loans to Iran. Similar provisions were repeated in foreign assistance appropriations for FY1995 (P.L. 103-326) and FY1996 (P.L. 104-107), but did not appear in the FY1997 appropriation (P.L. 104-208).

The United States did not win agreement from all its allies to curtail dual use exports to Iran, although the allies did agree to end such sales to known military end-users. During its first term, the Clinton Administration, along with Congress, achieved limited success in changing the policies of Iran's major arms and technology suppliers, Russia, China, and North Korea. The Administration's need to manage a number of complex issues in U.S. relations with these countries complicated U.S. efforts to end their dealings with Iran. On several occasions during the Clinton Administration, as noted below, Members of Congress issued statements and enacted legislation urging or requiring Administration steps to pressure Iran's suppliers to cancel deals with Iran. (For further information, see CRS Report 97-474 F, *Iran: Arms and Technology Acquisitions*.)

### **Additional Sanctions Imposed During the 104<sup>th</sup> Congress**

A turning point in policy toward Iran occurred during the latter stages of the first term of the Clinton Administration. In November 1994, apparently frustrated by U.S. allies' refusal to isolate Iran and the continuation of Iran's objectionable behavior, the Administration began an internal Iran policy review. On January 8, 1995, Iran and Russia finalized a major nuclear reactor deal that was perceived as providing Iran with the expertise and some of the technology to advance a nuclear weapons program. On January 22, 1995, a bombing in Israel by an ally of Iran, Palestinian Islamic Jihad (PIJ), killed 21 and wounded 60. Also in January 1995, the 104th Congress was inaugurated and strong proponents of additional actions against Iran assumed key positions. Senator D'Amato, who became Chairman of the Senate Banking Committee, proposed legislation to impose a total ban on trade with Iran (S.277, introduced January 25, 1995). On February 8, 1995, Speaker of the House Newt Gingrich recommended that the United States take active measures to overthrow the Iranian regime as "the only policy that makes sense."

The Administration's policy review, which was completed by April 1995, reportedly found that continued U.S. trade with Iran — particularly the trading of Iranian oil overseas by U.S. companies and their foreign subsidiaries — was creating a perception internationally that the United States was not serious about isolating Iran. In 1992, for example, the United States and Iran conducted \$748 million in bilateral trade, placing the United States among Iran's top five trading partners for that year. During 1994, U.S. oil companies purchased about one-quarter of Iran's total oil exports for resale outside the United States.

In the course of the policy review, the Administration decided that additional steps should be taken to weaken and isolate Iran. The first opportunity came in early March 1995, when the U.S. oil company Conoco, Inc., announced a deal with Iran to develop oilfields off Iran's Sirri Island in the Persian Gulf. President Clinton's Executive Order 12957 of March 15, 1995, barred U.S. firms and their subsidiaries from investing in or managing the development of Iran's energy resources. Conoco, although its contract was signed prior to the Executive order and was not required to withdraw from the deal, voluntarily canceled the contract. A French firm, Total SA, in partnership with Petronas of Malaysia, subsequently replaced Conoco as the developer of the Sirri fields. (In early October 1998, the field became operational at 7,000 barrels per day of production, and is expected to produce a maximum of 100,000 barrels per day.)

**The U.S. Trade and Investment Ban.** On April 30, 1995, President Clinton announced in a speech to the World Jewish Congress that he would ban U.S. trade with and investment in Iran. The ban, contained in Executive Order 12959 of May 6, 1995, also prohibited re-exportation to Iran of U.S. goods as well as any financing, loans, or related services for trade with Iran.<sup>24</sup> The Executive order prevented U.S. firms from even negotiating with Iran any investments or trade relations that would be implemented if and when the ban is rescinded. However, the Executive order provided for the case-by-case licensing of crude oil swap arrangements with Iran in the Caspian Sea and Central Asia, and did not prohibit the importation to the United States of Iranian oil that is refined outside Iran. (Refined oil is considered a product of the country in which it is refined.) The ban also left a loophole for U.S. products to be incorporated into goods manufactured in a third country, and containing more than 10% U.S. content, to be exported to Iran. (This loophole was closed by Executive order 13069 of August 19, 1997.)

The trade ban did not immediately shift international attitudes toward Iran. Only El Salvador, Israel, Ivory Coast, and Uzbekistan expressed outright support for the measure. Japan and U.S. allies in Europe said they would not work to undermine it, but they refused to give up their commercial ties to Iran. In October 1995, four months after the ban took effect, Administration officials testified before Congress that Iran had, for the most part, found new buyers for the oil previously purchased by U.S. firms. China and other Asian countries increased their purchases of Iranian oil, although some were motivated as much by economic growth demands as by the desire to become closer to Iran politically. The relative lack of international support for the U.S. trade ban appeared to convince the Administration and many in Congress that further steps were needed if Iran were to be isolated and kept strategically weak.

