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An unusually sophisticated and perceptive article on the question of economic sanctions. Well worth reading.

Maurice C. Ernst
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Robert Carswell

ECONOMIC SANCTIONS AND THE IRAN EXPERIENCE

Fifty-two Americans were taken hostage in Iran on November 4, 1979. Ten days later, in circumstances to be related, President Carter froze all assets of the government of Iran in the United States and under the control of U.S. banks, businesses and individuals outside the United States. This action, and related measures taken later, deprived Iran of the use of more than $12 billion in bank deposits, gold and other property. The President also cut off most export and other transactions between the United States and Iran and asked the U.N. Security Council to vote similar sanctions. U.N. action was blocked by a Soviet veto on January 13, 1980, but other nations gradually reduced their commerce with Iran. As the hostage crisis dragged on, these sanctions deprived Iran of critical supplies and spare parts and forced it into expensive deals with unreliable middlemen.

The Iran-Iraq war started in September 1980, and by the late fall Iran was bogged down in a costly war of attrition. Its receipts from the sale of oil dropped to virtually nothing, and its lawsuits to recover the $12 billion in frozen assets stalled or failed. Although Iran was able to keep some imports flowing, it found the volume of supplies necessary to conduct a shooting war increasingly expensive and hard to obtain. Its financial reserves were dropping rapidly and, unless replenished, would have soon limited Iran's ability to pay for imports.

We do not know precisely why Iran decided after 14 months to agree to the Declarations of Algiers and release the 52 hostages on January 20, 1981. Holding them had become an embarrassment rather than a domestic rallying point. The issue diverted Iran's leaders from their official duties and impeded efforts to gain support against Iraq in the United Nations and from other nations. These were undoubtedly important factors not connected directly with any U.S. action.

But at the same time it seems clear that a number of U.S. or U.S.-urged actions must have had an impact. The release of the

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hostages came as the result—or after the employment—of scores of direct and indirect initiatives taken by the United States and foreign governments and by private individuals. Diplomatic measures such as the closing of the Iranian Embassy in the United States and the deportation of some Iranians were part of the montage, as well as various actions taken to rally political support around the world against the Iranians. The abortive military rescue attempt of April 1980 and the presence of U.S. carrier task forces in the Indian Ocean may have heightened Iran's sense of vulnerability. The successful action brought by the United States against Iran in the International Court of Justice and the broad support of the U.S. position in the United Nations were also important. Finally, President-elect Reagan had made it clear that negotiations would stop when he took office.

To appraise the full range of actions taken by the United States or under U.S. urging is beyond the scope of this article. What is clear, however, is that by January 1981 Iran was faced with a practical certainty that, unless it reached agreement with the outgoing President Carter, it could look forward at best to continued isolation internationally, and to an indefinite freeze of major financial reserves and long-term shortages of critical imports.

The objective of the economic sanctions was to help precipitate this type of situation and thus to clarify the thinking of Iran's leaders and assist in forcing a solution. That objective was apparently achieved. Since nonlethal foreign policy weapons that work are always at a premium, it is worth reviewing this aspect of the Iranian hostage episode for whatever guidance it may provide.

II

The first and most important U.S. economic sanction was the blocking, or freezing, of the $12 billion of assets of Iran that were under U.S. control. This was by far the largest blocking of assets in U.S. history, and by far the most successful. It was controversial with our Western allies, potentially threatening to the Saudis and other foreign investors in the United States, who might view themselves as potential future objects of U.S. sanctions, and raised novel and often difficult questions of law and policy. It may also prove a costly precedent.

In the beginning, no one in the United States or Iran knew exactly how much had been blocked. Department of the Treasury officials originally estimated more than $8 billion, but when a census had been completed eight months later, the total exceeded $11 billion and later topped $12 billion as interest continued to

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accrue. This was an unexpectedly large amount, and the possible use of these assets was the subject of much debate.

Although it was not universally understood, from the beginning the blocking had a dual purpose, the release of the hostages and the protection of the property claims of U.S. individuals and corporations against Iran. The President's report to the Congress on November 14, 1979 explicitly stated those objectives.

If the hostages had been released by Iran in the first few months, the President might have been able simply to unfreeze the blocked assets and let the U.S. claimants fend for themselves. But as the impasse continued, U.S. claimants tied up the blocked assets with attachments filed in courts all over the country. They also argued forcefully to the Administration and to the Congress that their interests should be protected in any settlement with Iran. Thus, after some months it had become quite clear that the release of the hostages by Iran would also have to be accompanied by some kind of financial settlement between the United States and Iran. Iran would want its assets back when it returned the hostages, but U.S. claimants were in a position to delay or prevent the return of many of those assets. A negotiated settlement was the only way out.

