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SANCTIONS ON IRAN:
IMPLICATIONS FOR ENERGY SECURITY AND THE GLOBAL ECONOMY

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Welcoming Remarks:

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PANEL ONE: STRATEGIC AND ENERGY IMPLICATIONS OF IRAN SANCTIONS:

Moderator:

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Panelists:

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PANEL TWO: INTERNATIONAL APPROACHES TO IRAN SANCTIONS:

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P R O C E E D I N G S

MS. WITTES: Good morning, everyone. Delighted to have you here in the blissfully cool Falk Auditorium. And thank you for coming.

We're gathered today as new American and European sanctions are scheduled to go into full effect on Iran. This is the latest wave of an international effort that, as you know, has been building over a decade or more.

And as this screw has tightened, the sanctions effort has engaged increasingly with issues of the global economy, global energy supplies, the impact on rising powers -- and all of these issues at a moment of global economic challenge.

This tightening of the screw on Iran also comes at a moment of tremendous volatility in the Middle East, with mounting civil war in Syria, with the continued political upheaval in a number of Arab states.

So this really is happening at a critical moment, and it is a series of critical moves. And, of course, we've seen the international negotiations with Iran get under way, but hit some significant challenges.

So the latest measures in many ways represent a major step forward in the pressure on Iran. They represent a real achievement for international cooperation -- and, in particular, I would say, for the trans-Atlantic partnership -- in addressing the Iranian challenge.

But the impact of these sanctions on Iranian behavior and on the negotiations will be depending not only on the actors that are imposing those sanctions -- the U.S. and Europe -- but also dependent on the actions of other actors in the international system, particularly China and India, whose relationships with Iran remain considerable.

So, the issues at stake as we face the implementation of these sanctions really engage, in many ways, the full range of crucial foreign policy issues for the United

States and the world. And it's for that reason that I'm particularly delighted that we were able to put together the program that we've got for you this morning.

Many of you know that I just came back to Brookings after two-and-a-half years away. And one of the reasons I'm so happy to be back is because we've really got the deepest bench in the business to address these kinds of integrated global security and economic challenges. And that's what we're going to have for you in the two panels that will follow this morning.

Panel One, looking at strategic and energy implications of the Iran Sanctions, and Panel Two looking at international approaches -- how will other actors respond to these sanctions. And these two panels represent collaboration across almost all of the major components of the foreign policy program at the Brookings Institution -- the Saban Center for Middle East Policy, the Center for the U.S. and Europe, the John L. Thornton China Center, the Energy Security Initiative, and the Arms Control Initiative. And it is in many ways, I think, the best that we have to offer on these questions.

I also want to take a moment to note that we're introducing today a new fellow at the Brookings Institution, as part of our program, and I'm really delighted that Tanvi Madan is with us now. She is a new fellow in our new India Initiative. And we're really glad that you're here, Tanvi.

I also want to express our appreciation to the Carnegie Corporation, which has supported Brookings' work on these topics for some time, including the work that will be presented at today's event.

And so, without further ado, let me ask our first set of panelists, moderated by Steve Pifer from our Arms Control Initiative, to take the stage.

Thank you very much. (Applause)

MR. PIFER: Okay, well let's go ahead and get started with our first panel, where we're going to look at, really, three questions. First of all, what's the American strategy towards Iran at the present moment? Second, what impact are these sanctions having, in terms of implications for international energy markets? And then, third, what's the view from Tehran? How is this affecting what's going on in Iran?

And, as Tamara said, the international community has been steadily ratcheting up sanctions and economic pressure on Iran. As of yesterday, financial institutions doing business with the Iranian central bank related to oil purchases are subject to U.S. penalties. And on Sunday, the European Union imposes a ban on imports of oil from Iran.

And this is all aimed at affecting the calculation in Iran regarding their ongoing nuclear program which, unfortunately, continues. As of the end of May, the International Atomic Energy Agency reported that Iran had about 6,200 kilograms of enriched uranium, enriched to a level of 3.5 percent, and 145 kilograms enriched to a level of 20 percent. Now, if they put that back through the process and fully enrich to bomb-grade, that's about 90 percent, that would probably be about enough for four nuclear weapons. So there is increasing pressure, in terms of time, as the P5-plus-1 look at Iran.

Now, there was hope earlier in the spring, when the P5 renewed negotiations with Iran, that a way might be found forward, but last week's in Moscow did not produce any sign of a significant breakthrough. There will be a technical discussion next week, but most of the participants coming out of the session seemed to be rather pessimistic about what was going to happen next. I had a chance to speak to one U.S. official who was involved, and he said, in Moscow, both sides put on the table what it

regarded to be a serious offer, and each side found the other's offer wholly unacceptable. So it does suggest that there's still a significant gap.

So the question now is can these further sanctions, can this further economic pressure, affect the calculation in Tehran? And we have an excellent panel here to look at those questions.

We'll start with Ken Pollack, who is a senior fellow here in the Saban Center on the Middle East, and he'll look at the strategy and the logic of the U.S. at present.

Our second speaker is David Goldwyn, who is a non-resident senior fellow here at Brookings, but also president of Goldwyn Global Services. And he'll discuss the implications for energy markets.

And then, third, we'll have Suzanne Maloney, also a senior fellow in the Saban Center here, and she'll talk about how this is all being seen in Tehran.

So, Ken, why don't you get us started?

MR. POLLACK: Thank you, Steve.

Apparently I've been goofing off much too much recently. Because when we started to talk about this, Steve and Suzanne asked me to please cover the past, present, and future of U.S. strategy toward Iran, and do it all in less than 10 minutes (laughter).

MR. PIFER: Seven.

MR. POLLACK: Seven -- okay. (Laughter.) Oh, I've really been slacking. Let's see what we can do.

The policy, in many ways, really begins in 2002. It's not that there wasn't a policy, it's not that there wasn't a concern before 2002, but, of course, in 2002, the world realizes that Iran has made some very significant developments in its nuclear

program. And I guess the best way to put it is that Iran has shifted from a nuclear program that was primarily what was seen as in the research and development stage, to one that has moved into the production phase. With the discoveries of the Natanz and Arak facilities, it's clear that Iran is farther along in its nuclear program than anyone believes. And it's at that moment that the United States and its allies once again begin to think hard about an Iranian nuclear program.

Now, the truth is, the Bush administration really doesn't know what to do for the first two or three years. They're deeply enmeshed in Afghanistan, in Iraq, in the war on terror. That is where their focus is. And for a period of time, they just don't put a whole lot of effort behind the Iran issue.

But in 2004, 2005, they adopt an early version of the strategy that the United States has in place even to this day. It is a policy which President Obama once, infelicitously, actually described in its truest terms: It is a policy of carrot and stick. It is about trying to create incentives, both positive and negative, to get the Iranians to shut down their nuclear program. And it's also worth keeping in mind -- we don't talk about this much -- but it is also an element of American policy that we get the Iranians to give up their support for terrorism, get them to give up their other mischief-making, and stop their opposition to an Arab-Israeli peace process as part of this, as well.

Now, of course, with the Bush administration, you know, the carrot and stick was, of course, long on the stick, and short on the carrots. And it's one of the reasons why the Bush administration didn't get a whole lot of traction with it. Another reason was that even until the end, the Bush administration was, of course, much more focused on Iraq, on Afghanistan, and whole variety of issues. Iran wasn't irrelevant to it, but it was very much a secondary consideration. And, as a result, it didn't get a whole lot of traction.

When President Obama took office, they, in effect, picked up the same policy, but said we're going to actually -- we're going to do it differently. And we're going to put a real emphasis on the carrot piece. We heard this from the president in the campaign. And then, of course, when he took office, he made a very determined effort to try to reach out to the Iranians. Okay, he really wanted a rapprochement with Iran. He put some very serious things out on the table for the Iranians, in the hope that they would reciprocate, that they would be interested in actually having a better relationship with the United States. And I'm going to come back to this in just a minute.

Of course, the problem that the Obama administration had was that the whole premise of this policy, going back to the earliest days, was that it was about the idea, the notion, that there was a debate inside Iran. The idea was, look, we're not going to prevent the Iranians from acquiring a nuclear weapon. We have to convince the Iranians to give it up themselves. And the assumption was that there was -- and I think there was very good evidence for this -- a debate within Tehran for the entire period from 2002 at least through 2009.

There's a group of people who I will call moderates, because I think that is exactly the right way to describe them, who -- it wasn't that they were objecting to having a nuclear program, or even a nuclear weapon, it's just that that was not their highest priority. Their highest priority was the development of the Iranian economy, political reform. They wanted to move Iran in a very different direction, and they made clear, on any number of occasions, that they were willing to make compromises on the nuclear program, in order to secure those other goals. Okay?

The program that -- there was another group within Tehran who wasn't nearly as interested, the group that we typically call the hardliners. For them, the nuclear

program was part and parcel of some bigger, much more important things that they were seeking to accomplish, a different direction that they wanted to take Iran in.

And the idea behind the policy was that we would create positive incentives that would help the moderates, and negative ones that would disadvantage the hardliners. That was the goal of the policy.

And when President Obama came in, that was his objective. That was his strategy. And I give the administration a lot of credit. They made a real, good-faith effort -- again, I'm going to come back to that in just a moment. But the problem they had was that months after taking office, in June of 2009, Iran fundamentally changed. And I'll leave most of this up to Suzanne -- but, of course, June 2009 is when we had the Iranian presidential election, the birth of the Green Movement, and the great crisis of the Iranian regime when they made the decision to crack down on the Green Movement.

And as part of that, there was a purge within the Iranian leadership. And those moderates, the people who we were looking, as part of this policy, to empower, were largely pushed aside, and were moved from the centers of power. And their ability to influence Iranian power was dramatically reduced, maybe even demolished altogether. And so we had a policy that was designed to help empower a group of people who had become powerless -- for reasons having nothing to do with U.S. policy.

