Global Oil & Energy Sanctions

By

Robert E. Ebel
Director, Energy and National Security
Center for Strategic and International Studies
Washington, D. C.

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At last count more than 75 countries are subject to unilateral U.S. economic sanctions, embracing some 40% of the world's population. Moreover, some countries are subject to multiple forms of sanctions. Economic sanctions may include embargoes or restrictions on exports, imports, and direct investment, the cessation of aid, limits or outright bans on financial transactions, the freezing of assets, the curtailing of credit and loan guarantees by the U.S. government, the denial of normal tax treatment, and limits on travel.

Any sovereign nation is free to impose unilateral sanctions if it believes it is justified in doing so. The exercise of this freedom by the United States in itself is not of particular concern to others. Rather, it is the *extraterritorial reach* of U.S. sanctions that is deemed unacceptable.

North Korea, Serbia and the Federal Republic of Yugoslavia have faced energy sanctions by the European Union and the United States, while Cuba remains subject to comprehensive U.S. trade sanctions, including energy. Sanctions on Iraq are multilateral but remain in force largely because of U.S. efforts to keep them in place. More importantly, for our consideration, the United States has imposed unilateral economic sanctions on a number of key oil producing and exporting countries, including Iran, Libya, Sudan, and Syria. I will limit my remarks to these four oil producers and exporters, who together produce about 5.6 million barrels per day or 8% of the world total.

There are perhaps broader implications to consider. Just what has been the impact of U.S. sanctions on energy prices? Have U. S. sanctions on Iran, Libya, Sudan and Syria retarded field exploration and development in these countries, reduced export levels, and thus contributed in part to upward pressure on oil prices?

But, before exploring that question, let me set out those conditions under which **multilateral** economic sanctions work best. These conditions, and other useful insights, can be found in the CSIS study *Beyond Unilateral Economic Sanctions*, released several years go. The sanctions on Iraq, as noted, are multilateral and for those sanctions to be successful the following criteria would have to be met. As I work my way through these criteria then, *think Iraq* and judge for yourself whether these sanctions held any prospect at all for success.

- The target country is small, weak, unstable, and/or highly dependent on the sanctioners.
- The target has good relations and communications with the sanctioners.
- The target suffers high costs from the sanctions while the sanctioners endure low and sustainable costs.
- The change demanded is a modest one.
- The sanctions, where possible, are financial sanctions, not trade sanctions.

- The sanctions are roughly proportional to the offense.
- The sanctions, where appropriate, are targeted against specific people, activities, and policies.
- The sanctions are imposed quickly and given time to work.
- The sanctions allow for exceptions such as food and medicine.
- The sanctions avoid secondary boycotts that can inflict costs on allies and damage other strategic relationships.
- The sanctions are flexible and can be modified or terminated when appropriate.
- The sanctions where appropriate are backed by force or by the credible threat of force.

I would note at this point that Russian oil companies, once hopeful of becoming heavily involved in Iraqi oil and gas development, now seem to accept that U.N. sanctions against Iraq will not be removed until Saddam is replaced. When that does happen, Russian companies fear they will not be able to compete successfully in Iraq with those major international oil companies who surely will arrive to capture what they can of those opportunities presented.

What in comparison are the criteria to be met if unilateral sanctions are to be successful? In reality, as practice has shown, nearly all unilateral sanctions fail nearly all the time. Indeed, as former National Security Advisor Brent Scowcroft has observed, "unilateral sanctions have an unblemished record; they never succeeded."

There is no comparable set of criteria defining successful unilateral sanctions, very likely because unilateral sanctions by their very definition cannot be successful. We need look no further than a handful of miles off the Florida coast, to Cuba. Have our sanctions on Cuba produced the desired results? Of course not. But they remain in effect because those special interest groups who want to keep them are more vocal, more influential than those who would like to see them removed.

At the same time, the willingness of the U.S. government to impose unilateral sanctions, barring U.S. companies from investing in or doing business with the targeted country, has led to the perception that U.S. companies cannot be relied upon, that it would be best to align with non-U.S. companies.