**Imposition of Secondary Sanctions/ILSA.** Prior to the imposition of the U.S. trade ban, Senator D'Amato and others in Congress had proposed ways to try to compel U.S. allies to adopt U.S. policies toward Iran. In March 1995, Senator D'Amato introduced a bill (S.630) to impose U.S. sanctions on foreign firms that engaged in business dealings with any sector of Iran's economy. The Administration opposed the measure on the grounds that such broad secondary sanctions would incur vehement European and other foreign country opposition. However, the Administration agreed, in principle, with Senator D'Amato and others in Congress who maintained that, in order to reduce Iran's long term potential to fund terrorism and acquire weapons and technology, the United States should act to prevent foreign investment in Iran's crucial energy sector. The sector accounts for about 80% of Iran's foreign exchange revenues.

Shortly before Iran's November 1995 solicitation for foreign investment in eleven major petroleum and gas development projects,<sup>25</sup> the Administration and Senator D'Amato agreed on a mutually acceptable version of S.1228, introduced by

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<sup>24</sup> For further analysis of the trade ban and its effects, see CRS Report 95-909 F, Iran: U.S. Trade Ban and Legislation. Updated January 4, 1996, by Kenneth Katzman.

<sup>25</sup> These projects were offered to foreign investors as "buy-back" arrangements, in which the investing firm is repaid with a percentage of the proceeds when the project becomes operational.

the Senator in September 1995 and passed by the Senate in December of that year. The bill sanctioned foreign investment in Iran's (and Libya's)<sup>26</sup> energy sector. The House passed a stricter bill, H.R. 3107, in June 1996. A version of H.R. 3107 containing sanctions on investment in Iran or Libya's energy sectors as well as energy equipment exports to Libya, was cleared by both chambers by July 1996. The President signed the bill, the Iran-Libya Sanctions Act (ILSA) on August 5, 1996 (P.L. 104-172). ILSA expires five years after enactment, according to one of its provisions.

ILSA requires the President to impose, on any foreign person (individual, firm, or government enterprise) that invests more than \$40 million (the threshold investment dropped to \$20 million one year later, see below) in any one year, at least two of the following six sanctions:

- (1) denial of Export-Import Bank loans for U.S. exports to the sanctioned entity
- (2) denial of specific U.S. licenses for exports to the sanctioned entity (assuming the exports needs a license to be exported)
- (3) denial of U.S. bank loans of over \$10 million in one year to the sanctioned entity
- (4) disallowing a sanctioned entity, if it is a financial institution, to serve as a primary dealer in U.S. Government bonds or as a repository of U.S. Government funds
- (5) prohibition on imports from the sanctioned person to the United States
- (6) prohibition on U.S. Government procurement from or contracting with the sanctioned entity.

Guidelines (not formal regulations) for implementing ILSA, issued by the State Department on December 16, 1996, appeared to give the President substantial latitude in determining whether or not a foreign company should be sanctioned.<sup>27</sup> The guidelines primarily reiterated definitions and interpretations of such terms as "investment"<sup>28</sup> that are contained in the law itself or associated report language (H. Rept. 104-523, Part II). On January 7, 1997, the State Department issued a list of projects — the eleven projects put out for bid by Iran in 1995 — that would be subject to review under the law.

European and Japanese reaction to ILSA was negative. In addition to differing with the U.S. approach as to how best to change Iran's behavior, U.S. allies viewed ILSA as an unacceptable extraterritorial application of U.S. law. ILSA provided for the waiving of sanctions for firms of countries that join a multilateral sanctions regime on Iran but lowered the investment threshold to \$20 million for firms of countries that do not join such a multilateral regime within one year of enactment. In an effort to

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<sup>26</sup> An amendment to S.1228 applying all sanctions in the bill to Libya as well as Iran was introduced by Senator Kennedy and included in the Senate-passed version.

<sup>27</sup> Music, Kimberly. Vague U.S. Guidelines on Iran, Libya Could Signal Coming Policy Changes. *The Oil Daily*, December 17, 1996. P.1.

<sup>28</sup> As defined by the Administration guidelines, investment involves a contract to develop Iran's petroleum resources, a share of ownership of that project, or the derivation of royalties, earnings, or profits from that development. The definition of investment does not include the entry into, performance, or financing of a contract to sell or purchase goods, services, or technology.

defuse ILSA as an irritant in U.S.-EU relations, the Administration reached an agreement with the EU on April 11, 1997 to work toward a common policy that would enable the Administration to waive ILSA. It appeared that U.S. and European policies would converge following the April 10, 1997 German court verdict that Iran's leadership was responsible for a 1992 assassination of a Kurdish dissident in Berlin. However, the EU diplomatic sanctions on Iran were insufficient to achieve a State Department determination that the EU countries had taken economic steps against Iran. Therefore, on August 5, 1997, the State Department said that the original Iran investment threshold level of \$40 million in one year had dropped to \$20 million.