Now, it took the Obama administration a while to really grasp that. All through the summer and into the fall of 2009, they clung doggedly to this belief that the moderates were still there and they could help empower them. And it took a very long period of time to get them to understand that, no, this really wasn't going to happen. But by the end of 2009, the beginning of 2010, they began to realize, no, really, it is the case that we're dealing with a pretty homogeneous hard-line government. What do we do now? Well, we've got to shift much more heavily to the sticks side of things.

And, you know, here, I want to give them credit. They did a remarkable job playing, what was at that moment in time, not necessarily a weak hand, but certainly a very difficult hand. They did a remarkable job with the diplomacy. They did put together a remarkable coalition, and they were able to impose some remarkably hard sanctions on Iran. I was among the first people to propose this idea back in 2002, 2003, and when I was first arguing for it, I never expected that the United States would be able to impose the kinds of sanctions that we have so far.

And, again, I wanted to come back to this point -- as part of that, one of the things that was very helpful to the administration had been how they had handled things. In particular, the Chinese -- I've heard this from Chinese officials to my face in 2010 -- they said what the Obama administration did was everything that Iran needed, if Iran wanted a real rapprochement with the United States. And what the Chinese said is, "And take it from us, we went down that road with Nixon. We know how hard it is, we know what's required. The Obama administration did it." And the fact that the Iranians were unwilling to reciprocate at that moment was why the Chinese joined in Resolution 1929 and some of the other very harsh sanctions that were imposed on Iran. Because what the Chinese said is, the Iranians have demonstrated that they are not interested in the rapprochement that the Obama administration is genuinely offering.

Now, the administration had help from another quarter, as well. And it's very important that we mention that. And that is the government of Israel. Okay? The government of Israel has ceaselessly, since 2002, beaten the drum about the threat of an Iranian nuclear program. And perhaps even more important than their efforts to demonstrate the dangers of an Iranian nuclear program, the government of Israel has steadfastly threatened that if the program is not turned off peacefully, they will do it themselves through whatever means are necessary. And I think that we need to

acknowledge that the threat of an Israeli military strike has been absolutely critical, both in driving the administration's own strategy, and in helping the administration to garner the kind of international support that it has.

Again, I give the administration a lot of credit, its diplomacy has been very deft. But the Israelis have been at least half of the diplomatic success that the United States has had, because so many governments around the world are terrified of a new war in the Middle East, between Israel and Iran.

Where are we today? Well, I'm sure we'll get into this in greater detail, but, as you know, the ratcheting up of sanctions, this marvelous coalition that the United States -- with a big assist from the Israelis -- has put together, has imposed unprecedentedly harsh sanctions on the Iranians, and that does seem to have brought the Iranians back to the bargaining table.

But we've now had three rounds of very unproductive talks between Iran and the United States, and the other members of the P5 -- France, Britain, Germany, Russia, China. And from the administration's perspective, they'd love to keep these talks going, at the very least, through the presidential election. As long as the talks are going, it's very, very hard for the Israeli's to strike. And, what's more, it allows the Obama administration to tell a great story about their Iran diplomacy. They employed the carrot-and-stick far more deftly than President Bush did, unprecedented diplomatic success, unprecedented levels of pressure on Iran, forced the Iranians back to the negotiating table, which is something that they didn't want to do. And, you know, "Mr. Romney, you know, what would you have done differently? What could you have done better?" It's a wonderful argument for the administration, going into the elections.

But we're already seeing that it's starting to get very, very hard -- okay? And what we're already starting to see is a debate emerging here in Washington,

between Washington and Tel Aviv, Washington and Jerusalem, and within the administration itself, over how long the United States can keep showing up for talks when the Iranians aren't going to give anything.

And my sense, my strong sense, is that the president's political advisors -- his reelection campaign -- are in there saying keep it going as long as you can. And his foreign policy advisors are increasingly saying, this is becoming very embarrassing, to keep going back and back and back. Because we're convincing the Iranians that we're desperate for these talks. And they can pretty much do whatever they want. And the talks are becoming fruitless. And the Israelis are starting to get restless, as well. And if -- as I am convinced the Obama administration wants -- the United States is going to prevent Israel from actually going to war with Iran, it may require something new.

But that's the big problem for the administration. As they look out into the future, it's not clear what something new, something different, would look like. They've tried one policy -- they tried the carrot when they first came in. When that didn't work, they shifted over to the stick. They have now worked incredibly hard, for almost three years, on the kind of stick piece of it, to bring the Iranians to the table. They've got the Iranians to the table. And now they're getting nothing.

And the big question-mark for them is, if that really isn't going to work -- and that's how it's looking -- what do we do next?

MR. PIFER: Thanks, Ken.

David.

MR. GOLDWYN: Good morning. Sorry, I've been in Washington too long. I can't really say "good morning," without a PowerPoint presentation. (Laughter.) So I'm going to show you a couple of pictures.

But, really, I want to make four points to you this morning. First is that the sanctions, particularly the oil sanctions, have been more painful for Iran than they have been for the oil market.

Second, that this is largely because increases in global oil production, and reductions in consumption, have more than made up for the loss in Iran's reduced exports. And, in fact, inventories have built over the last couple of months, creating great flexibility.

Third, I think this success is a combination of effective diplomacy, second, the inability of shippers to get indemnity insurance, tanker insurance, which has had more of an effect on reducing Iran's exports, I think, than diplomacy. Third, that the price decline, the decline in the price of oil, particularly the Dubai benchmark, which Iran's oil is priced in, has hurt Iran's revenues. And you can imagine a world where prices, in a tighter market prices would have gone up, and really erased the revenue impact of the sanctions. And, fourth, good compliance, due to this flexibility in the market.

My fourth point is that the future, I think, is less certain, because we don't know where demand is going to go, we don't know whether prices are going to go back up. We don't know whether this insurance problem is going to get solved by countries' self-insuring, and whether there's good compliance will be as effective 180 days from now, as it is today. But the future is hard to predict, and that keeps the rest of us in business.

Let me go first to prices. This has been the biggest change over the last year, the price of the Dubai stream, which is the blue one -- the blue one, there. It was \$108 in May 2011, it's down to \$94. And that means, for every barrel that Iran is able to export, they're getting far less money. In a tighter market, if oil had gone to \$130, instead

of going down, Iran might have reduced its exports, but the revenue might have been a wash. So that's been fortuitous.

And price formation happens because of fundamentals, supply and demand -- So there's been more production and less consumption -- but also expectations about future prices. And the fact of this diplomacy, in fact, has taken about some of that \$10 or \$15 fear-factor or uncertainty premium out of the market, as well. So that's been fortuitous.

The second part of the story is production and consumption. And the fact is that over the last year, and even the last six months, production is up, consumption is down, and inventories are building. And we had a one million barrel per day surplus of production over consumption just in the last quarter. And so you can see, the blue bar is "production," and the reddish bar is "consumption," and one's a little bit higher than the next.

And then there's spare capacity, which is how much oil, in particular, does OPEC have in the market that can be delivered to market within, say, 90 days. And that number has dropped considerably, but it's expected to go back up as we see some production increases over the next year. That affects the price because the lower spare capacity is, the more people are worried that if there's a bump in the world, another producer goes off-line, prices will spike.

So this led to the EIA's, I think, report that there's flexibility in the market, prices are in a good place -- but the market is fragile, and another disruption could, in fact, erase spare capacity, cause a price spike and might the use of the SPR to address that concern.

Now, I take a moment here, because we talk a lot about whether production matters. Does U.S. production matter? Isn't all production the same?

The reality is, in the last year, U.S. production is up 900,000 barrels a day. Canadian production is up 400,000 barrels a day. Iraqi production is up 300,000 barrels a day. Libya came back on the market, now it's about 1.2 million barrels a day over the last year.

That was pretty fortuitous, and it made a huge difference. Because if you're trying to impose these sanctions where there high prices, maybe these waivers don't happen because there isn't enough oil on the market. Maybe Iran doesn't get the revenue pinch. Maybe you don't get the compliance. Maybe this diplomacy is a lot harder.

So production matters. And the fact that we have some demand restraint has reduced consumption, but also the fact that, you know, Europe is in shambles, and the U.S. is still not growing very fast helps it all. That could all change, but that has been more than fortuitous. It's made all the difference in the world in terms of the effectiveness of these sanctions. And so we've got to think about whether that's going to remain true.

This is the story on production and exports. And you can see, the blue bar is "production," and the red bar is "exports." The data here are really squishy, but the bottom line is that exports have dropped dramatically over a year. And I think Secretary Clinton said they had gone from about, you know, 2.5 million barrels a day to about 1.5. I think some people may have slightly different numbers.

But the bottom line is 20 countries are complying. A lot of countries have cut back on those exports. Iran is having trouble getting that oil shipped. It's putting a lot on its own tankers, those tankers are also the tankers that normally would have been used to deliver oil to market, but they haven't been able to. They can only fill these tankers for so long, and then one of two things are going to happen: either they're going

to find a way to get them insured, and deliver them to those countries that want to still buy their oil at some discounted price, or they're going to have shut in production at some point, because the logistics will defeat their ability to sustain production. And that is a, you know, an aspiration devoutly to be wished. But it's also something that's really hard to accomplish. And so that's a space to watch.

The insurance has really been key to this, because if you can't move those tankers -- and they have these insurance clubs, which are essentially aggregations of shippers which self-insure. So now those aren't available. You've got to go to private insurers -- European insurers are prohibited, and don't want any part of this -- or sovereign governments have to take that risk of the cost of a carrier, and the cost of the oil, and if something goes boom they've got to pay that out in cash. In the shipping clubs, you don't actually pay that out, it's sort of self-insurance, and everybody ponies up if something actually happens. But this is real money, and real risk -- and we're talking billions of dollars. So it's hard to fix.