Apart from the very large amount of assets blocked, some $12 billion in total, the unique and unprecedented feature of this blocking was that it included more than $5.6 billion of deposits and securities held by overseas branches of U.S. banks. While all U.S. blocking actions since World War II (e.g., against the People's Republic of China in 1950, Cuba in 1962 and North Vietnam in 1970) by their terms have blocked assets under the control of U.S. persons or institutions outside the United States, this was the first time any significant amount of such overseas assets had actually been caught. Thus the Iranian freeze raised important issues involving the extraterritorial effect of U.S. laws and interference with the international banking system. By a stroke of his pen, the President of the United States had immobilized over $5 billion in deposits in other countries and kept them immobilized for 14 months.

The repercussions of this overseas blocking are by no means over. Some grasp of how the U.S. orders worked is necessary to understand the impact and hazards that flow from the use of this extraordinary sanction.

The blocking of overseas assets was justified on two grounds. The first was that every country has a right to legislate and exercise power over its nationals wherever they may be. This was

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a conventional U.S. assertion and has led in the past to bitter confrontations between the United States and other countries. For instance, during the Vietnam War the United States took the position that the French subsidiary of the Fruehauf Corporation was prohibited from carrying out a contract to sell vans to another French company acting for the People's Republic of China. The French court said French law governed the situation; it then intervened in the management of the French subsidiary and directed that the contract be honored. In this confrontation the United States eventually backed down, but in other situations it has successfully asserted economic power over property held by Americans abroad, to the occasional consternation of its allies.

Moreover, both the U.S. case for blocking of the overseas deposits and its capacity to make this effective were reinforced by the structure and operation of the international banking and payments system. Virtually all of Iran's financial reserves were held in dollar deposits and the bulk of them in so-called Eurodollar accounts. Those are accounts denominated in dollars maintained by offices of banks located outside the United States and principally in Europe (hence the name "Eurodollar").

For reasons rooted in history and practice, virtually all banking transactions in Eurodollars clear through New York. Thus a payment by Iran from a dollar account in London to an exporter in Germany is made through a bank payments clearance system in New York. The payment is electronically routed through New York: Iran's London bank tells its New York correspondent bank to pay the New York correspondent bank of the German exporter.

Since Eurodollar accounts operate through New York, the United States asserted that it could effectively block those accounts without resort to extraterritorial power simply by blocking the use of the U.S. clearing or "cover" accounts, that is the dollar accounts all foreign banks maintain with their U.S. correspondent banks in New York to cover or facilitate payments. Although the theory of utilizing a cover account as a basis for blocking overseas assets had occasionally been asserted by Treasury's Office of Foreign Assets Control, this was the first occasion when it assumed real importance. The cover account theory has never been tested in either a U.S. or foreign court.

The original freeze order blocked not only Iran's dollar deposits held by U.S. banks abroad but also deposits held in other currencies, for instance, an account maintained by Iran in francs at the Paris branch of a U.S. bank. Other governments quickly expressed their objections to that extensive a U.S. extraterritorial reach, and

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since the aggregate amounts appeared not to be large, non-dollar accounts at U.S. overseas bank branches were unblocked.

Within a few weeks after the blocking, Iran brought suit in London demanding that the U.S. overseas bank branches immediately pay over their blocked Eurodollar deposits. The banks defended the suits on the ground that the U.S. blocking order prohibited them from doing so, and asked foreign courts to give effect to the U.S. blocking order. Later, after the United Nations had voted to impose sanctions on Iran and the International Court of Justice had declared Iran's taking of hostages to be in violation of international law, the banks urged foreign courts as a matter of national policy to support positions on international law that their governments had already endorsed and accordingly to deny relief to Iran.

The situation became more complicated when the Administration permitted the banks to set off loans that they had made to Iran against the overseas deposits of Iran, that is, prematurely to pay off loans they had made to Iran from the Iranian deposits they held. The banks promptly took over two billion dollars in setoffs, and the validity and effectiveness of those setoffs also became an issue in the U.K. litigation. The Administration licensed these overseas setoffs in part to strengthen the banks' litigating posture but also in recognition of the fact that setoffs might provide a quick and simple way to settle a substantial amount of claims by U.S. parties against Iran and from assets that were only tenuously within the control of the United States.