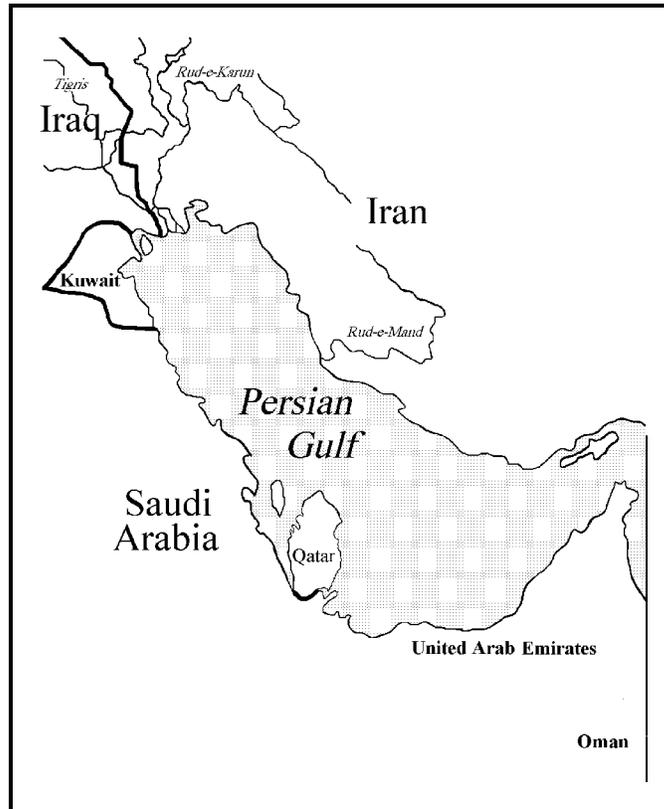
By virtue of its place on the U.S. terrorism list, other secondary sanctions were imposed on Iran by the Antiterrorism and Effective Death Penalty Act of 1996 (S.735, P.L. 104-132, signed April 25, 1996). Major provisions include the following:

- Section 321 imposes penalties on any U.S. person that engages in financial transactions with a country on the terrorism list. This section essentially legislated the U.S. trade bans already in force, by Executive order, for most of the terrorism list states, including Iran. The section did not provide for a presidential waiver but does allow for implementation based on regulations by the State Department, in consultation with the Treasury Department.
- Section 325 of that law amends the Foreign Assistance Act to authorize the President to withhold foreign assistance to any country that aids countries on the U.S. terrorism list. The provision provides for a presidential waiver on national interest grounds.
- Section 326 amends the Foreign Assistance Act to authorize the President to withhold U.S. assistance to any country that provides lethal military assistance to a terrorism list country. A national interest waiver is provided for.
- Section 327 amends the International Financial Institutions Act (22 U.S.C. 262c et seq) to require the United States to oppose any multilateral lending to terrorism list states. No waiver was provided for.

## Other Measures

### Military Pressure.

During its first term, the Clinton Administration publicly highlighted concerns about Iran's conventional military modernization program. The Administration cited, in particular, Iran's growing naval and anti-ship missile capabilities and the perceived potential of these systems to disrupt world energy supplies transiting the Strait of Hormuz or attack U.S. and Gulf state facilities. U.S. naval officials also noted concerns about the ability of Iran's three Russian made submarines to lay mines undetected or deliver torpedoes, and about Iran's ability to deliver Chinese-made anti-ship missiles from land (the C-802) and sea (the C-801K).



Although confident it could quickly defeat an Iranian attempt to block the Strait of Hormuz, the Clinton Administration took some specific military steps to deal with Iran's emerging capabilities. It maintained a carrier battle group in the Gulf nine out of twelve months of the year, as well as two U.S. submarines, not only to deter Iraq but to demonstrate U.S. power to Iran as well. In 1994, the U.S. Navy reportedly fitted its warships in the Gulf with torpedo decoy equipment.<sup>29</sup> In early 1996, the U.S. Navy began to deploy minesweepers in the Gulf.<sup>30</sup> The Administration apparently encouraged the Gulf states to allocate an increasing portion of their procurement budgets to upgrade their naval capabilities, in part to counter Iran's submarine acquisitions.<sup>31</sup>

**Counterterrorism.** During its first term, the Clinton Administration consistently characterized Iran as "the world's most active and most dangerous state

<sup>29</sup> Iran Sparks Off a Boat Race. Middle East Economic Digest, April 29, 1994. P. 15.