U.S. State and Municipality Sanctions

U.S. economic sanctions are not the sole purview of the federal government. A surprisingly large number of states and municipalities have proposed or enacted sanctions laws although the target countries are few in number, with the top targets being Burma, Nigeria, and Indonesia, reflecting concern over the absence of human rights and religious freedom. Most of the sanctions have originated from East Coast and West Coast cities and states. Generally these sanctions preclude the purchase, by the state or municipality, of goods and services from the targeted country.

Iran

The U.S. Iran-Libya Sanctions Act, known more popularly by its acronym ILSA, was signed into law in August 1996 and was renewed in late July 2001 for five more years. ILSA imposes mandatory and discretionary sanctions on those non-US companies that invest more than $20 million in the Iranian oil and gas industry. One major U.S. company—Conoco—has fallen victim to ILSA and had to walk away from a $550 million contract to develop two offshore oil and gas fields. ILSA also has discouraged several foreign companies from investing in Iran. But others have moved ahead, some with waivers granted by the United States, some without.

The granting of waivers raises an interesting question. Presumably the action was taken because it was in the U.S. national interests to do so. Just what national interests were being served? Was it the need to develop more oil for the world market, to help reduce price volatility? But then, foreign companies are seen to benefit from the absence of U.S. competitors, leading to pressures on the U.S. government to provide a more level playing field.

We can recall that the imposition and renewal of ILSA reflected U.S. concern regarding 1) Iranian meddling in the Middle East peace process; 2) Iranian support of terrorist activities; and 3) continuing Iranian desire to acquire weapons of mass destruction. It is this latter concern that is more worrisome to the United States and perhaps the key reason why sanctions were renewed last year, although the Department of State last annual report on *Patterns of Global Terrorism*, released in April 2001, identified Iran as the most active state sponsor of terrorism in the year 2001.

There had been good reason to expect better relations with Iran under President George W. Bush, largely because of the pro-business, pro-trade attitude of the incoming administration. But the American Israel Public Affairs Committee recognized that prospect and worked diligently and successfully to secure passage of the 5-year extension. The United States and Iran continue to wait, trying to find a way to open a dialogue. Unfortunately, the difficulty of having to deal with essentially two governments in Iran reduces the prospect of any early or easy success.

But it should be said that Iran itself, with its complex buyback contracts and, more recently, revisions to these buyback contract terms, has removed much of the attractiveness to investing in its oil sector. Moreover, the allegations of corruption made against key officials have further clouded the future. For Iran, it comes down to a struggle between the reformists and conservatives over control of the oil industry. For the United States, it is a matter of which approach will win out: supporters of engagement or supporters of containment.

There is one last element of U.S. sanctions on Iran to consider. And that is the U.S. opposition to the construction of any pipeline originating in Iran to serve foreign markets and opposition to the construction of any pipeline *transiting* Iran. This opposition in its own way has drastically altered the flow of oil and of gas out of the Caspian and Central Asia. How might I sum up current U.S. policy toward that region? This policy could be defined, with tongue-in-cheek, as "happiness is multiple export pipelines, all running in the same direction, and all bypassing Iran." Could an argument be made that this policy has slowed oil and gas development in the Caspian and Central Asia, in part by unnecessarily adding political complications to that development? Probably so.

Libya

U.N. sanctions against Libya, in place since April 1992, were suspended in 1999 following the extradition of two men suspected in the 1988 bombing of Pan Am flight 103. But, as noted earlier, in July 2001 the U.S. Congress voted to extend ILSA for five more years. U.N. sanctions against Libya will not be removed permanently until that country has met a number of remaining requirements.

How has the Libyan oil sector fared? In 1970 the country produced 3.3 million b/d but in the latter half of 2001 was averaging just some 1.3 million b/d, not much less than current producing capacity of about 1.5 million b/d. Libya very much would like to expand its producing capacity to 2 million b/d by the year 2003, but needs foreign company help to do so.

Two U.S. companies withdrew from Libya in 1982, following a U.S. trade embargo instituted in 1981. Five more U.S. companies left Libya in 1986, upon orders of President Reagan. Italy's Agip-ENI is the leading foreign oil producer in Libya today

Unquestionably, the Libyan oil sector has suffered because of the sanctions imposed. Reserve replacement has been falling for the past several decades, for example. A number of foreign oil companies are operating in Libya; that is not the problem. Rather, Libya needs to provide potential investors with better incentives and production terms, as well as better access to exploration acreage and an elimination of bureaucratic obstacles.