While the United States was successful for 14 months on one theory or another in preventing Iran from using these overseas assets, no one was under any illusion that these assets could later be vested by the U.S. Congress and brought back to the United States to the benefit of U.S. creditors and to the possible derogation of creditors in the United Kingdom (and elsewhere). While Her Majesty's Government might be slow to help the Iranians while they held hostages, it seemed quite unlikely that it would permit up to six billion dollars to be removed from the books of bank offices in the U.K. and confiscated solely on the basis of legislation enacted in the United States, with the implications that might have for sanctity of contract and equal protection of law in the U.K.

No foreign government was prepared to take rigorous action such as blocking Iranian funds denominated in its currency or under its control; however, they did nothing to help Iran free its dollar assets blocked by the United States. Privately, some ex-

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pressed the view that the United States had overreacted, but they agreed that if the United States felt action was necessary, extraterritorial blocking was preferable to the use of force—at least so long as no oxen of theirs were gored and the blocking, and any unpleasant fallout therefrom, was restricted to U.S. banks and to dollar accounts. They also were clear that "blocking" was infinitely preferable to the U.S. government's "vesting" or seizing the Iranian accounts. (Vesting, which would have required legislation, was urged from time to time in various quarters to demonstrate the seriousness with which the United States viewed the situation, but was not seriously pursued.)

Since the final settlement embodied in the Declarations of Algiers rendered litigation over the overseas blocking moot, one can only speculate whether in the end the courts of the U.K., and of France, West Germany and Turkey where litigation was also initiated by Iran, would have supported the blocking. Some knowledgeable legal experts think Iran in the end might have prevailed, but it would have taken a very long time and intervening political events might have altered the course of the litigation. Whether that judgment would have proved correct is not particularly important, because by the end of 1980 it had become clear that the U.S. blocking action would be effective indefinitely unless the foreign governments changed their positions and supported Iran. They were not about to do that while the hostages were held.

The United States devoted considerable resources to keeping the Iranian assets blocked. The Department of Justice monitored and intervened in lawsuits all over the United States. It engaged counsel in the U.K. and France. All during the period the hostages were held, the Treasury published detailed regulations and interpretations, and Treasury officials conferred with representatives from the hundreds of banks and corporations that held blocked assets. The $5.6 billion in blocked overseas deposits were held by ten U.S. banks, Bank of America being the principal one. Because of the size and novelty of that blocking and the likelihood that those assets would prove crucial to any settlement and hostage release, Treasury made a particular effort to understand the claims those banks had against Iran as well as the blocked assets they held. When the time came to settle with Iran that familiarity proved indispensable.

III

Very few exports moved from the United States to Iran after the hostages were seized, because U.S. longshoremen refused to

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load cargoes destined for Iran. Three days after the hostage taking, the President prohibited U.S. companies from purchasing oil from Iran. A week later, at the time Iran's assets were frozen, the President also proscribed certain exports to Iran and transactions with Iran. The scope of the proscription was expanded as the months passed, and in April 1980, after U.N. intermediation had broken down, all imports from Iran and all U.S. exports to Iran (except for food, clothing and medicine) were formally prohibited.

The sanctions against Iran imposed by allies of the United States were considerably less rigorous. In early December 1979 high-level U.S. officials visited the capitals of the U.K., France, West Germany, Italy, Switzerland and Japan and discussed sanctions those countries might impose. Simultaneous efforts were pursued to have sanctions mandated by the U.N. Security Council. After the U.N. effort had been frustrated by the Soviet veto, most of the allies of the United States unilaterally imposed the limited array of financial and export sanctions for which they had voted at the United Nations. Basically these amounted to a prohibition against the export of military supplies to Iran and an agreement not to extend new credit to Iran. Some of them, and in particular Japan, which had been the largest purchaser of Iranian oil, at first refused to pay premium prices for Iranian oil and eventually stopped purchasing oil from Iran.

Many allies of the United States were concerned that a successful embargo might so weaken Iran that it would descend into chaos or come under Soviet influence. Others had large numbers of nationals still working in Iran and extensive contractual or financial interests in Iran that they were loath to jeopardize. Some felt that diplomatic approaches they were conducting gave more promise of results.

Administration of the U.S. sanctions was relatively simple because as a practical matter major U.S. companies had little interest in trading with Iran. Over the period of 13 months when U.S. controls were in effect, there were indeed several hundred inquiries or applications for licenses to export to or import from Iran, but the great bulk of these were by small companies or for minor items. A few hardship situations were licensed, but most applications were denied. Only a handful of significant enforcement situations involving U.S. persons were processed during the whole period.

An extensive effort was also made to monitor non-U.S. trade with Iran, and when instances of shipments of military goods were identified or apparent transgressions of sanctions discovered, the friendly countries involved were contacted. With varying degrees

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of enthusiasm, they usually sought to enforce their sanctions.