But the Japanese government is looking at legislation which would allow it to insure. The Indian shippers have asked for the Indian government to step up with sovereign insurance. The Iranians may decide to go into their \$100 billion reserves and insure it themselves. So we've got to watch that space, and see whether this continues to be true. Because, otherwise, they discount the price, and that oil can move, and then we're talking about a less effective economic impact than we have otherwise.

But the bottom line is, for now, the revenue loss is pretty significant. And, again, you've got to agree on how much has actually been lost, and what's the right price, and whether it's been discounted. But we're talking roughly a \$30 billion loss. That's what Secretary Clinton said: Iran made \$90 billion on export revenues last year. And if you project out to the end of the year, maybe it's going to be \$60 billion this year.

Give or take, we're talking somewhere between \$28 billion and \$32 billion, at current prices.

So that's a bit hit. Is that a big enough hit to force Iran to give up its nuclear program? Probably not. But is it an incredibly effective tool? Is it going to drain the cash? Does it work if you sustain that over a long period of time? I would say the answer to that is yes.

So it's pretty significant. Recession, new production has led to compliance. Price decline has led to a real hit on Iran.

So the question is what's going to happen in the future? Where are prices going to go? What's going to happen to the insurance issue? Will a soft market lead to better compliance 180 days from now? Or will higher prices mean that we have to grant more waivers for less compliance 180 days from now? And will the U.S. government use tools that it has in its toolkit to ensure that the market remains soft and flexible and well supplied so it is easier for countries which are dependent on Iranian oil now to substitute other crude streams for that oil?

Watch this space.

But in the meantime, it's working pretty well. And I would agree, having watched this also since 1991, it's amazing that we are where we are, in terms of diplomatic unity. It's amazing we have the Europeans leading on compliance. And we are extremely lucky that the market is where it is, and that it's actually working.

Thank you.

MR. PIFER: Suzanne.

MS. MALONEY: Great. Thank you. And I want to thank Steve, Ken, and David for coming this morning and engaging in this discussion. I'm the only person here today who has the luxury of working on, basically, only Iran almost all of the time.

But these are all the people that I speak to about what's happening in Iran, and the implications for diplomacy and for energy markets. And I think this is obviously a story that extends well beyond Iran.

But my brief here this morning is to talk specifically to the impact on Iran, and answer what I think is a bit of a conundrum. We've heard Ken talk about the very effective diplomacy that the Obama administration -- building, I would argue, on some of the policies that Ken described that the Bush administration had put into place -- with this very effective diplomacy. David has talked about the sort of forces in the oil markets that have made this set of sanctions particularly effective, without terribly dramatic blowback, either to Iran's typical customers of its crude exports, or to those of us in the global economy who simply rely on relatively stable and affordable energy prices.

So we've got a set of sanctions that have been very effective from the standpoint of diplomacy, from the standpoint of oil markets. What has not yet happened has been the result that we have all been hoping for, which is some sort of resolution to this long-term standoff on the Iranian nuclear issue.

So I'm here to explain that specific conundrum, with respect to Iran. Why is it that the sanctions, in particular, have been working as intended, but have not had the desired result with respect to the Iranian leadership and its position on the nuclear issue?

Let me speak first to the impact of sanctions within Iran, in terms of the broader economic picture, second, to the leadership perspective and logic -- and, finally, make just a couple of points on sanctions as an appropriate tool of U.S. diplomacy, and a mechanism for resolving the nuclear crisis.

First, as some of my prior speakers here today have suggested, the sanctions are really working. And we know that they're having a dramatic impact in Iran. We know this because the leadership, despite a sort of longstanding narrative which

tends to argue that sanctions are not a problem, that the international community, the U.S. in particular, cannot do a thing to hurt the Iranian, sanctions are a blessing, an opportunity, as the oil minister recently said, for Iran to develop its own indigenous capabilities, and to decrease its problematic reliance on unreliable partners in the international community.

In fact, now we have a fairly robust set of commentary from across the political spectrum in Iran, both at a leadership level, and what's coming out in the press, the semi-official blogosphere, and then, of course, the vast social media that exists today in Iran, that suggests that everybody is acknowledging, from the top to the street, that the sanctions are really hurting the country. As David said, exports are down by somewhere in the range of a million barrels a day, which is obviously incredibly significant.

The sanctions are exacerbating a long-term production decline that has been much steeper in Iran than it ought to have been, simply because the country has not had access to technology and capital as a result of the sanctions that have been in place for many years. And so Iran's overall production was somewhere in the range of 3.1 million barrels a day several months ago, which was the lowest level since 1990. We're looking at an overall production decline for this year expected to be somewhere in the range of 20 percent.

Now, of course, Iran has a kind of natural production decline, but this is quite substantial. And it has long-term implications for the country's competitiveness, and for the health of the economy that has always been tremendously reliant on oil exports and oil revenues.

We all know that there was a dramatic slide in Iran's currency, a crash that occurred even before the sanctions began to be implemented, starting in early January, as soon as the United States announced the National Defense Authorization Act

would go into place, the sanctions on the central bank. There was a kind of crisis of confidence. Iranians began trying to sell off rials in massive numbers, and the currency lost about 60 percent of its value in a matter of weeks. The government has stepped in to try to stabilize it. We now have an official rate, which is substantially below where it was only a few months ago, and the unofficial rate vastly -- on a day-to-day basis, depending on the state of diplomacy, and depending on what the sense is of where things are going with the country. We know that there are substantial inflations, particularly on basic foodstuffs, which is really hurting Iranians on the street.

These are the first sanctions in history -- and, of course, Iran has been subject to American sanctions and, to some extent, some multilateral sanctions, over the course of the past 33 years. But this is the very first time that we've seen sanctions have a dramatic and immediate impact on the wallet of the average Iranian, on the quality of life of the average Iranian. Iranians went to the marketplace in November, December, and what they could buy several months later was substantially less. And we know that this is causing a great deal of dissatisfaction among a population which has demonstrated time and again that this regime is not one that represents its interests, particularly with respect to basic economic productivity.

The sanctions have also played into, I think, a sort of psyche in Iran, an uncertainty about what comes next, about the prospects, as Ken suggested, for some sort of a military strike -- a sense of fear and panic that we really haven't seen in Iran. Despite, you know, constant levels of unhappiness and popular resentment of the regime, and economic problems over the years, we haven't seen this sense of sheer panic, hoarding of goods, people trying as desperately and as quickly as possible to expatriate their capital and, where possible, themselves and their families.

And all of this builds into an economy that has experienced massive disruptions from, particularly, the financial sanctions, the banking restrictions that have been put in place over the course of the past decade by the United States and, more broadly implemented by the international community, as well as a long-term history of mismanagement. Iran grew, its economy grew over the course of the past decade, but that growth was really just a function of the very high oil process that the world experienced. Iran has never performed, since the revolution, to its potential, has never sort of emerged as the economy that most Iranians and, certainly, others in the Middle East recognize is its potential.

So why is it that this amount of financial pain is not having an impact, or not producing the sort of concessions that, in particular, I think the administration really hoped that it would. When you spoke to senior U.S. officials over the course of the past six months, what you kept hearing was, you know: Whatever they may say in public, the leadership, the regime understands just how devastating these sanctions are, and just how devastating they're likely to become over the course of the next few months.

And yet, what we haven't seen is a tremendous increase in flexibility at the negotiating table. The Iranians came to the table, there was some excitement and optimism for the first time in years about the prospect of a negotiated resolution of the standoff, but we've really gone nowhere. And I think that, to some extent, has come as a surprise from this side.

I think if you understand where the Iranian leadership is, and their own experience, it's not so surprising. And at this stage, I would argue that they have explicitly adopted a kind of survivalist approach to these sanctions.

I wasn't always certain of that, I would say. But it's quite clear, at this point, they believe that they can weather the storm. This is a legacy of the post-

revolutionary experience: an economy that has been disrupted, and suffering from chaos, since the revolution itself, since the massive upheaval of the revolution, and then of the war, an economy that has dealt with sanctions for many years.

And it's also a country that has been the subject of several prior international oil embargos -- not simply the U.S. cutoff of oil purchases, first the embargo in 1979, and later relaxed and reimposed, but also an embargo between 1951 and 1954 that was the product of the Iranian effort to nationalize its oil industry. This is a historical episode which tends to be remembered for the U.S. intervention, the coup, and the legacy that that produced. But for Iranians, that two to two-and-a-half year period in which the entire international community refused to purchase Iranian crude -- and Iran, at that time, was one of the major suppliers of Middle East oil -- the fact that Iran survived, the fact that the economy survived is remembered in a very different way than that embargo may be interpreted here.

The regime believes it can rely on the tools that it has used to deal with U.S. sanctions for much of the past three decades: evasion, sanctions-busting efforts to try to woo countries that may be fence-sitters to engage in backroom deals. There are ways that they can mitigate sanctions, and they've been working at this for many, many years. Even the subsidy reform program, the removal of subsidies which resulted in higher prices at the pump, and higher prices for basic commodities, but cash pay-outs to the average Iranian on a monthly basis was an effort to ensure that the economy could be more self-sufficient, and some of the vulnerabilities, like the reliance on imported gasoline would be mitigated.

And this is also a regime that is quite comfortable with the idea of austerity. Remember that so many of the hardliners who are in positions of influence in Iran today have a sort of nostalgia for the period of the war, this halcyon moment in which

the entire country came together. The war was fought, and the war was waged in Iran -- the war with Iraq -- simply because the regime was able to adopt a fairly draconian policy of austerity. It was not pleasant to live in Iran during those years. And that is something that the average Iranian remembers, perhaps more than those from the Revolutionary Guard, who are eager to reimpose these policies. But it is a recognition that Iran can survive even drastic economic difficulties.