…The Expanding Influence of Non-Governmental Organizations

I would like to divert for a moment from the topic at hand, to emphasize the growing role of non-governmental organizations, or actors as they are sometimes called, in shaping energy-related decisions, with this influence coming at the expense of the investing companies and host governments. At the same time, we can note a relationship between NGOs and economic sanctions, for quite often sanctions come about because of NGO pressures.

NGOs have become very successful, through use of the internet, in rapidly bringing together very diverse interests, to focus on one particular issue. That one particular issue today may be *transparency*. Diverse actors—for example, Global Witness, Save The Children, Transparency International, Oxfam. and Tearfund---are coming together to seek full disclosure of payments to national governments by international oil companies, *as a necessary precondition to development*. Indeed, one NGO—Global Witness—has proposed that transparency in payments should be a condition of corporate listing on the New York and London stock exchanges, among others.

Moreover, minimum standards of disclosure would be sought for all major players for all their countries of operation. John Browne, CEO of British Petroleum, has already staked out the lead in this issue by stating that his company intends to publish details of all the payments made as BP develops Angola's oil reserves.

The NGO community strongly believes that transparency is the most effective way to ensure that the oil wealth generated benefits the entire population not just a privileged few.

Unfortunately, transparency must embrace both the paying companies and the receiving governments if the purpose of the effort—eliminating corruption—is to be successful.

Now let me turn to two countries where NGOs have played a substantive role in the energy decision-making process: first, Chad, and then the Sudan.

…NGOs Shaping Energy Decisions

The African country of **Chad**, one of the poorest countries in the world, looks to improve its position through development of its substantial oil potential. Construction of a pipeline to a port of export in Cameroon, critical to that development, was strongly opposed by a coalition of local, national, and international human rights and environmental groups for a variety of reasons. This opposition came about as part of their campaign against globalization. As a result, the project was delayed, the pipeline routing was changed, and an International Advisory Group was appointed by the World Bank to monitor, among other things, the use of public revenues by the government, environmental management, and social impact.

Sudan

Crude oil production and exports from the Sudan have risen quite rapidly over the past several years, tracing back to the completion of a major oil export pipeline in mid-1999. Averaging about 209,000 b/d during 2001, the prospects are good for increases to perhaps as much as 450,000 b/d by the year 2005. This growth brings new importance to those economic sanctions imposed by the United States on Sudan in late 1997. These sanctions prohibit trade between the two countries and also prohibit U.S. investment in Sudan. In early 2000, U.S. firms were precluded from doing business with the Greater Nile Petroleum Operating Company but these sanctions do not apply to the foreign individual parent companies of Greater Nile, including Talisman Energy, based in Calgary.

The United States has been working diligently to isolate Sudan, although some improvement in bilateral relations could be noted post-September 11, as the United States sought Sudanese support in the war against terrorism.

The Sudanese government stands accused by a number of human rights organizations of financing wide-scale human rights abuses with oil-derived revenues. In September 2001 the U.S. Congress delayed consideration of the so-called "Sudan Peace Act," which would toughen U.S. policy towards Sudan, including the imposition of possible sanctions, such as limiting access to U.S. capital markets, on foreign oil companies operating in Sudan. Proponents of the "Sudan Peace Act" are well organized, have not given up, and are likely to embark on another attempt later this year to secure passage. There is strong Congressional support for the "Sudan Peace Act" although the Department of Treasury and the Department of State are opposed.

The Sudanese government has indicated it was prepared to share oil revenues with southern rebels if they gave up their armed struggle. Could oil revenue sharing provide the basis for a negotiated settlement between the rebels and the central government? A number of possible revenue sharing models are now being explored in Washington. But, the question arises: might revenue sharing lead to a demand for greater revenues and to a more rapid development of the country's oil potential than warranted, shortening, in terms of time, oil's contribution to the country's economic health?

Syria

Syria is a declining oil producer, now at about 527,000 b/d, and exporter, reserves are limited, domestic demand is increasing, and there are good prospects that the country may become a net oil importer within the next decade, although expanded exploration and production efforts could reverse this trend.

Syria is included on the list of countries designed by the U.S. Secretary of State as state sponsors of terrorism. Indeed, Syria was one of the original countries to be placed on the list that was initiated in 1979.