Assessing the effect of the trade sanctions is difficult, particularly since the results of economic mismanagement in Iran can easily be confused with problems arising from externally caused shortages. Many units of the Iranian armed forces had been equipped from U.S. sources and were dependent on those sources for resupply; many of Iran's key installations, particularly in the oil and gas sectors, had been constructed and maintained by U.S. contractors. Iran was thus uniquely vulnerable to U.S. sanctions. But even though the sanctions largely prevented direct resupply of these critical areas, Iran apparently was able, by paying exorbitant prices through middlemen, to meet its most critical needs. After the start of the war with Iraq, the situation rapidly worsened, and by the end of 1980 it is likely that the U.S. sanctions against exports were having real impact.

There is insufficient available information on which to base an assessment of the effect of sanctions imposed by allies of the United States. Some military equipment Iran badly wanted was not shipped from one country; transshipment of some spare parts was stopped by another; but export of key oil and gas equipment parts was permitted by a third. There was no way for the United States to monitor more than a portion of what went on. Hence, the best that can be said now is that the sanctions undoubtedly caused Iran difficulties but probably not insuperable ones.

IV

In retrospect, it appears that by early January 1981 Iran had decided to release the hostages if it could make a satisfactory deal for release of the frozen assets. Demands for political apologies and $24 billion in guarantees had been dropped. What remained was to find a formula by which U.S. private claims against Iran could be resolved, by which some kind of face-saving commitment could be given by the United States to assist in recovery of the Shah's assets and, most important, by which at least a significant portion of the frozen assets could be returned immediately to Iran.

About one-third of the $12 billion in blocked assets was held by banks and businesses in the United States. To return more than a small percentage of those assets to Iran, some 20 courts across the country would have had to discharge attachments and other forms of process. That could not be done on any time schedule then forseeable. The Federal Reserve Bank of New York held another $2.4 billion in cash, securities and gold owned by Iran, and both the Attorney General and counsel to the bank had

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concluded it could obey a presidential order to return those assets. So those funds could be made available—but Iran wanted more.

The balance of Iran's assets were blocked overseas. About $5.6 billion (including almost $800 million in interest) was on deposit in the overseas branches of U.S. banks (mostly in the U.K.), free of attachment, and could be returned to Iran if the President cancelled his blocking order. But the banks had substantial legal arguments for refusing to return the deposits until Iran settled its loans from them on some acceptable basis. Since some of the banks had agreements to share any repayments they might receive from Iran with foreign banks who had participated in making particular loans to Iran, it was difficult to determine the amounts necessary to pay off the loans. In addition, no one knew whether Iran intended to refuse to pay some of the hundreds of outstanding loans—because they were "debts of the Shah"—or how much interest Iran thought should be paid by the banks on the blocked accounts.

Attorneys for the banks had been meeting secretly since May 1980 with the U.S., U.K. and German attorneys for Iran. Treasury and State Department officials were briefed on the meetings as they occurred, and although progress seemed very slow, at least both sides were getting educated in the complications of the situation. The banks worked with the Treasury and the Federal Reserve Bank of New York, and eventually with a specially retained accounting firm, to develop accurate numbers on all outstanding loans and deposits—a considerable job in view of the very large amounts involved and absence of cooperation from Iran.

Senior bank officers understood that at least some of the deposits would have to be returned concurrently with the hostage release. No bank wanted to accept responsibility for delaying the hostage release, but the banks also wanted to improve the prospects for the payment of several billion dollars of dubious loans. The President had no legal power to force loan settlements. A public dispute with the banks would be difficult to control and might well derail the Algerian intermediation that began in late 1980. The situation was delicate, and the terms of settlement elusive.

In the second week of January 1981, Iran sent its U.K. and German attorneys to New York to work on the details of a settlement involving the overseas assets, and the increasing realism of Iranian demands as transmitted through the Algerians signalled Iran's resolution to end the crisis.

The final two weeks of around-the-clock negotiations were

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conducted in various segments in Washington, New York, London, Algiers and Tehran. This was an extraordinarily short time in which to complete a transaction of this size and complexity. That it closed as President Reagan was returning from the inauguration ceremonies was a testament as much to endurance and luck as to skill and planning.

It had been clear for some time to everyone—the United States, Iran, the Algerian intermediaries, and the private claimants—that all U.S. claims against Iran could not be settled in advance of the hostage release. After a week of tough bargaining on language, agreement was reached on the framework by which non-bank claims against Iran, and by Iran against the United States, would be resolved—through international arbitration based on rules formulated several years ago by a U.N. agency, UNCITRAL (U. N. Commission on International Trade Law). But a procedure for reinstating the bank loans and for Iran providing security for the reinstated loans was proving difficult to work out.