David's chart, I thought, was, you know, incredibly powerful in showing the decline in revenues, and the decline in production. But recall, of course, that Iran's production has been, and its revenues, have been substantially higher over the course of the past few years than was historically the case. The 73 billion that Iran earned in 2010, estimates of 88 billion in 2011, from oil exports, contrast this with 1985, '86, when Iran was engaged in a total war with its neighbor, and oil revenues topped just about \$6 billion for that year.

So this is a regime that has direct experience, and believes that -- it is prepared to sacrifice 5, 10, \$20 billion in potential revenues this year, in order to preserve what it believes is a more important asset.

And the second element of this logic is that there is certainly a cast of characters in Iran who do this kind of narrative of sanctions as an opportunity. And believe me, you hear this coming from the leadership. And some of it is certainly propaganda, it's an effort to rally the country. But there are those who believe that sanctions have, in fact, helped Iran by forcing it to cut off some of its very high import bill, by forcing it to export more in order to engage in the barter trade. The only way that they are, in fact, able to import is if there are export goods, first. So, in fact, it is improving the overall structure of the Iranian economy.

There are also many Iranians -- and here I would say this is not just the hardliners, or those from the regime right now who are convince of this -- who see the West as potential at least as vulnerable as Iran is, and so have believed from the outset that the United States, in particular, would be very cautious in the way that it implemented these sanctions, to avoid massive escalations in the price of gasoline, and particularly during an election year. And, of course, the fact that we've now granted waivers to, I think, something along the lines of 20 countries contributes to this sort of a conviction that, in fact, the world is going to let Iran continue to export at a level that is probably viable, tolerable, for the regime.

And, finally, there is, I think, a logic that holds that Iran's leverage increases if it can, in fact, persist. You know, they see survival as a victory -- even if it comes at a very high economic cost.

I'd say there are a couple of problems with this logic -- and David has really gone into some of the details about them. One is the fact that oil prices have declined, and that was not, of course, the trend that we saw in the initial aftermath of the announcement of these sanctions. It has come as a result of the increases in production from the Gulf and North America, as well as the disarray in Europe. But it's something, I think, of a surprise to the Iranians. They were, I think, hoping to count on prices that were somewhere in the range of \$100 a barrel, because it made it easier for them to find purchasers for gray-market barrels, and it made it easier for them to consider discounting purchases, where necessary.

The other piece of this is regional flux, the regional flux that is potentially looking to cost them their most longstanding ally in the Middle East, in Syria, but also the sense that this is a region that is not the quiescent, popular opinion that existed only a few years ago, at least on the surface. This is a region in which we have seen upheaval

change governments. And Iranians have a very different view of the Arab Spring, a very different view of the role of popular movements.

But it's got to make the regime quite nervous when they see Facebook campaigns around this whole issue of price increases -- people engaging in boycotts of consumer goods because they're upset about the prices, and the extent to which so much of this is going to play out on a popular basis. The regime knows that it's vulnerable. It's very careful about its economic, about the level of economic grievances in the population.

Finally, let me just say a couple of words on sanctions as an instrument of policy, and their efficacy with respect to Iran. I would argue that, you know, they're obviously quite powerful. They hit at the Iranian regime's bottom line, and it's a bottom line that matters to these guys. Don't kid yourself, this is a regime that has gotten very comfortable in power, and comfortable with the perks of power, and the access to the massive oil revenues. And so the decline, the difficulties in doing business, the overall shrinking of the revenue really hurts Iran.

But the sanctions also play into the basic problem that we have with the negotiations, which is that it's almost impossible to build trust with this regime. They don't believe that, in effect, if they give something that they will get something in return, and they're probably not wrong about that. They're going to get very little for anything other than a wholesale capitulation on the nuclear issue, as well as the other issues that we have at stake with Iran. They're not going to get wholesale sanctions removal in exchange for modest confidence-building measures on the nuclear issue. And, as a result, it makes it very difficult for them to make the first move.

The sanctions do provide leverage for the West, but they also may increase the price. The Iranians, from the outset of this standoff on the nuclear issue

have suggested they want to be compensated. They want something in return. This was the reason that the suspension that the former Iranian government had engaged in eventually collapsed, that before Ahmadinejad's inauguration Khatami, in fact, approved the decision to restart the enrichments because the Iranians believed they weren't being effectively rewarded for their concessions. They want to be rewarded.

And we have to decide, I think, from this standpoint, whether or not having a process, having at least the fig-leaf of some sort of diplomacy on Iran is worth the concession of providing some sort of relaxation of sanctions.

And, finally, let me just say, you know, I think it's very powerful to think a little bit about this prior embargo, the 1951 to '54 embargo with respect to Iran. It was incredibly effective. Iran exported, over the course of two-and-a-half years, about the same as it had in a single day prior to the embargo. No one was buying Iranian oil. The embargo worked, and it was a victory for the international community.

But, obviously, it was a short-term victory, because the long-term implications of what happened in Iran, of the way that that embargo led to an intervention that was incredibly disastrous -- for our interests in the region and, I think, for political development in Iran -- is a lesson we might pay attention to as we move forward into, I think, an uncertain future on Iran.

Thanks.

MR. PIFER: Thank you.

Let me pose the first question, which is about time. And I go back to -- I think it was in 2010 there was the sense that something had to happen by the end of 2010 or there would be need for dramatic action. And then 2010 we moved to 2011, and also the timelines seemed to stretch out.

So, Ken, let me ask you, looking out over the next year -- and you discussed the pressures on the White House now, with a political desire to push this down the road, with the foreign policy people saying we may be reaching a crunch point - how do you see the timeline for Washington?

And then, also, how do you see the timeline for Israel? I mean, if Washington has a one-year timeline, it loses its relevance if Israel's timeline is six months.

And then if I could just add two other parts to that -- maybe, David, anything that would happen, that you would see happening in the energy markets over the next year, in that timeframe, that might either increase or decrease the efficacy of the sanctions in the oil sphere?

And then, Suzanne, anything happening in Tehran in the next year that would be a crunch point, in terms of perhaps leading to a change in their approach.

MR. POLLACK: Thanks Steve. Yeah, this issue of time is a critical one. When I wrote my book *Persian Puzzle* back in 2004, about this entire issue, I introduced this metaphor of "the tyranny of the two clocks." And the point that I was making there is that you've got different clocks. And since I put up the two clocks, people have added a third clock, fourth clock, fifth clock -- I don't know how many clocks we're up to now.

But, as you point out, there are a lot of clocks ticking, and they're all ticking at different speeds, and they're all set to go off at different times. And a lot of the problems that we've had on Iran have been reconciling all these different timelines, all of these different ticking clocks.

In some ways, the most important clock out there has been the Israeli clock -- okay? And, you know, the good news here, I guess, is, as I said, the Israelis have been remarkably effective in driving the Iran train.

I mean, again, back in 2002, when the Israelis started doing this, I figured they'd be able to cry wolf a certain number of times. I never thought they'd be able to cry wolf four times a year for 10 years -- and they've done it. And, you know, you've got to give them a lot of credit. And, you know, again, let's give them a lot of credit in terms of they have focused international opinion on Iran, and they've done it without actually going to war with Iran. That's actually a good thing for everybody involved, except for the Iranian regime that may want to have nuclear weapons.

But we just don't know where the Israelis are. I mean, my conversations with the Israelis, it is very clear the Israeli people do not want to go to war with Iran, and the Israeli elite is very concerned about going to Iran.

But they also have this tremendous fear of an Iran with nuclear weapons. The Iranian system is very opaque, they don't quite know where the Iranians are, they don't quite know what the Iranians ultimately want from this program. And they don't quite know what the Iranians will do when they get to the end of it.

What we have seen from the Israelis, though -- and, again, I think it's worth keeping in mind -- is that the Israelis have actually been quite patient. Now part of that is because they don't want to go to war. They don't have a great military option. But, you know, they will say, "We will do it if we have to." But what they saying is, if you give us an alternative, we will take the alternative.

So one of the things that's out there, one of the most important things, has been the fact that the U.S. and the international community has answered the Israeli call, and has, you know, put this pressure on the Iranians. And the Israelis have actually been quite patient.

The Israelis have one big thing lying out there, which is the Fordo facility in Iran, which we've not yet mentioned, which is this nuclear enrichment facility built deep

inside of a mountain near the city of Qum. And the Israelis are very concerned about it because it is probably impervious to an Israeli strike.

And one of the things that we've been doing in the negotiations is demanding that the Iranians close down the facilities, the Fordo facility, and the Iranians have very consistently been telling us to take a hike. And the Iranians are on really good grounds to do so, and they're going to keep doing so, because their point is: You want us to stop doing this, you want us to close this facility, so that we will be more vulnerable to someone else's aggression.

"Okay, where's your basis in international law for asking us to do this?"
Okay, they're on very sound ground, and I think it's going to be very hard to do that.

But for the Israelis, they are very concerned. They are fearful. Ehud Barak has talked about Iran entering a zone of immunity. And that will happen probably at some point in the fall or the early winter.

Now, again, there's nothing that says the Israelis will definitely strike. It's just that the Israelis will have a decision to make.

On the U.S. side, I think it's a very calculation. I think that the administration has already suggested, wants the current policy, wants the current situation to prevail at least through November 9, 2012. Again, where things are now, in a kind of broad theoretical sense, is exactly what they want. It's exactly what they need. It allows them to tell the best story that they can imagine, going into the election.

And any other change, any other development, is going to be worse for them. And it will be worse, if only because they have invested so much into this policy over the last three, three-and-a-half years. And it would be very problematic, in the run-up to the election, to have to admit that it all failed. It's also very problematic because, as I've also suggested, they don't yet have a good alternative.