Inclusion on the list has resulted in Syria being placed under a series of stringent economic sanctions. It is a criminal offense for U.S. citizens to engage in financial transactions with governments supporting international terrorism. That in turn effectively curtails U.S. involvement in the oil sector because the state-owned Syria Petroleum Company controls all oil resources, and accounts for about 25% of the country's oil production.

It has been the unattractive contract terms offered by the Syria Petroleum Company, **and not U.S. sanctions,** that have led to the departure of most foreign oil companies.

Recently, Syria has demonstrated some flexibility regarding contract terms that gives some hope for a renewal of oil field exploration.

Interestingly, oil continues to flow by pipeline from Iraq to Syria, in volumes ranging from 150,000 b/d to possibly 200,000 b/d, in violation of the U.N. sanctions, and earning considerable unrestricted sums for Iraq. But the United States, though clearly unhappy, has chosen not to pursue this violation.

U.S. Sanctions and Energy Prices

Washington Policy & Analysis, a private consulting company, last year released a research report that examined the impact of U.S. sanctions on energy prices. This report was prepared as a response to the administration's call for a review of U.S. sanctions policy. This call was contained in *National Energy Policy*, a report of the National Energy Policy Development Group led by Vice President Cheney and submitted to President Bush in May 2001. While this report noted that U.S. unilateral as well as multilateral sanctions can advance important national and global security objectives and can be an important foreign policy tool, nevertheless, sanctions should be periodically reviewed to ensure their continued effectiveness and to minimize their costs on U.S. citizens and interests.

It is important to note, as did Washington Policy & Analysis, that U.S. unilateral sanctions against Iran and Libya are designed to hinder energy sector investment, but that they do not affect oil exports. Washington Policy & Analysis did not buy into the argument that foreign oil companies are ready to disregard American sanctions and charge ahead with plans to exploit fields in Iran and Libya. Rather, they pointed out that the U.S. Securities and Exchange Commission views investments in sanctioned countries as significant material investor risks and requires foreign firms raising funds in the U.S. capital markets to publicly disclose their dealings with sanctioned countries, thus making them more vulnerable to scrutiny. In sum, and given uncertainties over the future direction of U. S. policy and actions, non-U.S. firms are likely to approach Iran and Libya with restraint.

It is difficult, even when employing sophisticated modeling techniques, to measure the impact on production and export levels, first under current sanctions and, second, the impact should those sanctions on Libya, Iran, Syria, and Sudan be reduced or even eliminated. Clearly, investment levels would benefit but the near-term and longer-term impact on production and exports are perhaps beyond meaningful quantification, other than to presume some growth would be forthcoming if host government terms were acceptable and if oil market conditions were attractive.

A recent CSIS 3-volume report—*The Geopolitics of Energy into the 21st Century*—concluded that if the estimates of future world oil demand contained in the report were reasonably correct, then the **sanctioned countries of Libya, Iran, and Iraq must be producing at or near capacity if that demand is to be fully satisfied.** Nevertheless, it does appear we have traded reduced world oil supplies for an opportunity to express our displeasure over the actions or inactions of a number of countries. Keep in mind that every energy-related decision taken is accompanied by a tradeoff, and that tradeoff in turn carries its own cost and its own risk. Producers and consumers accept these tradeoffs, often unknowingly.

Concluding Observations

Let me conclude my presentation with a few observations regarding U.S. sanctions.

- First, is there a U.S. sanctions policy? I would suggest that no, there is no sanctions policy, at least not in the strictest sense of the word.

- In reality, as practice has shown, nearly all unilateral sanctions fail nearly all the time.

- Congress is particularly vulnerable to pressures by special interest groups to impose sanctions whenever or wherever unacceptable behavior is noted.

- The "feel good, do good" approach of unilateral economic sanctions appeals to Congress, as a way of indicating that the problem, whatever, is recognized and that action is being taken. But only as long as sanctions have no negative impact on the voters back home.

- Sanctions are like taxes. Once imposed, they are difficult if not impossible to remove.

- It is difficult to quantify the impact that U.S. unilateral economic sanctions may have had on oil production and export levels—and in turn on prices. For, sanctioned country policies themselves may deter foreign investment.

In sum, I can only assure you that the use of sanctions will continue in the future, for purposes and in ways as they have been in the past.