Then, on January 15, 1981, the break came. Iran reduced the amount of cash it demanded be returned and announced it would pay off its syndicated bank loans, that is, the loans made to Iranian entities by syndicates of U.S. and foreign banks. Payment of those loans used up almost $3.7 billion of the nearly $5.6 billion of blocked overseas deposits. Iran agreed that another $1.4 billion would go into an escrow account to secure payment of non-syndicated loans made by U.S. banks and contested interest of about $130 million paid by some U.S. banks on Iran's overseas deposits. Iran ended up on January 20 with most of its foreign loans paid off, and with a little less than $3 billion in cash ($500 million from the overseas deposits and about $2.4 billion in assets returned by the Federal Reserve Bank of New York).

In short, the eventual settlement not only dealt with the syndicated bank loans, but substantially improved the situation of non-syndicated loans and of other U.S. claimants against Iran—on any realistic comparison with the situation in November 1979, when the hostages were taken.

At that time U.S. corporations were engaged in hundreds of disputes with the new revolutionary government of Iran involving incomplete construction projects, expropriation or nationalization of oil, gas and mineral properties, seizure of equipment and plants, and uncompleted contracts for both military and civilian goods. Many billions of dollars were and are involved in these disputes. Iran was taking extreme negotiating positions and asserted that its sovereign immunity placed its assets beyond the reach of U.S.

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claimants and creditors. In addition, U.S. banks (individually or in syndicates) had extended more than $1.8 billion in loans and credits to various Iranian government units. The prospects for repayment of those loans and credits, like the prospects for settlement of the many claims, were uncertain.

The settlement provides for binding, impartial arbitration to resolve the various contractual disputes. Almost two-thirds of all bank loans have been paid off, and the balance will be resolved either through negotiation or by binding, impartial arbitration. Payment of arbitral awards will be secured by Iranian assets held by a third party escrow agent.

The history of recovery by U.S. companies or banks from revolutionary governments has not been good. Cuba has paid nothing. The People's Republic of China settled after 30 years for 40 cents on the dollar. In that context, the settlement with Iran looks very good. Even if it is subsequently modified by agreement or court order, the overall position of U.S. claimants has been improved from the unpromising status of two years ago. The leverage that the blocking and the sanctions gave the United States in the final negotiations is almost certainly responsible for that result. Iran could not get its assets back without agreeing to a framework to resolve legitimate commercial and financial claims.

While it may be decades before all U.S. commercial problems with Iran are resolved, the freeze and the sanctions—for all practical purposes—are now history. It seems clear now that they were a short-term success. But it is equally clear that, because of the negotiating complexities caused in the final week by the freeze, they also came very close to frustrating or delaying the release of the hostages. The margin of success was very thin.

V

Foreign policy makers do not always give weight to the appropriateness, or cost-effectiveness, of the imposition of a unilateral economic sanction by the United States. Rather than work through a rigorous analysis, they justify the imposition of a sanction by some variation of sonorous themes: some action is necessary; there is no other appropriate response available; a political or military response is too risky; the United States must show leadership and it will take too long, or it is too doubtful a prospect, to attempt a coordinated response with one's allies.

Once that type of rationale is accepted, it is unnecessary to pursue whether the particular economic sanction in the short or

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long run will hurt the United States more than the country sanctioned or even whether it will be effective. The fact, or appearance, of action, combined with the perceived lack of any other immediate response, carries the day. Thus it is possible to announce an immediate grain embargo against the U.S.S.R. in response to the latter's aggression in Afghanistan before establishing whether or how the embargo could be effective and what its cost would be. The fact that the embargo later proves domestically costly, is undercut by key allies and (depending on whose analysis one accepts) is only partially or marginally effective, can still be answered by the generalized themes that an immediate response was necessary, the United States must lead, etc.

A similar response could be made to the question of whether the blocking of Iran's assets, particularly the overseas assets, was appropriate. For ten days following November 4, 1979, Iran had imperiously refused to take action to obtain the release of U.S. diplomatic personnel being held by an irregular student group and indeed was holding the U.S. chargé d'affaires at its Foreign Ministry. Mobs were chanting and burning the U.S. flag in front of our embassy. U.S. property in Iran had been taken without compensation. Economic spokesmen for Iran had stated that Iran would not honor the "Shah's debts," and on November 13, 1979, its acting Finance Minister Bani-Sadr threatened to withdraw Iran's dollar deposits from U.S. banks and attack the dollar. All this was being carried with great prominence in the world media.