This is an administration that doesn't want to go to war with Iran. We've heard the President suggest that he will, if he has to do so. I have no way of judging whether that is true or not. But what I do know, and I'm certain of, is that the President would prefer not to have to go down that road. And I think that is also very clearly the case for most of his senior advisors, as well. They don't want to go to war.

They also do not want to see Israel go to war. But the question for them is, can they push that Israeli window out at least past the November timeframe?

And then, you know, a last point to make -- go back to something that Suzanne said -- you know, so far, the West has not been terribly forthcoming in these negotiations, in part because what we've been asking for is bigger things from the Iranians, in return for bigger things from us. But a big part of that has been about our own elections, has been about not wanting to look like we're making concessions to the Iranians in the run-up to our elections.

I suspect that we might be a little bit forthcoming after the elections. But, again, the question is, can you preserve the talks or, if the talks break down, could you reopen them after? And if they break down beforehand, what do the Israelis do in the interim?

MR. GOLDWYN: Well, Steve, oil markets are notoriously volatile, so lots of things can happen in the next six months to a year that could either drive prices up, or send prices down.

On the upside, you could have a spike in demand, a situation in Europe where the risk of, you know, financial collapse in Spain and Italy recedes, people think that European demand might recover, and you could see that demand actually recover and prices go up. Brent went up \$2 to \$3 this morning, based on the euro zone deal yesterday. So that could be a surprise.

The U.S. economy could recover significantly and demand could pick up. Or Chinese demand -- in fact, Chinese policy to stimulate demand could change. Those are all possibilities on the upside.

You could have a supply shock. Iraq has done well, but Iranian mischief in Iraq could provide a supply disruption. Internal dissension in Iraq could cause a supply disruption.

Libya, a very fragile government, and seeing how the elections go there, you could have disruption in Libya. There really is no national police force, there really is no security. It's incredibly fragile. They've stormed the gates of the prime minister's office, you know, at least twice, maybe three times in the last few months. That's fragile.

If Chavez dies, in Venezuela, you may have some sort of popular uprising there. Low probability, I think, but you could have a disruption in Venezuela.

And then the largest one, which is in Iran's control, is the Iranians could do something which -- either a military attack, or something in the straits which would send the price of oil up 30 bucks, probably overnight, and that's in their control.

And the last would be cutbacks in OPEC policy. I think also unlikely, because Saudi Arabia sees that its increased production and this price moderation is helping on Iran policy -- in fact, indispensable to Iran policy. But a change in OPEC policy which had a cutback in production could send prices up and tighten the market.

So I think all of those are things that could surprise to the upside.

But, on the other hand, you could have a lot of things that could send prices down, which is Iraq could make more progress on infrastructure, as it seems to be doing, and you could see another 200,000 barrels a day of production there. You could have progress on infrastructure in the U.S., and better efficiency and movement of Canadian oil south, and Bakken tight oil east, as well as moving oil out of Cushing south,

so you could see more liquidity in the U.S. system, and that U.S. boom. And you could see an action by the United States and the IEA to release reserves from the Strategic Petroleum Reserve, and the IEA through their reserves, in response to a potential price spike, which could send prices down dramatically.

So, as the oil markets like to say, the prices could be \$30 higher, or \$30 lower six months from now from where they are right now. The tail risks are huge, and most of them are not in our control.

MR. PIFER: Suzanne?

MS. MALONEY: On the Iranian side of things, they, of course, also have an election coming up next year, a presidential election -- although I don't suspect that that's going to play a major role in shaping their approach to the nuclear issue. The nuclear issue has been, and at this stage is now very clearly in the hands of the Supreme Leader. Presidential politics are much more of a side-show than I think we have always understood them to be, with respect to this core security issue.

I think the Iranians are looking very clearly, as Ken said, to our electoral timetable in shaping their own sort of sense of time sensitivity and urgency. They will play for time until the elections, and they may see more incentive to move after the elections.

The other piece of this, of course, is something David referred to, which is the fact that the Iranians have already stored quite a bit of oil on tankers floating, with their GPSs turned off, around the world. Eventually, they're going to run out of storage space, and they're very averse to shutting in production to actually, you know, beginning to shut in fields, because it will be very hard to restart those. So, at a certain point, they're going to have a need to do something more drastic in order to get the oil to market. And that may begin to incentivize them a little bit.

MR. PIFER: Great.

Okay, let me go ahead and open up the floor to questions. If I could ask that you could identify yourself, and also your affiliation, and wait for the microphone.

First question up here in the front.

MR. HASSAN: My name is Hassan. I was born in Tehran. I have an organization called Global Bridges for Humanity.

And my question is to the panel: How would the Iranian government and the people comply with the international -- so-called international -- demand of them to stop building a bomb that Iranians are not building?

And I can repeat that question again. How could the international community stop the Iranians of building an atomic bomb which Iranians are not building?

Thank you.

MS. MALONEY: I can give a short answer and then turn it to Ken, who I suspect will have a better answer.

My short answer would be that the international demands are not to stop building a bomb. The international demands -- as codified in U.N. Security Council resolutions, about five them to date -- are for Iran to suspend its production of enriched uranium, and other measures. So that is what is requested of Iran, and that is what, thus far, Iran has refused to do.

MR. POLLACK: I think that is the right answer. And, you know, there is a lot of debate as to exactly what the Iranians are up to. There's a lot of debate, in particular, about how much the Iranians are doing on the weaponization part of it.

You know, it is clear that this enrichment program, though, is weapons-related -- in part, because there's nothing out there on the civilian side that the Iranians are doing. And there's a whole lot of other evidence, as well.

But, you know, you are getting to the point, which is there's a lot of ambiguity around this. And, you know, I think that, in particular, our experience with Iraq, where we thought we were certain -- in fact, we thought we were a lot more certain about Iraq than we think we are about Iran -- you know, needs to inform what we're doing.

And, of course, we need to -- our colleague Dennis Ross just put a piece in *The New Republic* pointing out that, you know, look, at the end of the day, we're going to have to recognize that Iran does have certain legitimate rights. And a solution probably is going to have to accommodate those legitimate Iranian rights.

At the same time, you know, what the P5-plus-1 have been trying to do is to impose certain constraints that will prohibit the Iranians from actually developing an arsenal -- which, of course, is prohibited by their signature of the MPT.

So you're absolutely right, this is a very, very difficult, very, you know, problematic, very ambiguous situation. And, you know, at the end of the day, it's one of these where you've got to have both sides willing to act in good faith if you're going to make it work.

And, of course, one of the biggest problems that we've had is that neither side trusts the other. And so we're not there yet. And we may never be. But, *insha Allah*, we will.

SPEAKER: My name is Niku. I also was born in Iran, and actually, I'm a living history, I went through the revolution, I was in the (inaudible) war. And I'm not a politician or study history or politics, but my hobby is history and politics.

Go back to mention in regarding the carrot and stick policy which was developed almost the end of the Bush administration, and then his side was stick is longer than the carrot side. And then come back to the Obama, basically, you had the longer carrot.

But if you know that -- I remember before Khatami leave the office, he shut down the enrichment process for two years -- I believe. As Ms. Maloney mentioned, that he is the one ordered, before he leave the office.

To take us back to this question, what is really going on behind the scenes? Forget about all these headlines, you know. We go from the point to telling the Iranian government people, "You don't have a right to have a nuclear bomb," let alone -- I mean, I'm sorry, you have no right to have a technology of the atomic activity, let alone have a nuclear bomb.

Now we got to a point, they say, okay, you can have an enrichment technology up to (inaudible) percent.

I mean, this is a game. Where are we heading? I mean, come on, let's just be honest with ourselves, and tell exactly what's going on.

In my opinion, the way I look at it, the West wants Iran to have the nuclear bomb. You go back and look at the history of the nuclear bomb, go back to World War II. We go look at it. Hitler developed the nuclear technology. He's the one, basically, his administration, shut down the development of the Germany in 1941. Suddenly, in the three, four, six months, you got the Manhattan Project started.

You go back to the Cold War -- all the way back. It's always a game.

So where are we going, really? Is the issue the bomb, or just something that's going on behind the scenes?

MR. PIFER: Do want to take a crack at that one, Ken?

MR. POLLACK: Sure.

I've worked on the Middle East for 27, 28 years. And one of my great experiences with Iran, which I've worked on for that entire period of time, in a whole variety of capacities in the U.S. government and elsewhere, I've always been struck by

the fact that whenever I've really gotten close to an Iranian, and developed a really good relationship -- in almost every case, and there are some exceptions, some of whom are sitting in the audience -- but in almost every case, at some point they'll say to me, after years and years of knowing each other, and friendship, and getting together, they'll say to me, "Come on. Explain to me, be honest with me, why did you guys put Khomeini in charge?" (Laughter.)

And my answer is -- you know, this is -- we seem to be all-powerful, and we seem to know what we're doing in Iran. And let me promise you that we don't.

We have no capacity for this stuff. And most of what happens in Iran is exactly the opposite of what we want to have happen. And, you know, in my 25, 26 years of working on Iran, that has been the consistent message. In fact, again, when I wrote *Persian Puzzle*, not to keep talking about it too much, but the point that I made there is, look, we've kept trying to manipulate internal Iranian politics to make it work out the way that we want to, and the one consistent lesson from it is that we keep getting exactly the wrong answer. And so trying to do that is a mistake.

I will assure you: the United States government does not want Iran to have a nuclear weapon. If I know anything in this world, it is that. We're not always very good about how we go about preventing it. I think we've had some successes, I think we've had some failures.

I think, you know, the bigger sets of issues, really, for the United States -- if I can kind of take your question in a little bit different direction -- is what kind of a relationship do we want with Iran? And, of course, related to that is what kind of relationship does the Iranian government want with the United States? I think we have a better sense of what the Iranian people want, but I don't think that we know what the

Iranian government wants. And I don't think that the U.S. government truly knows what it wants from a long-term relationship with the Iranians.