<sup>30</sup> U.S. To Send Mine-Clearing Ships To Gulf. Reuters, February 14, 1996.

<sup>31</sup> Country (Saudi Arabia) to Buy Submarines to Guard Gulf, Coastlines. Agence France Presse, April 14, 1994. This report quotes the Saudi deputy Defense Minister as saying Saudi Arabia would like to purchase its own submarines. Other Gulf states are reportedly interested in frigates or anti-submarine warfare systems to deal with Iran's submarine fleet.

sponsor of terrorism.” Of particular concern have been the Iranian-supported groups, such as Hizballah, Hamas, Palestinian Islamic Jihad, and the Popular Front for the Liberation of Palestine-General Command, that have tried to derail the Arab-Israeli peace process. Administration officials have tried to enlist the help of other countries to combat Iranian supported terrorism. For further discussion of specific steps taken to counter the terrorist threat from Iran, see CRS Report RL30277, *Terrorism: Middle Eastern Groups and State Sponsors, 1999*. August 9, 1999, by Kenneth Katzman.

## **New Policy Directions During the Administration’s Second Term**

At the beginning of its second term, the Clinton Administration said it would continue to isolate Iran. In a written response to confirmation questions from the Senate Foreign Relations Committee in January 1997, the new Secretary of State Madeleine Albright said U.S. policy toward Iran would not change and that no formal review of Iran policy was under way or planned.<sup>32</sup>

Statements such as this might have represented an attempt to address speculation among outside observers that the Administration was considering a change in policy. Speculation of an imminent policy change had been generated by statements and writings by sitting and former high-ranking U.S. officials. In an October 24, 1996 informal speech in Dubai, then Assistant Secretary of State for the Near East Robert Pelletreau said he was “hopeful” that Iran would take up the long-standing U.S. offer of political dialogue during a second Clinton term. In a Council on Foreign Relations study and a related Foreign Affairs magazine article published April 21, 1997, former National Security Advisers Brent Scowcroft and Zbigniew Brzezinski, and former Assistant Secretary of State for the Near East Richard Murphy, said the United States should offer some incentives to Iran in order to moderate its behavior. In addition, U.S. and other multinational corporations stepped up criticism of U.S. policy toward Iran, particularly U.S. sanctions, that they said placed them at a disadvantage in competing for business in Iran and for large Caspian Sea energy.

### **Implications of Mohammad Khatemi’s Election**

The unexpected landslide victory (69% of the vote) by a relative moderate, Mohammad Khatemi (see box), in Iran’s May 23, 1997 presidential elections accelerated the debate over U.S. Iran policy. Khatemi, known for his tolerant views on social behavior and respect for civil liberties, succeeded Ali Akbar Hashemi-Rafsanjani, who was elected president in August 1989 (and re-elected to another four year term in 1993) and who, under the Iranian constitution, could not serve more than two terms. Khatemi was widely expected to be defeated by a rival, who was backed by the dominant conservative clerical establishment, including Iran’s Supreme Leader, Ali Khamene’i. Khamene’i, who succeeded Ayatollah Ruhollah Khomeini as

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<sup>32</sup> Giacomo, Carol. Albright Sees China Concerns, Russia Initiative. Reuters, January 20, 1997.

paramount leader following Khomeini's death on June 3, 1989, leans toward the conservatives on most issues. Khatemi was backed by a faction<sup>33</sup> of technocrats loyal to Rafsanjani, by leftist intellectuals who felt shut out of the national debate by the conservative clergy, and by women and youth who resent heavy-handed enforcement of traditional and Islamic norms of social behavior.

Rafsanjani himself did not completely depart the political scene. After leaving the presidency, he was appointed by Khamene'i to head a major governmental council (the Expediency Council) and, in late 1999, began to reemerge as a bridge between Khamene'i/conservative clerics and Khatemi/reformist elements. Rafsanjani is running for parliament (Majlis) in the February 18, 2000 elections and is widely expected to win and be selected as Majlis Speaker – the same position he held during 1981-89.

Although he still remains very popular, Khatemi's hardline opponents have dealt him several setbacks. The Majlis impeached his Interior Minister, Abdollah Nuri, in June 1998, and conservative judiciary officials tried and convicted him in 1999 for "insulting Islam" as publisher of a pro-Khatemi newspaper. Other pro-Khatemi newspapers have been closed down. On October 23, 1998, Khatemi's opponents took advantage of a conservative-controlled candidate screening process to win a large majority of the seats in elections to the 86 member Assembly of Experts, which formally oversees Supreme Leader Khamene'i and would choose Khamene'i's successor, should he pass from the scene. Internal security forces – who generally answer to Khamene'i and the conservatives – attacked pro-Khatemi student demonstrators in July 1999, thereby instigating several days of violent student riots. On the other hand, Khatemi allies swept local elections on February 26, 1999, and despite efforts by the conservatives to screen out pro-Khatemi candidates, the president's allies are expected to win a plurality of seats in the February 2000 Majlis elections.