So far as any real threat to the dollar was concerned, there was a surrealistic quality about all this. When Bani-Sadr made his threat, Iran had somewhere between $1 billion and $2 billion in deposits available to dump on the market in an "attack" on the dollar. That would not have caused much of a ripple in the $400-billion Eurodollar market, where daily foreign exchange trading normally exceeds $100 billion by some margin. Perhaps it could have dumped another $6 billion as dollar securities were sold and time deposits matured over the next year. U.S. reserves of over $20 billion were available, plus assured support from other central banks against a renegade. The risk of Iran destabilizing the dollar with that level of resources was not significant.

But in the political heat of the moment the naïve Iranian rhetoric was blandly accepted, and the threat to the dollar was presented to other nations as a major reason for action. Faced with a unique situation in which psychological elements played a large part, it was not difficult to conclude that the President had to do something. The United States could not afford to be seen as

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a paper tiger. Since Iran had threatened economic measures against the United States, the necessity of moving fast was readily justified. Acceptable alternatives were in short supply. The decision to block was easily taken.

Fourteen months later, events appeared to have validated the decision. The blocked assets proved a key bargaining chip in obtaining the hostage release. The Iran-Iraq war, the increasing isolation of Iran, a growing need for the blocked assets and the prospect of dealing with a hostile-sounding new Administration combined to force Iran to negotiate. The ensuing settlement not only freed the hostages but also put virtually all U.S. lenders and claimants against Iran in a much more favorable position than they had been prior to the seizure of the hostages.

Even if the blocking was successful in achieving its objectives, however, it is important to assess its costs and its limitations, rather than use it uncritically as a justification for this type of unilateral sanction in a future international crisis. Prior to Iran, U.S. blockings since World War II have proved much easier to impose than to remove and sometimes more an embarrassment than a positive influence on policy.

In 1950 during the Korean War the United States cut off trade with and blocked the assets of North Korea and the People's Republic of China. Since the blocked assets under U.S. control had only a fraction of the value of the U.S. assets seized by the People's Republic, the blocking was classically ineffective, while in time the trade sanctions served only to reinforce the 25-year isolation of the United States from China. These sanctions remained on the books until the claims settlement with the P.R.C. in 1979.

In 1962 after Cuba had nationalized properties of various U.S. nationals in Cuba, U.S. trade with Cuba was cut off, and Cuban assets in the United States were blocked. Since Cuba seized U.S. properties worth at least ten times those blocked by the United States, the U.S. blocking was regarded with amusement by President Castro. The trade sanctions have been quite successful in achieving the isolation of Cuba from the United States. The wisdom of that policy involves judgments about a broad range of policy alternatives toward Latin America, but it is clear that the sanctions have created nasty confrontations with various of our allies, have been economically costly to both Cuba and the United States, and have thus far been ineffective in producing changes in the politics or policies of Cuba.

In 1970 the United States cut off trade with and blocked the

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assets of North Vietnam, and after the fall of Saigon and Phnom Penh in 1975, did the same with Vietnam and Cambodia. The principal effect has been to reinforce the isolation of the United States from that area of Southeast Asia.

The only other sanctions that combined blocking and a trade embargo were against Rhodesia during the 1970s when the United States, along with some other nations, implemented the U.N. vote to impose sanctions against Rhodesia. Since South Africa and various other countries did not join in the U.N. action, the sanctions were only marginally effective. In addition, it soon became clear that the embargo on Rhodesian chrome was making the United States dependent on chrome from the U.S.S.R. and, at least in the view of some, hurting the United States more than Rhodesia. That led to a congressional modification of the sanctions through the Byrd Amendment (reversed in 1977), and the sanctions themselves were rescinded when Zimbabwe was established two years ago.

In this list the sanctions against Iran stand out because they were effective and short-lived. This success may lead some observers to conclude that there is more potential in the use of sanctions than the China-Cuba-Vietnam episodes indicate. That is not likely to be the case.

VI

The Iran situation was unique in at least three respects. First, the blocking was keyed to an event (the hostage seizure) that could be quickly resolved, and the blocking itself was therefore destined to have the same resolution. Second, by accident of history a very large amount of Iranian assets was under U.S. control, far larger than the U.S. assets under Iran's control. Third, the principal allies of the United States also had vital interests to protect in Iran. Thus the United States had extraordinary leverage, a condition that did not exist in the China-Cuba-Vietnam situations and is not likely to be repeated.