And, for me, my greatest concern, the thing that has been frustrating to me over my many years dealing with Iran, has been this incredibly short-term American focus on whatever the crisis du jour with Iran was, and then the moment that the crisis went away, trying to forget about Iran as fast as we could, because it was such a difficult country, such a problematic country. And not taking advantage of the periods when we could, to try to fashion some kind of a longer-term strategy toward Iran.

MR. PIFER: If I could just offer a perspective -- you know, having followed this for awhile, too -- the big choices have been: Do we really want regime change, or are we talking about containment and coexistence, and crossing our fingers that maybe the Iranians will change the regime?

And those have been, I think, two big areas. And there have been U.S. administrations which have sought regime change, without success. And there have been others that had, particularly Democratic administrations, which have offered a hand, only to see it rejected.

And I think we're in the world now where there's no secret that, you know, that seeking, actively seeking regime change is not viable and not likely to be effective.

Containing the nuclear program, and hoping that Iran will evolve is where we are. I don't think it's been very inconsistent. I think, pretty much since the revolution, that's where U.S. policy has been, and that's where it's evolved. And the more we realize we have very few tools to cause that change, and the more we actively try to promote the change, the less likely it is to occur, the more we end up where we are right now.

But the big red line is enrichment, and eventually a bomb. And I think that's where every administration is going to be. And I don't think we've every really taken our eye off that ball. It's just a question of, you know, how much it's been, you know, in the top two, or the subject of actively diplomacy.

MS. WITTES: Thanks very much. Tamara Wittes, Saban Center at Brookings.

I'd like to ask Suzanne maybe if you can help us get a little bit of a sense of thinking in Tehran about how the confrontation over the nuclear issue relates to what they see going on in the rest of the region.

I think many of us looking at developments across the Middle East in the last year see a lot of disadvantage to Iran in the broader situation -- that, you know, at the ideological level, the sort of narrative of resistance and confrontation as a way to achieve dignity has been undermined by peaceful revolutions and Arabs' finding their own way to make change. And then Syria, of course, threatening Iran with the loss of an ally of 30 years.

So you can look at that and say, well, Iran is under tremendous pressure. This should give us greater leverage on the nuclear issue.

But how do you think they see it in Tehran? And is this inclined to make them tighten down further, rather than be more flexible?

MS. MALONEY: That's a fantastic point, because my sense, at least from what I see in the press, and the leadership statements, and the blogosphere, is that they absolutely see the regional context and the nuclear issue as directly related to one another, and indivisible. Which is to say that their approach to the region, first and foremost, has been one that is very opportunistic. They may be objectively in a less positive position as result of the democratic upheaval, and the pro-democracy

mobilization around the region but, instead, the leadership identifies, senses a sort of familiarity to this process, both in the sense of old autocrats with incredibly strong relationships with the United States tumbling wholly unexpectedly, but also in the sense of chaos and uncertainty that now exists in many of these countries.

I mean, look at what's happened in Egypt over the course of the past few months. Even the sort of death-watch over Mubarak must be intensely familiar to those sitting in power in Tehran, who went through something somewhat parallel with the shah.

More, I think, directly, there is a sense that the sanctions are part of a broader strategy of soft war that is, you know, coordinated, and involves this sort of mobilization of peoples, and attempt to create faux "color revolutions" across the region, and then penalize governments that remain in place. And here, I would go back to the sort of 1951 experience, in which sanctions did precede external intervention and an externally orchestrated coup.

And so, you know, they look at these sanctions very much as an element and a tool of regime change. And they see what's happening across the region as evidence that, in fact, the U.S. is using this tool elsewhere in Syria, even if that doesn't entirely fit the narrative, and it certainly doesn't fit the reality of what is happening across the region.

And the end result, I think, is to make them that much more averse to compromise, that much more skeptical of a negotiating process, and that much more intent on receiving a higher price for any sort of cooperation that they do demonstrate as part of this process.

MR. PIFER: I see a question here from the back.

MR. COPERT: I'm Stanley Copert.

We've been through this before, with Japan in the late 1930s, early 1940s. We sanctioned Japan. Sanctions were very effective. But the Japanese replied by attacking Pearl Harbor.

The Iranians recently may have instigated responses. In Thailand there were attacks on Israeli diplomats, for example, in New Delhi.

What if sanctions are effective, but we have the Japanese model as the precedent? What if they respond to the stick with a stick?

MR. POLLACK: This is a great point. And Suzanne and I love it, because we've both written pieces recently warning of exactly that. And, you know, warning of the fact that, not -- let's remember, you know, we haven't really talked about it too much -- but not only is the West trying to employ sanctions against Iran, but there is a very active covert war being waged against Iran. It is being waged in cyber-realm, in a Stuxnet and Flame.

It is being waged in the realm of covert action against Iranian nuclear scientists. You know, I'm reminded of, you know, *Someone is Killing the Great Chefs* -- well, someone is killing the great scientists of Iran. I don't know who it is, but I've got some guesses. And the Iranians clearly have some guesses. The Iranian government believes that someone is making contact with a whole variety of armed Iranian opposition groups.

And I think that, you know, we are seeing the Iranians responding to that. And, you know, this government, this regime -- to go back to a point that I made that this is now a much more homogeneous hard-line regime than we have seen in the past, and their MO has typically been to fight fire with fire. You know, you push us, we're going to push you right back.

You know, when I think we all heard the news about these attempts to assassinate Saudi Ambassador Adel al-Jubeir by blowing up Cafe Milano, we all kind of went, "What?"

But, you know, the evidence that has emerged increasingly indicates that this was a very live operation. Whether it was a contingency operation, or one that had been ordered is a matter of debate, but it seems more and more clear that they were thinking about doing this.

And I think that that is very consistent with exactly this point that you're raising, which is that we need to recognize that the Iranian MO has been to fight back under these circumstances. And I suspect that we are going to see more along the lines of the Iranian responses that we've seen. And it's why -- I think that, you know, we need to simply be awake to this fact that going down this road is not likely to just cause the Iranians to take the kind of passive response, the survival response, of "We're just going to dig in, and we're going to, you know, hunker down and withstand it and get through it." They're probably going to push back.

And one of the things that we need to keep in mind is that a lot of their push-back is because of us pushing in the first place.

One of the concerns that I've had is that the Iranians will push back, and the American reaction will be, "My God, this was entirely unprovoked" -- okay? And we will go nuts, because we see it as an unprovoked Iranian action. It may not be an unprovoked Iranian action.

That doesn't necessarily mean we should roll over and take it. That doesn't necessary mean it will be outrageous, egregious, illegal -- all of those different things. But we should recognize that, you know, both of us are tangoing here.

MS. MALONEY: And let me just add one quick point to that, which is that there isn't just a strategic logic for an Iranian response. And I think Ken is exactly right, it really does play into the mindset of the current leadership.

There is an opportunistic economic logic. Because if you want to change one element of the context, you may not be able to change a lot of the broader economic conditions, but you can change all the things that David talked about. You can change the overall sense of the market that there is currently a sufficient supply by, you know, doing something relatively modest.

But those relatively modest actions -- whether it's trying to intensify chaos in Iraq, or to sponsor groups in Arab Gulf states, that might have intentions of harassing or blocking exports there -- could have a really dramatic escalatory impact on a set of circumstances. Particularly the regional dynamic in the Gulf is so toxic right now that you can see something relatively small-scale on the Iranian side playing into a process of escalation that becomes very ugly very quickly.

MS. ELLIOT: Kim Elliot, with the Center for Global Development.

And I wanted just any of the panelists sort of to speculate a little bit. I mean, I don't think it's surprising that Iran didn't respond immediately. I mean, the whole history is that sanctions, even if they're working economically, have an economic pain, take time to translate into a political response. And so I think this whole issue of the time, and trying to get past the U.S. election is critical. And there are many things that could disrupt that, and make that impossible or difficult.

But just assuming for a moment that we do get past the election, and that Obama is reelected, I'd like to ask you, if you could, I mean, what are some significant sanctions that he might offer to suspend -- not lift, perhaps, but maybe suspend -- that

could be reimposed real easily and quickly, but that would get Iran's attention, that really might open the door?

And then what should he ask for? Not to, you know, solve everything in one fell swoop, but at least to get a really serious negotiation going that might to a resolution of this.

Any ideas?

MR. GOLDWYN: Well, if I could offer one not to do, I'd say it has taken so long, and it's been so remarkable, to get particularly the EU embargo and the insurance sanctions in place, that I would not give that up unless for a serious and sustainable concession on the part of the Iranians. Because the economic pain, at least for now is real, but the aggregate impact, if you sustain it for a year, or you sustain it for a year-and-a-half, is significant. One of those impacts is the potential shut in production, but the more important one is the ability to change the supply relationship with Iran's primary consumers.

And if you're able to develop those relationships between those refineries, and particularly in the Asian countries, and other suppliers, and they get good long-term supply arrangements in there, you will have had a permanent shift in the structure of the oil market.

And that's not something I would give up very easily, because it's taken decades, I think, to get where we are right now.

MS. MALONEY: And my answer will only highlight why this is such an intractable problem, because I would have argued that, particularly the insurance ban on the European side, is the lowest hanging fruit in the sense that it is causing a lot of headaches in a lot of countries that we don't wish to make difficult, and that there are a

lot of people even in Europe who would prefer to see that one at least deferred rather than implemented on Sunday.

So -- and yet, as David suggests, it required an enormous amount of diplomatic heavy lifting to bring the Europeans to this point, and there are tremendous consequences as a result of these sanctions.

I would say, from the U.S. side, there is almost nothing we can lift very quickly and offer up, even after the elections. It's not simply the political consequences, and the extent to which the administration leaves itself vulnerable to critiques from either Republicans or from Israel that I think hamstrings us. It's really, if you look at the content of these sanctions, and the justification for their imposition, they have been determinations that specific institutions have been engaged with development of weapons of mass destruction and/or promotion of terrorism.