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<sup>33</sup> Like minded individuals compete as groupings in Iran's elections. Iran's Interior Ministry has not licensed any formal parties, although parties, as such, are technically not banned.

**Foreign and Defense Policy.** Khatemi's professed tolerance on social issues led many observers to believe that he would try to move decisively to end Iran's isolation. He has tried to convince the Persian Gulf monarchy states that Iran poses no threat, and he has succeeded in communicating that message. Saudi-Iranian relations improved rapidly in the first two years of Khatemi's presidency, culminating in a May 1999 visit to the Kingdom by Khatemi. Relations have improved to the point at which the two countries agreed in May 1999 to exchange military attaches, and Iran's Defense Minister – a key organizer of the radical Revolutionary Guards – has been invited to visit Saudi Arabia later in 2000.

Iran's position on the Arab-Israeli peace process has undergone some positive change since Khatemi took office. As early as four days after his election, Khatemi said that Iran would not intervene against the process but that it reserved its right to oppose the process as constituted, which Iran feels is biased against the Palestinians. In keeping with that position, Khatemi denounced the October 23, 1998 Israeli-Palestinian Wye River Memorandum as unlikely to bring peace. Iran also denounced the September 4, 1999 Sharm el-Sheikh Memorandum between Israel and the Palestinians. Responding to Syria's resumption of peace talks with Israel in December 1999 after a three year break, Iran's Foreign Ministry said it was for Syria to decide whether or not to talk with Israel. Foreign Minister Kharrazi said in January 2000 that it would be up to Hizballah how to respond to a peace between Israel, Lebanon, and Syria, if that were achieved. However, press reports and Administration statements continue to indicate that Iran is assisting groups opposed to the peace process.<sup>34</sup> These groups include Hamas, Palestinian Islamic Jihad, Hizbollah, and the Popular Front for the Liberation of Palestine-General Command (PFLP-GC). This continuing aid suggests continuing foreign policy influences by the more hardline Revolutionary Guard and intelligence services, which have established channels to and ideological support for

### President Mohammad Khatemi

Mohammad Khatemi was born in 1943 to a religious family, and he pursued theological studies in Qom in the 1960s. He attained the rank of Hojjat ol-Eslam, one rank below Ayatollah, in the Shiite theological hierarchy. He joined the anti-Shah, pro-Khomeini revolutionary forces at Isfahan University, distributing pro-Khomeini political tracts and organizing religious and political debates. Khatemi subsequently was named chairman of the Islamic Center of Hamburg, Germany, before the revolution. The Hamburg center was a bastion of Iranian revolutionary activity in Europe before the fall of the Shah. He speaks German, as well as his native Farsi.

In 1982, he was appointed Minister of Culture and Islamic Guidance, serving in that post until 1992, when he was forced to resign by religious conservatives who considered him too tolerant on such issues as the playing of live music, independent book and newspaper publications, and women's dress codes. Following his resignation, President Rafsanjani appointed Khatemi as his cultural advisor and as head of the national library.

He is married, and has two daughters and a son.

<sup>34</sup> Lancaster, John. U.S.: Iran's Terrorism Role Grows. Washington Post, December 4, 1999.

the anti-peace process groups. This continued aid to terrorist groups also appears to enjoy the backing of Supreme Leader Khamene'i, who sides with those in Iran who want to preserve the revolutionary elements of Iran's foreign policy.

Khatemi also has continued the efforts of his predecessor, Rafsanjani, to stress engagement and economic ties to the Central Asian states. Khatemi has inherited a hostile regime in Iran's neighbor to the east, Afghanistan. Iran and the ruling Taliban regime in Afghanistan nearly came to hostilities in September and October 1998, although U.N. mediation calmed the tensions by late 1998. Iran has served as a mediator in the internal conflict in Tajikistan, a Persian-speaking former Soviet republic. Iran helped broker a November 1997 ceasefire between warring factions that has brought some measure of peace to that strife-torn state. *(For further information on Iran's policy in these regions, see CRS Report 98-106 F, Afghanistan: Current Issues and U.S. Policy Concerns; 98-86 F, Iran: Relations With Key Central Asian States; and South Asia Crisis: Effects on the Middle East.)*

Seeing Iran surrounded by potentially adversaries including Iraq, Afghanistan, U.S. forces in the Gulf, and the new nuclear state of Pakistan, all factions in Iran appear unified on the need to build up Iran's strategic capabilities. As a result, Iran's defense planning and its reported WMD and missile programs do not appear to have slowed since Khatemi took office. Even if Khatemi wished to scale back Iran's strategic military buildup, it is doubtful he could do so; Supreme Leader Khamene'i is constitutionally the Commander in Chief of the Armed Forces, and he makes or approves all major appointments in the regular military and the Islamic Revolutionary Guard Corps.