For at least five years the U.S.S.R. has been careful to owe more to U.S. banks and corporations than the aggregate Soviet deposits and assets under direct U.S. control. That is true of most countries, particularly those that like to posture against the United States. Only Saudi Arabia has a significantly larger amount of deposits under U.S. control than its debts and obligations to the United States. But anyone who believes this gives the United States substantial leverage over the Saudis fails to appreciate that the

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Saudis also have massive assets outside of U.S. control and that cessation of Saudi oil sales would seriously affect the U.S. economy well before the Saudis would run out of financial reserves.

It is now important to emphasize again what made the Iranian blocking effective—this was the U.S. decision and ability to block dollar accounts outside the United States. This exercise of extraterritorial power meant the difference between depriving Iran of $6 billion and $12 billion. It also demonstrated that the United States has the theoretical capacity to block any dollar account maintained anywhere by a U.S. bank or by a foreign bank. As discussed earlier, virtually all transactions in dollar accounts must clear through a cover account in a bank in New York, and the United States has today the theoretical capacity to block that cover account and clearance in the United States. In the Iran blocking the United States made it clear it was not blocking dollar accounts maintained for Iran by foreign banks, and Iranian transactions in U.S. dollars took place through the cover accounts of foreign banks in New York all during the hostage crisis. That the reach of the U.S. blocking was limited to U.S. banks was simply a recognition of the practical limits of U.S. power.

In practice, as opposed to theory, it would be mechanically difficult, perhaps impossible, to identify which transactions in a foreign bank's cover account actually involved Iranian money. Whereas the United States by various processes can obtain whatever information it needs from U.S. banks, it has no comparable control over foreign banks unless the foreign bank's governing authority cooperates with the United States. Tentative approaches to foreign governments early in the Iran crisis indicated cooperation would not be forthcoming. It is understandable that foreign governments are not enthusiastic over this kind of prospective extension of U.S. power. This lack of enthusiasm is particularly prevalent among central bankers, who traditionally have taken the view that the intrusion of political considerations into the international financial and banking system would ultimately destroy the system—and in this they may well be correct. It is also probable that an extension of power beyond that exercised would have resulted either in a change in the way clearings are handled in the Eurodollar market or in a general shift away from the dollar.

There is no law or economic theorem that requires Eurodollar transactions to clear through New York. That is historically how the system evolved, and it is presently the most efficient way to handle the very large volumes of transactions generated. The

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conventional banking wisdom is that a clearing system must be backstopped by the central bank of the country where the clearing system operates. Only the Federal Reserve (the U.S. central bank) can provide enough dollars and influence to guarantee that a dollar clearing system will work in the event of a cataclysm. The Bank of England can produce pounds sterling without effective limit—but not dollars.

Hence, the argument concludes, dollar clearing systems must be located in the United States where the Federal Reserve conducts its business. It is at least debatable that this conventional wisdom stands up today, in a world where at least $400 billion is resident outside of the United States, where instantaneous electronic transfers significantly alter the terms and the risks of a clearing system, and where laws other than those of the United States may govern significant dollar transactions.

Certainly the human mind is capable of developing ways to effect clearings outside the United States. And if an alternative clearing system proved too expensive or hazardous to set up and if Eurodollar holders grew sufficiently concerned about the present system, they could always move some, or eventually all, of their assets and transactions out of the dollar. Such a movement would probably trigger a significant decline in the exchange value of the dollar and finish the dollar as the world's premier reserve currency. On balance, most observers conclude that the dollar's status as the world's reserve currency has bestowed significant advantage on the United States. The loss of that status would be potentially serious.

A general concern was expressed at the time of the Iranian blocking that even the mere exercise of the power to block—particularly the extraterritorial feature—would cause a deposit and loan movement from U.S. banks and from the dollar generally. The United States took the view that the situation was unique because Iran had been recognized as a unique transgressor, beyond the pale of acceptable international conduct; no respectable nation need worry. As part of the January 20 settlement and concurrent with the hostage release, all exercise by the United States of extraterritorial power was terminated, and foreign bank syndicate lenders were paid off on the same basis as U.S. lenders. The talk subsided, but the lawyers and the bankers have learned the lesson of what the United States can do.

The figures on the disposition by OPEC countries of their 1980 surpluses recently became available, and they do not provide assurance that all is forgotten. OPEC countries continued to invest

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heavily in dollar-denominated assets in 1980, but there has been a noticeable decline in the proportion of OPEC assets held in the form of direct claims against U.S. banks and their major foreign branches. In 1979 about $16.5 billion of the $40 billion OPEC increase in claims against the international banking system was held with U.S. banks. In 1980 only $1.1 billion of the corresponding $44 billion increase was held with U.S. banks. OPEC deposits with U.S. banks were not reduced in 1980, but new dollar deposits were made with foreign—not with U.S.—banks. There are a number of possible reasons for this change in policy by OPEC countries, but among them may well be a reaction to, or fear arising from, the Iranian blocking.

