

**Testimony of Stuart Levey, Under Secretary
Office of Terrorism and Financial Intelligence
U.S. Department of the Treasury**

Before the Senate Committee on Banking, Housing, and Urban Affairs

Chairman Dodd, Ranking Member Shelby and other distinguished members of the Committee, thank you for this opportunity to update you on our efforts involving Iran. I welcome the Committee's ongoing focus on this important issue, and, more broadly, your continued support for our efforts to protect the integrity of the international financial system.

Less than a week ago, the five permanent members of the UN Security Council and Germany – the P5+1 – met with Iran in Geneva. As the President said, that meeting was a constructive beginning to our dialogue, but much work remains to be done. He was clear that, “[i]f Iran does not take steps in the near future to live up to its obligations, then the United States will not continue to negotiate indefinitely, and we are prepared to move towards increased pressure.” Deputy Secretary of State James Steinberg has outlined to the Committee our overall two-track strategy toward Iran, focused on both engagement and clear consequences if Iran declines to take concrete steps.

Even as the Administration focuses on diplomacy, we have also been working with our colleagues across the U.S. government to develop a strategy for imposing substantial costs on the government of Iran if the President determines that is what is needed to affect Iranian policies.

The plan we are developing is comprehensive. It takes into account that no single sanction is a “silver bullet” – we will need to impose measures simultaneously in many different forms in order to be effective. It also takes into account Iran's potential vulnerabilities and those activities that have the greatest influence on Iran's decision

makers. As we consider various measures, we are particularly mindful of potential unintended consequences on the people of Iran, and the internal dynamic now playing out in that country.

Because financial measures are most effective when imposed as part of a broad-based effort with the support of the largest possible international coalition, we are working closely with our allies as we put together this strategy. We believe that by consulting with them closely and pursuing engagement genuinely we have a better chance to generate the coalition we will need if dialogue does not lead to demonstrated progress.

We should be realistic about the ability of sanctions to achieve our political and security objectives with Iran. If, however, we accurately target the key vulnerabilities and fissures in Iran and then implement our plan with a broad coalition of governments and key private sector actors, we can at least demonstrate to the Iranian government that there are serious costs to any continued refusal to cooperate with the international community. Although we cannot describe the particulars of our planning in an open hearing, I would like to explain some of our thinking.

Financial Measures

Beginning in 2006, we developed and implemented a strategy to target Iran's illicit conduct. We took formal action against many of the specific banks, government entities, companies, and people involved in Iran's support for terrorism and its proliferation activities. We did so using two powerful Executive Orders, E.O. 13382 and E.O. 13224, that allow us to designate proliferators of weapons of mass destruction, terrorists, and their supporters, freezing any assets they have under U.S. jurisdiction and preventing U.S. persons, wherever located, from doing business with them. We have designated more than 100 entities and individuals supporting Iran's nuclear and missile enterprises, including the key organizations within Iran, scores of their front companies, Iran's major

banks that finance their conduct, and Iran's major shipping line, the Islamic Republic of Iran Shipping Lines, that handles illicit shipments for these dangerous enterprises. We have also acted against the Islamic Revolutionary Guard Corps, or the IRGC, and several of its companies for proliferation, as well as the IRGC's Qods Force for its role in supporting terrorist organizations.

As a result of the State Department's intensive diplomatic efforts, the UN Security Council resolutions on Iran contain many of the same designations we have implemented here in the United States. The European Union and Australia have gone beyond implementing the Security Council's list, joining us in other designations, such as that of Iran's Bank Melli. These actions are particularly powerful in that they give us an opportunity to explain publicly our reasons for acting, thereby exposing the illicit conduct of those we have designated.

Importantly, we combined these government actions with unprecedented, high-level outreach to scores of banks, banking associations, and other private sector leaders around the world. We discussed the risks of doing business with Iran and shared information about Iran's illicit and deceptive practices. As a result, the international private sector has amplified the impact of government actions, as banks and companies around the world have come to understand that, if they are dealing with Iran, it is nearly impossible to protect themselves against becoming entangled in that country's illicit conduct.

We have seen firsthand that the financial measures applied by the United States and the international community on Iran since 2006 have had an impact. At this point, most of the world's major banks have cut off or significantly scaled back their business with Iran because of the reputational risks involved. Iran is increasingly dependent on an ever-shrinking number of trade and finance facilitators. Many foreign companies have pulled back from business deals with Iran, including investment in Iran's energy sector. Iranian

businessmen face greater inefficiencies, higher operating costs, and increased difficulty finding business partners and banks to provide them with financing.

Iran's foreign borrowing has sharply declined since 2006, a significant change from 2002 to 2005, when foreign credit growth to Iran outpaced that of the wider Middle East. External credit to Iran fell 18 percent between September 2006 and September 2008, in stark contrast to the 86 percent rise in external credit to the Middle East region during the same period. And, to the extent that Iranian firms have been able to replace lost credit with domestic credit, they are likely doing so at a much higher cost.