Iran continues to attempt to purchase conventional arms — including tanks, combat aircraft, naval craft, cruise missiles, and air defense systems — and associated support from a variety of countries including Russia, China, and Eastern European countries that were formerly part of the Soviet bloc. However, acquisition of new equipment continues to be constrained by Iran's continuing external debt burden, as well as U.S. efforts to prevent suppliers from selling new weaponry to Iran.

Since Khatemi took office, Iran's ballistic missile programs have made substantial progress, aided in large measure by Russian entities and technicians. Iran's missile programs appear intended to give it the capability of striking Turkey, Israel, and parts of Europe. Iran fears the strategic alliance between Israel and Turkey and it appears to want to be in position to deter an Israeli attack against Iran's Bushehr nuclear reactor (now under construction by Russia) or other key targets. Iran might also want to put U.S. bases in Turkey or Western Europe at risk as a deterrent against any future U.S. military action against Iran. The core of Iran's increasingly sophisticated missile production efforts is the Shahab (Meteor) program. The 800-950 mile range Shahab-3 and 1,250 mile range Shahab-4 apparently are based on North Korea's Nodong I (800 mile range) missile, for which Iran reportedly helped fund development, and on Soviet SS-4 technology. Iran tested the Shahab-3 on July 22, 1998, although it is unclear whether or not the test was successful, and has continued work on longer range versions of the missile. Iran is believed to be working on chemical or biological warheads for the Shahab. In the 105<sup>th</sup> Congress, Members tried to address Iran's missile program by passing the Iran Missile Proliferation Sanctions Act (H.R. 2709), which was vetoed on the grounds that it

might hurt reform in Russia. Another version of the bill, the Iran Non-Proliferation Act (H.R. 1883), has been passed by the House in the 106<sup>th</sup> Congress, and is under might get considered in the Senate. (*For further information, see CRS Report 97-474 F, Iran: Arms and Technology Acquisitions, and CRS Issue Brief IB93033. Iran: Current Developments and U.S. Policy.*)

The status of Iran's nuclear program is less clear. Iran is a party to the Nuclear Non-Proliferation Treaty and, since 1992, has allowed International Atomic Energy Agency visits to declared nuclear sites in Iran. No violations of Iran's treaty obligations have been noted and no clandestine nuclear weapons program has been exposed. However, Russia is continuing construction of a nuclear power reactor at Bushehr, which could give Iran vital nuclear weapons-related expertise. U.S. proliferation reports continue to indicate that Iran is seeking to purchase technology and materiel that can be used for a nuclear weapon. Some experts have written recently that Iran apparently is pursuing a nuclear option and that it might become the next nuclear power in the Middle East.<sup>35</sup>

### **U.S.-Iran Relations Since Khatemi's Election**

Although Iran is still pursuing policies that are at odds with U.S. interests, the Administration appears to believe that Iran's moderation under Khatemi has been sufficient to provide an opportunity to end 20 years of mutual estrangement. Six days after Khatemi's election, President Clinton called the vote a "reaffirmation of the democratic process [in Iran]," and he said that he has "never been pleased about the estrangements between the people of the United States and the people of Iran." One press report suggested that, in the aftermath of Khatemi's election, the United States began to send diplomatic messages to Iran via Saudi Arabia that it wanted to improve relations.<sup>36</sup> This press article reported that the United States was responsible for the passage of the final communique of the G-8 summit in Denver (June 22, 1997) that indirectly praised Iran's mediation role in Tajikistan.

U.S. hopes for an early improvement in relations with Iran increased in anticipation of Khatemi's Cable News Network interview on January 7, 1998, advertised as a "message to the American people." In the interview, Khatemi ruled out dialogue with the U.S. government, but he proposed that the two countries rebuild trust through unofficial exchanges of scholars, athletes, tourists, and other cultural groups. After the interview, Administration officials expressed disappointment that Khatemi had ruled out a government-to-government dialogue. Administration spokespersons indicated that an official dialogue is the best way for the two countries to resolve their longstanding differences. However, recognizing the political constraints on Khatemi, the Administration announced in February 1998 that it would accept his call for unofficial cultural exchanges and look for ways to facilitate such ties.