And until and unless you have an American administration which is willing and able to certify that the central bank, or the, you know, range of other Iranian financial institutions and entities are no longer involved in those activities, it is literally not possible to remove those sanctions. They are permanent elements of the landscape now with respect to dealing with Iran, until and unless we see a radical change in the approach of this regime.

MR. POLLACK: Kim, I just wanted to take your question in a different direction, because I've been waiting for someone to ask something along this line, and I'm so glad that you did.

Because I want to make a different point, which is I was one of the guys all through the 1990s who was responsible for keeping the sanctions in place on Iraq. David was, as well. That was, in my mind, a searing experience. That was a horrific

experience. And I am very frightened that we are making the same mistakes with Iran that we made with Iraq -- okay?

The mistake that we made with Iraq was to miss the point that you made, which was that sanctions, when they work, take a long time to work. And we've had a bad habit of thinking that you can use sanctions to create a short-term psychological shock which will then force an unfriendly government to change its policy completely -- okay?

I am hard-pressed to find an example of history when that occurred. Typically, you get the opposite response, and typically, you just get nothing for a long time. And in those cases where sanctions did work -- whether it be South Africa, or Libya, or Iraq itself -- it took years to make it work -- okay?

And what we found in the case of Iraq in the 1990s was that the sanctions that we imposed were so draconian that they became unsustainable.

We have imposed extremely harsh sanctions on Iran. And we have invested an enormous amount of political and diplomatic capital to get those sanctions. And I am afraid that if we don't get the psychological shock that we are looking for -- and, I suspect, for all of the reasons that Suzanne laid out we're not likely to do so -- we're going to find it very hard to keep these sanctions in place and intact.

The laws will stay on the books -- okay? And the U.S. will continue to abide by them. But the rest of the world probably won't -- okay? By 2002, the Iraq sanctions were hemorrhaging. Even our closest allies were simply ignoring the laws -- their own laws and international law -- and going ahead and trading with the Iraqis -- okay?

And I am afraid that we will wind up doing the same thing with Iran. It's why I always wanted a much more gradual ratcheting up of the pressure on Iran than

what we've done, which looks to me like that. And, again, that's exactly what we did on Iraq, and what we saw was we just -- we tried, we invested a lot, and over time, we just couldn't hold it.

That's my fear of what we've done in Iran, as well.

MR. PIFER: In the back?

MR. THIELMANN: Greg Thielmann, Arms Control Association. And I wanted to key off a remark that Ken made, that we are convincing the Iranians that we're desperate for negotiations, or continuation of talks.

And in light of the fact that it seems like we toughened up our position between Baghdad and Moscow on the all-or-nothing part of the three demands, and that we did not dangle any kind of sanctions relief, even knowing that new sanctions are going to be imposed, could you elaborate on what the Iranians are convinced that we're desperate for talks?

MR. POLLACK: I'll start, but I'll turn it back over to Suzanne, as well.

I mean, look, first, Greg, as you well know, we have no idea what the Iranian government is thinking. This is all conjecture, it's all speculation on our part.

What I'd say is that, you know, what has been remarkable to me is we've had worse and worse and worse talks with the Iranians, and yet we keep agreeing to come back -- okay? It's really hard to know, you know, if you're just an outside observer - - and this is the Israeli position, as well, you know -- just looking at it on face, why on earth are we showing up for the expert talks in Istanbul after what happened in Moscow? Why exactly did we agree to Moscow after what happened in Baghdad?

We got nothing. The Iranians went in the opposite direction, and yet we still came back to the table.

And, you know, you're talking about how the American position has hardened, the Iranian position has hardened. And I see that as the Iranians clearly are not fearful of what the consequences of a failure would be. And, probably, they are increasingly comfortable, confident, that the talks won't fail, even as they harden their own position.

MS. MALONEY: I'm still trying to interpret what's happened over the course of the past two-and-a-half months in this dialogue.

You know, it's the first time we sat down in a serious way with Iran in, you know, almost a year-and-a-half, and, you know, they were substantive talks, they were detailed, and they were sustained over a day or two at each point. But that's not a lot of data to understand and to test what is possible from a negotiating process with Iran.

So, I'm not clear if they're desperate and we're desperate. I think they can read the sort of basic calendar, and recognize that this is an administration that does not want a Middle East war erupting on the eve of a reelection campaign. It's just -- there's no possible way that they can miss that obvious reality. And so they've got to recognize that they have -- the administration is more eager to see something come of this process, in order to hold off pressure from Israel, in order to make a case to its Republican adversary that its diplomacy, that its foreign policy writ-large has been a successful one.

So I think that piece of it is obvious.

I also, you know, spend a lot of time looking at Iranian history and, you know, our colleague Bruce Riedel has a fantastic new volume coming out that looks at the American role in the Iran-Iraq war. And one of the passages in that book, which is a sort of oral history of a number of American officials and other players, talks about how

the Iranians came to the table in the ultimate negotiations that led to the U.N. Security Council resolution and the cease fire.

And the foreign minister at that time came to the table and said, "I must have a deal. I will not leave here without a deal. Those are my orders."

I don't think we have seen that yet from the Iranians. (Laughter.) Whether or not they're eager, they're more ready to come to the table as a result of sanctions -- yeah, that's probably the case, although I would say they've been signaling for months and months, prior to even the first round in Istanbul, that they're ready to do something, or may be ready to do something on the 20-percent issue.

But we have not yet seen an Iranian negotiator, or an Iranian leadership which is clearly invested in an end to the standoff. And I think there is a sense of brinkmanship on both sides, where the West -- and, in particular, Washington -- believes that as these sanctions begin to have a greater impact on the economy, and on popular opinion, that the regime will become more eager for a solution. And there is a sense on the Iranian side that if they can just withstand long enough that, in fact, they will have gained the upper hand.

And, you know, it's unclear how that's going to play out.

MR. RICHMAN: Al Richman, former State Department.

Print accounts suggest Iranians made a strong point of the right of enrichment, but not necessarily high enrichment, 20 percent.

I wonder if there's -- to inaudible 01:26:24), whether they were leaving some room to negotiate on that basis.

MS. MALONEY: I think we all believe that there is, you know, more possibility to work on the question of 20-percent. Ahmadinejad talked about it as long ago as last fall. The Iranians have effectively said they're only enriching because they have

to, and if they can come up with a deal, they'd be happy to have one. But we've never been able to find terms that both sides seem to believe are acceptable.

I think this whole question of right-to-enrich is one that's complicated. I tend to believe that there are rhetorical formulas that we can find that would overcome that -- in particular, to the extent that I hear more coming from Iran now about, you know, "The issue is weaponization, the issue shouldn't be enrichment." This is the world that they want to get to.

And, ultimately, our concerns are about weaponization. Our concerns are about weapons capability.

And so, you know, if we had the sort of basic conditions, the fundamental conditions that one needs for a successful negotiation -- the possibility of building trust on both sides, and an investment in a solution on both sides -- I think we could actually fashion something that would be mutually tolerable. But Steve and Ken may have better thoughts on all that.

MR. PIFER: No, I mean, the Iranians, their rationale right now for enriching to 20 percent is to support the Tehran research reactor. But I think most experts believe that, even with the enrichment to 20 percent, that they don't have the technical capability to actually produce the fuel to make that reactor run, because they don't have the needed specifications and expertise.

There was an interesting statement, I guess about a week-and-a-half ago, where Iran said, I guess one of their naval commanders said they were going to build a nuclear submarine -- which I think most would argue is probably well beyond Iran's capacity. But maybe that's another rationale.

But it does suggest that, you know, maybe there is a way they could get up to 20 percent, which I think would be seen as a positive step. But how quickly they're prepared to make that step is unknown.

MR. POLLACK: They may build it. I just, I wouldn't want to serve on it.

(Laughter.)

MR. PIFER: Okay. The person back here.

MS. BRAZYAH: My name is Menush Brazyah. I'm BBC Persian Service. This is a question for Ken.

You mentioned that prior to 2009 election, President Obama made serious offers on the table for Iranians. Can you elaborate on that, and tell us what was the offers? And what was the Iranian response.

MR. POLLACK: I'm not going to elaborate too much. There were a whole range of back-channels that were opened up. And I give the administration a lot of credit, they did it both kind of the front-door and the back-door. They publicly made it clear -- the President made a number of statements -- but, privately, they were broadcasting on all channels.

Actually, the most useful way to answer that question, though, is to again not talk about what I believe, what Suzanne believes, what we heard from these different entities about what was being talked about, but again to go back to that point that I made about the Chinese. And maybe I'll elaborate on that a little bit.

Because, again, there's a lot of debate on our side about who said what and who did what -- and whether it was a genuine offer, and whether it was something that the Iranians could have, should have accepted.

What I find so dispositive -- and before I really did go to Beijing and start to talk to the Chinese, and also, you know, our wonderful experts in the Thornton Center

here, which, you know, we have a world-class group of China experts who were echoing the same point. And I didn't really know what to believe in terms of, okay, how real was this? What did they put on the table? Had they really put on the table what they said they put on the table?

It was really striking to me to hear the Chinese talk about it, and to say, look, you know, we've been down this path. We were exactly where the Iranians were, back in the 1960s. We went through this. And what we saw from the Obama administration, the conversations that we had with them, the messages that they asked to pass to Tehran, the things that they did to convince us that they were genuine, absolutely convinced us that they were genuine.

And, again, that they went to the Iranians on any number of occasions and said, "What the Americans are offering you is everything that you need. If you want a rapprochement, the Americans are serious, and they've given you what you need."

And, you know, what the Chinese, in effect, said was, look, a rapprochement does not start with both sides having everything under control, and saying exactly what the other side needs. It's always ugly. There are always spoilers out there who will say the wrong thing, who will try to sacrifice it.