Iran's Economic Vulnerabilities

The Iranian government's mismanagement of the Iranian economy, its increasingly corrupt business practices, its ongoing threatening and deceptive conduct, and its handling of the recent elections have fostered dissatisfaction, divisions, and discord within Iran and have made Iran an even less attractive business partner.

Some experts estimate Iran's unemployment rate to be well over 20 percent, with a lack of jobs disproportionately affecting the young – three out of four unemployed Iranians are under 30. Inflation remains high at about 13 percent. The banking sector is unhealthy and reliant on government support. Iran is ranked 137th out of 183 countries on the World Bank's Doing Business report, in terms of ease of doing business, and 165th in terms of protecting investors. And, as a result of the Iranian government's economic mismanagement and its self-isolating conduct, foreign investment in Iran has declined. All of this results in decreased opportunities for the people of Iran.

The Iranian government's reliance on corruption and nepotism in business further limits opportunities for all Iranians. The Transparency International Corruption Perceptions Index of 2008 ranked Iran 141st out of the 180 countries. The Iranian government has

increasingly awarded no-bid government contracts to companies associated with the IRGC – a group that counts Iranian President Ahmadinejad and many senior government officials as former members. These companies, some of which have been designated by the United States and the UN Security Council for their role in Iran’s illicit missile program, operate under names that obscure their IRGC affiliation, so many unwitting non-Iranians are in fact doing business with the IRGC.

In the name of “privatization,” the IRGC has taken over broad swaths of the Iranian economy. Former IRGC members in Iranian ministries have directed millions of dollars in government contracts to the IRGC for myriad projects, including developing the South Pars gas field, managing the Imam Khomeini International Airport in Tehran, and expanding Tehran’s metro system. Furthermore, the IRGC seeks to monopolize black-market trade of popular items, funneling the proceeds from these transactions through a patronage system and using them to help subsidize the government’s support for terrorist groups.

There is broad acknowledgment that the Iranian government engages in a range of deceptive financial and commercial conduct in order to obscure its development of nuclear and missile programs and facilitate its support for terrorism. International understanding of these practices – underscored by the UN Security Council resolutions on Iran and six warnings issued by the Financial Action Task Force about the risks Iran poses to the financial system – has been brought about in part by our efforts to share information about Iran’s deception with governments and the private sector around the world.

These deceptive practices taint all Iranian business because they make it difficult to determine whether any Iranian transaction is licit. Iranian banks request that their names be removed from transactions so that their involvement cannot be detected; the government uses front companies and intermediaries to engage in ostensibly innocent

commercial business to obtain prohibited dual-use goods; and Iran's shipping line, the Islamic Republic of Iran Shipping Lines, or IRISL, repeatedly manipulates bills of lading to shield prohibited cargo from scrutiny.

To a greater extent than ever, private companies across industries are now alert to these kinds of risks. Banks worldwide have been repeatedly warned by regulatory and standard-setting bodies to regard Iranian transactions with caution. Traders and shippers know that transactions with innocent-sounding Iranian counterparts can expose them to risk – both reputational and legal. Energy companies have put Iranian investments on indefinite hold, cautious of the political risk of investing too heavily in Iran. And exporters of sensitive and dual-use technologies know that supplying Iran can lead to severe sanctions and even prosecution. Across the board, then, transactions with Iran are already handled differently than transactions with any other country – except perhaps for North Korea – engendering either heightened suspicion or outright refusal to engage in them.

Finally, the vulnerabilities in Iran could be compounded by the internal fractures resulting from Iran's elections of 2009. As Secretary of Defense Gates recently stated: "It's clear in the aftermath of the election that there are some fairly deep fissures in Iranian society and politics and - and probably even in the leadership. . . . [T]his is one of the reasons why I think additional and especially severe economic sanctions could have some real impact . . . [W]e know that the sanctions that have already been placed on the country have had an impact."

United Coalition Necessary to Exploit Iran's Economic Vulnerabilities

This Administration has demonstrated that it is committed to a diplomatic resolution of the international community's issues with Iran. The world is now united in looking to

Iran for a response. If Iran does not live up to its obligations in this process, it alone will bear the responsibility for that outcome.

Under these circumstances, the United States would be obliged to turn to strengthened sanctions. We are intensifying work with our allies and other partners to ensure that, if we must go down this path, we will do so with as much international support as possible. For the less united we are in applying pressure, the greater the risk our measures will not have the impact we seek. This challenge will be difficult, but not impossible. Over the past three years, the U.N. Security Council has adopted three unanimous Chapter VII resolutions against Iran. Those resolutions now represent the baseline. If Iran chooses to defy the international community yet again, and not live up to its obligations, these resolutions as well as other steps taken to date have laid the groundwork for a concerted and meaningful international response.

Conclusion

The Administration remains committed to the dual-track strategy and views last week's developments as a step forward. We will now wait to see whether Iran follows its constructive words with concrete action. If it does not, and if the President determines that additional measures are necessary, we will be ready to take action, ideally with our international partners.

I would be happy to answer your questions.