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<sup>35</sup> Eisenstadt, Michael. *Living With a Nuclear Iran?* Survival. Autumn 1999.

<sup>36</sup> Wright, Robin. *In Shift, U.S. Makes Quiet Overtures To Iran Following Election Upset.* Los Angeles Times, July 9, 1997.

This position left some U.S. officials, outside experts, and U.S. corporations unsatisfied, maintaining that the United States needed to do still more to reach out to Khatemi. Some strategists believe that better U.S. relations with Iran can help contain Iraq, which has been challenging the U.N. weapons inspection regime since October 1997 (and no inspections have been conducted since December 1998). Others believed that, unless the United States were more active in reaching out to Iran, Khatemi would progressively lose power to his hardline opponents who maintain that the United States is implacably hostile to Iran's revolution. On the other hand, some in Congress opposed a bolder outreach toward Iran on the grounds that doing so would ultimately lead to an end to U.S. efforts to contain Iran's strategic capabilities. Some in and outside the Administration were concerned that U.S. overtures toward Iran would be politically unpopular; many Americans associate Iran with the 1979-81 hostage crisis, the holding of American hostages in Lebanon, and the failed attempt to reach out to purported Iranian "moderates" during the Iran-Contra Affair.

In mid-1998, apparently frustrated at Khatemi's inability or unwillingness to begin an official dialogue, the Administration opted for a bolder approach to Iran. On June 17, 1998, in a speech to the Asia Society, Secretary of State Albright called for a temporary alternative to a political dialogue. She offered that the two countries undertake unspecified mutual confidence building measures — a "road map" that would eventually lead to normalization of relations. President Clinton reiterated and reinforced the comments the following day.

The Administration has taken several other steps over the past few years to signal its willingness to improve relations with Iran. These apparent overtures include the following:

- On October 8, 1997, the State Department officially designated the Iranian opposition People's Mojahedin Organization of Iran (PMOI) as a terrorist group, in accordance with the provisions of the Anti-Terrorism and Effective Death Penalty Act of 1996 (P.L. 104-132). Two years later, the Administration designated the PMOI's umbrella group, the National Council of Resistance (NCR), as an alias of the PMOI, thus applying the same restrictions on the NCR as apply to the PMOI (a ban on contributions by U.S. persons to the group, and a ban on entry into the United States by group members, and a freezing of group assets in the United States). However, the NCR continues to operate in the United States. Some in Congress consider the PMOI/NCR a legitimate organization fighting the regime in Tehran, and that the U.S. terrorist designation represented an unwarranted concession to Tehran.
- Many experts interpreted a May 18, 1998 U.S. waiver of ILSA (see above) sanctions against Total SA and its partners in part as a concession to Tehran, even though the official rationale focused on U.S. efforts to prevent Iran policy from dividing the United States and the EU. Administration statements that a deal between Royal Dutch/Shell and Iran to develop two Iranian oil fields would take "a

long time” to evaluate was taken by many as a signal that no ILSA sanctions would be imposed on that or similar deals.

- On December 7, 1998, the Administration removed Iran from the U.S. list of major drug-producing countries. The decision exempts Iran from the annual certification process that had placed some economic sanctions on Iran (although these sanctions were generally duplicated by other laws and designations). The removal from the list was based on objective criteria of area under narcotics cultivation in Iran, but it was widely viewed as a positive signal toward Iran.
- Since Khatemi’s election, President Clinton and other senior officials have referred to Iran as a great nation and a great civilization, and Islam as a major world religion. In April 1999, President Clinton said that Iran had been subject to “quite a lot of abuse from various Western countries,” and that it had a right to be angry. His comments were viewed as an apology for reported U.S. and British efforts to oust nationalist Prime Minister Mohammad Mossadeq in 1953, and for the strong U.S. backing for the former Shah of Iran.
- In April 1999, the Administration announced it would consider, on a case-by-case basis, commercial sales of food and medicine to Iran (and Libya and Sudan). Under regulations issued on July 27, 1999, private letters of credit can be used to finance approved sales, but U.S. exporters cannot deal directly with Iranian banks and no U.S. government credit guarantees are being provided. However, Agriculture Secretary Dan Glickman said in September 1999 that U.S. credit guarantees for such sales (which do not meet the standard definition of U.S. foreign assistance, since the guarantee would be paid to the U.S. exporter, not Iran) were under consideration.
- On October 5, 1999, the Administration confirmed press reports that it had sent a direct message to Iran asking for cooperation into the June 5, 1996 bombing of the Khobar Towers military housing complex in Saudi Arabia. Many viewed the direct message, reportedly passed via an Omani official intermediary, as an overture toward Iran. However, in confirming the direct message, State Department spokesman Jamie Rubin was also portraying continued U.S. concerns about Iran by stating that the United States had “information, but not proof,” that Iranian government officials might have been involved in the bombing. If it is shown that Iranian officials were involved in the bombing, the consequences are uncertain because the bombing preceded Khatemi’s tenure and Saudi-Iranian relations have since improved substantially.
- On November 24, 1999, the State Department confirmed that it had requested Iran allow periodic visits to Iran by U.S. officials to facilitate consular work associated with expanded people-to-people contacts between the two countries. Iran turned down the request.