One can only speculate as to whether the prompt action of the United States in terminating the blocking after the hostage release will be reassuring, or whether the use of the blocking sanction will result in a permanent shift of OPEC dollar deposits from U.S. banks. Since deposits are the lifeblood of the banking business and the core of banking relationships, such a shift could be expensive. The loss of the deposits would not cripple U.S. banks. They can buy the OPEC deposits from the foreign banks that receive them, but that will increase the cost to U.S. banks and deprive them of direct contact—and future influence—with important customers. The long-term price, if any, is therefore not yet clear. What is clear is that a future blocking will be evaluated by a more knowledgeable and critical audience.

Similarly it is not clear whether the trade sanctions will in the longer term have an adverse effect on U.S. contractors and manufacturers. The United States already has a reputation as a partner that breaks contracts for political reasons. The Iran experience can only reinforce the trend among some countries to diversify their purchases and contracts, even at some increase in cost, to avoid unnecessary dependence on any one country.

The foreign financial community also worries about another economic weapon that the United States could have used, but did not, in the Iran episode. In addition to blocking the Iranian assets under its control, the United States could also have seized, or vested, those assets, and then used them to pay off Iran's debts to U.S. claimants. For a foreigner with investments in the dollar and in the United States, that kind of action would have been profoundly disquieting. If Iran's assets could be vested, why not those of the nationals of some other country when some new unexpected crisis develops? The only sure protection for a foreigner with that kind of concern is to pull out. Such vesting was urged by some

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during the Iranian crisis, but resisted by the Administration because of clearly foreseeable and serious consequences to the dollar, and also because an asset once vested is hard to preserve and return.

VII

In sum, the financial sanctions employed against Iran over the hostage issue were effective because of special circumstances that differentiated the situation sharply from other cases where economic sanctions had historically been attempted. And the freeze of Iranian assets not only created negotiating complications but involved both short- and long-term costs that cannot yet be fully assessed, as well as risks of a major change in banking practice that could seriously affect the status of the dollar as the world's principal reserve currency. Finally, it must again be emphasized that the degree of leverage the sanctions exerted—whatever its exact weight—depended on a high degree of cooperation by other countries.

As one looks at the possible use of financial sanctions in particular, in possible future situations, it is this last factor that stands out. Financial sanctions, such as the Iran blocking, can be effective in special situations, but as with embargoes or more targeted trade controls, their effectiveness in more generalized situations depends on multinational cooperation. If key governments were able to act together, financial sanctions could be designed that would be a good deal more effective in some situations, and easier to administer, than trade sanctions. Most significant trade transactions in the modern world require the use of credit and a payments system. A relatively few countries control that system, and could administer almost any level of controls. But absent a joint program, financial sanctions are not likely to be effective, and run the grave risk of harm to our financial institutions and to the system.

The past policies of the United States have significantly limited its future options to use economic sanctions generally. There is, for instance, little the United States can do unilaterally that would visit economic punishment on the U.S.S.R. Those options were used up decades ago. The large volume of U.S. lending in the last 20 years to both friendly and potentially hostile countries almost ensures that unilateral sanctions will be very costly to the United States and with results much more likely to parallel those obtained against China and Cuba than the impact on Iran. Special situations may arise from time to time, but it is quite unlikely that the United States will benefit from a repetition of the factors that

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made the Iran blocking a success.

I conclude that, when the next international emergency arises, U.S. policymakers should exhaust every possible avenue of multilateral cooperation before considering unilateral sanctions—and should be prepared to accept even substantial modification of what the United States itself might deem desirable in order to achieve a united front with other major industrialized countries (and with key regional nations if necessary). Only if such efforts fail or are clearly inadequate should the United States consider moving to unilateral economic sanctions—and before actually deciding to do so it will be important to take the time to assess the costs to the United States of any proposed actions involving such sanctions.

The United States can no longer afford the luxury or cost of leadership when our allies do not follow. The spectacle of the United States saying publicly what it will do if others join, but only if they join, is an option thus far largely avoided. No one likes to be tough with a friend, but friendship does not prosper in an atmosphere of inequality. A unilateral blocking that weakens the dollar or causes billions of dollars of losses for U.S. banks and other U.S. creditors may make a vivid ideological point, but the costs should be evaluated in advance.

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