- In December 1999, the Administration licensed the sale to Iran of Boeing spare parts to repair potential defects in seven Iran Air passenger aircraft. The licenses were granted under a provision of the 1995 trade ban that allows for licensing of parts for the safe operation of civilian passenger aircraft. However, the Administration did not encourage interpretation of that license as a policy signal to Iran.

**Iran's Response to U.S. Overtures.** Most Iranian leaders have welcomed what they term a change in the "tone" of U.S. statements and actions toward Iran, but they maintain that the United States needs to demonstrate its sincerity through deeds before relations can improve. Supreme Leader Khamene'i, on the other hand, has continued to rule out a dialogue with the United States and has called those Iranians who favor talks with the United States naive or ignorant. Foreign Minister Kamal Kharrazi, in a September 28, 1998 speech to the Asia Society that was billed as a formal response to Secretary Albright's June 1998 address on Iran, continued to rule out a formal dialogue with the United States. However, he said that there could be some areas of cooperation with the United States, such as bringing peace to Afghanistan and combating narcotics trafficking. Iran's leaders continue to stress their grievances with U.S. policy in the Middle East and toward Iran. These grievances, the U.S. response, the outcome of the February 2000 Majlis elections in Iran, and the outcome of the U.S. presidential election in November 2000, might determine whether U.S.-Iran relations are able to improve. These issues are discussed below.

- First and foremost, Iran believes relations with the United States, the world's sole remaining superpower, will always be unequal and the United States will not treat Iran with respect. Despite tacit U.S. apologies for past interference in Iran's affairs, Iranian conservatives maintain that if relations with the United States are restored, the United States will revert to its past policies of attempting to manipulate Iranian politics.
- Some Iranian leaders believe that the United States is still trying to overthrow the Islamic regime. As evidence, they point to press reports of \$20 million in U.S. funding for covert operations against Iran in the FY1996 intelligence authorization law (P.L. 104-93).<sup>37</sup> The relevant provisions of that law are classified. When it was established in October 1998, Iran also complained about Radio Free Iran as an effort to change the regime.<sup>38</sup> Some Iranian leaders maintain that, although the PMOI and NCR have been designated as terrorist organizations, the NCR's continued operations in the United States suggests that the United States has been insincere in its treatment of the group as terrorist.

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<sup>37</sup> Washington Post, December 22, 1995.

<sup>38</sup> This service was established by H.R. 2267, P.L. 105-119 (H.Rept. 105-405), the Commerce/State/Justice appropriation for FY1998.

- Iranian leaders, particularly Rafsanjani (most recently on December 21, 1999), have demanded the United States release “frozen” Iranian assets as a condition of improved relations. The disposition of these assets was discussed above. U.S. officials maintain that some of the funds Iran claims are frozen are under discussion at the U.S.-Iran Claims Tribunal at the Hague. The United States says it will continue to contest the Iranian claims. However, some outside experts believe that the United States could agree to settle the cases under U.S. government control — such as those involving undelivered military equipment and services — if it wanted to make a substantive concession to Iran. It is unlikely the United States would unblock Iran’s diplomatic property unless or until there were an agreement with Iran to resume relations.
- Iranian leaders complain that the substance of U.S. policy has not changed since Khatemi’s election because U.S. sanctions remain in place. Although the ban on commercial sales of food and medicine to Iran has been eased, Iran maintains that it still cannot sell its products, such as carpets and caviar, to the American people. Iranian leaders also complain that ILSA is still in place, even though no sanctions have been imposed on any foreign energy firm deals with Iran. They note that the Administration has threatened to sanction, under ILSA, energy projects that would transit Iran. Iran advertises itself as the cheapest and easiest route for Central Asian states to bring their oil and gas to markets in Asia and Europe. The Administration and many in Congress, although supportive of the general concept of multiple energy routes in the region, do not want Iran to be in position to use energy routes for political leverage or to accrue additional revenues with which to augment strategic military programs.
- Iranian leaders have complained that the United States seeks to keep Iran militarily weak and, therefore, unable to defend itself in a dangerous region. On WMD, Iran says it is abiding by the Chemical Weapons Convention, and that it allows IAEA safeguards of nuclear facilities.