But once you've made a strategic decision that this is in your interests, you work past that. You get past the suspicion, you get past the spoilers. You push all of that aside, and you focus on what you need.

And what they said is, "The Americans have demonstrated that they want this, and they've given you the opening that you need. If you want it, take it. And we advise you to take it."

And the Iranians couldn't, wouldn't do it.

And, of course, I don't feel like I have enough insight into the Iranians to know exactly why they didn't. But they clearly were not ready.

And, you know, for me -- again, this goes back to previous instances. And, obviously, there have been lots of periods of time when the Iranians were willing to signal maybe some readiness to have something, and the Americans weren't. But there were also periods of time when the Americans demonstrated -- and, again, I was part of that at the end of the Clinton administration, where we twisted ourselves into a pretzel for the Iranians, did everything that Khatami's people asked us to do, and the regime still wasn't ready. And it wasn't Khatami's fault. I think he wanted it genuinely. But there was this other piece of the regime that just wasn't ready.

MR. PIFER: Okay, we've got about six minutes. I'm going to take three quick questions, and then we'll give each of our panelists a chance to comment.

Start here?

MR. SLIFKA: Hi. Randy Slifka. First, I just want to say thank you, Brookings, and to the panelists for this excellent day of discussion.

So, we haven't spent too much time on the Israelis, and I was hoping to spend a minute or two trying to understand the red lines, and particularly with respect to timing of red lines, versus the U.S. election and the zone of immunity.

And then, just as a follow-up, in terms of the Chinese and the Russians in particular, we haven't spent very much time talking about the negotiations. I mean, the Russians hosted this event, and there was a fair amount of dialogue with the Russians, and there's been a fair amount of feedback that both the Russians and Chinese may not have been as constructive during this negotiation as they might have been.

I was hoping to get the views of the panelists, particularly on what sort of went on behind the scenes with respect to the Russians and the Chinese in the most

recent negotiations, and how that could have played out differently, or might play out differently in the future.

MR. PIFER: Two more questions.

Okay.

SPEAKER: Ken, I actually, I want to ask this question to you, and I know that we don't have any insight in what is in the mind of Obama or his close advisors, but based on your, you know, contacts and your experience, I want to know -- we all know, or we all also agree, as the panel said, that up to election time, November, nothing is going to happen in terms of military.

But I wanted you to speculate -- "speculate," I want to underline it -- what you see, or what possible scenario would you see comes after November, both, you know, in terms of how U.S. is going to contain Israeli, you know, threats for actions? Or, you know -- and new action by Obama? Because as you also admitted to, there is already debate in Washington from the right toward, you know, the President (inaudible) for Obama to do something more.

So I would really appreciate a comment on that.

MR. PIFER: One more, over here.

MS. ASSID: Hi. Carleen Assid, Department of State. Thank you for your presentations.

My question is about the U.S. electorate and U.S. interests. I'm curious to know what the panel sees as benefits to overcoming this issue with Iran -- aside from staving off a confrontation that we might get involved with -- that would make the U.S. electorate make this a priority that they would reflect in their vote in November.

Thank you.

MR. PIFER: Okay. Ken, do you want to start?

MR. POLLACK: Sure. I'll pick up the two threads, because they're in many ways linked, the Israel and the America question, in terms of moving forward, and timelines, and things like that.

What's striking to me is that both American and Israeli officials speak in categorical terms, and they have to. It's very important for them to do so. But the moment that you get them in private, everything becomes gray. The black and white goes out the window.

They're both trying to make calculations -- American policy-makers, Israeli policy-makers -- about what they could do to the Iranian program if they acted against it, what the danger would be from the Iranian program if they didn't act against it. What the other would do if they acted, or -- that is, what the Israelis would do if the Americans acted, what the Americans would do if the Israelis acted. What the Americans would do if the Israelis didn't act. What the Israelis would do if the Americans didn't act.

It's an incredibly complicated set of calculations.

And, of course, it's not limited to just those two actors. You know, Tanvi raised the question of the Arab Spring. There's an incredible -- I was in MS.

SYLVESTER: a few weeks ago, and when you start talking to very senior Israelis about these questions, you start getting -- Egypt, you start getting Syria. And you start talking about Iraq, and Turkey, and Saudi Arabia. And all of this goes into it, as well.

And the debate is all over the place. We had an earlier question, you know -- for some Israelis, the events of the Arab Spring have made an attack on Iran a better proposition. For other Israelis, it's made it a worse proposition.

And my experience with them is, it's the traditional Rorschach test -- how they answer depends on what they believed before they ever started to think about this before the Arab Spring ever began. So it's an incredibly complex set of calculations.

You know, I think that the Israelis are very, very concerned about an Iranian program, but they're also very, very concerned about what their strike would do -- that it wouldn't actually end the program, and it could create other problems for them. It's why the Israelis have very, you know, consistently said, "We want you to take care of the problem so that we don't have to."

And it's why -- you know, this conversation about red lines. And, again, in public, the Israelis always have to talk about red lines. In private, they look much more like pink lines to me -- okay? Because the Israelis are absolutely torn about what to do. And it's why Steve's earlier question about the timing is so important. Because I could see the Israelis making very different calculations at different points in time, depending on what was happening at that moment, and where other things were.

And I think the same thing is true for the United States leadership. I am, you know, quite convinced that Barack Obama does not want a war with Iran. I am quite convinced he doesn't want an Israeli war with Iran.

Is it impossible to me to imagine that things might play out differently?
No, it's not impossible. Because a lot of things could happen.

And I'll be honest with you, to a certain extent, I'm much more concerned about, you know, this issue raised earlier of the covert action campaign and, you know, if we get into a covert war there, and the Iranians do kill, you know, somebody important at, maybe it's not Cafe Milano, you know. Maybe it's Clyde's that they blow up. You know, God only knows what the United States of America does under those circumstances. And I actually see that as, in many ways, a much greater risk of provoking an American war, than a direct attack in response to Iranian noncompliance. Because that's going to be a very hard one to do.

But, you know, it's why I think that we need to be very, very careful when we try to make predictions about the future on this. This is an absurdly complicated issue. And all of the different actors out there has deeply contradictory interests going into it, where what they want -- and they want very, very much -- runs in very different directions. And in many cases, they are hoping that the actions of other actors are going to save them from having to make the choice between these dilemmas.

MR. PIFER: David?

MR. GOLDWYN: I would just say, I don't know that the general American electorate spends a lot of time thinking about whether regime change or containment, or Iran policy is at the front and center.

But I think, since the polling shows that they're mostly worried about jobs, the economy, and maybe domestic terrorism, I think the biggest risk for the administration is starting a conflict which blows up at home, and which sends oil prices through the roof. It would be a hard time explaining to people the complexities of why we intervened in that way overseas, and caused so much trouble here.

So I think that's probably what the administration has its eye on. That's a real serious risk. And while constituency politics plays a high priority on ending the Iranian nuclear program, as the general electorate, I think you've got to worry about blowback, I agree, more than anything else.

MR. PIFER: Suzanne?

MS. MALONEY: Just to echo David, I think there is almost no one in the United States who is going to determine their vote in November on the basis of the Obama administration's policy toward Iran -- which is why, in effect, you've seen a decline in the extent to which the Republicans are talking about Iran today, as compared with the early period of the primary, when there was a lot of jousting and a lot of tough

talk. No one is going to go to the polls either because they're pro-engagement or opposed to engagement. And there's probably even a lower likelihood that people are going to go to the polls because a candidate promises he's going to take a potentially more aggressive, and even military approach to dealing with Iran.

So it's not a winner of an issue for either side.

And, finally, to the point of what happened in the latest rounds of negotiations, and Russian, as well as Chinese, approach to those, I will use this as an opportunity just to flag our next panel, which has world-class experts speaking precisely to those issues. And they know far more than I would ever be able to offer on those subjects.

So look forward, and I hope you all can stay.

MR. PIFER: Good segue.

Okay, we've intruded five minutes into the coffee break. Could I ask you to get your quickly and then be back here at 11 o'clock for our second panel?

But first, join me in thanking our panelists. (Applause.)

MR. BANKS: Ladies and gentlemen, if we could get started, please.

Good morning, ladies and gentlemen. Welcome to our second panel of today's event. This panel will address international approaches to Iran sanctions. My name is John Banks. I'm a nonresident fellow in the Energy Security Initiative at Brookings.

Our panel today comprises three outstanding Brookings experts. To my right is Fiona Hill, senior fellow and director of the Center for the U.S. and Europe. To her right is Erica Downs, a fellow in the John L. Thornton China Center. And at the end is Tanvi Madan, a fellow in the India Initiative. I won't take any valuable time reading their bios. I believe those are provided in the handouts that are available.

Our format will follow that of the previous panel. We'll start with introductory comments from the panelists, followed by discussion, and then audience question and answers.

The three countries forming the focus of the discussion today, along with the EU, are certainly very critical actors in Iran policy and sanctions, particularly from an energy and economy standpoint as we heard this morning. The EU, China, and India together as major oil consumers account for about 60 percent of Iran's oil exports. And with oil sales accounting for about 65 percent of government revenues and 80 percent of hard currency earnings, significantly reduced sales from these three have the potential for very severe impacts, as we have seen, on Iran's economy.

And Russia, as one of the world's leading oil producers, certainly is well positioned in terms of its existing pipeline infrastructure as well as the ability of its Urals

crude to substitute for Iranian crude to realize enhanced oil revenues. Of course, as we heard this morning, there are major global economic trends and oil prices playing a role here. As David highlighted quite well, I think, the drop in economic demand as well as robust supplies has certainly put downward pressure on prices. And this seems to have led to a situation in which it's easier for oil-consuming countries to adapt to the sanctions.

But there is much more to this than oil markets, and this is what we'd like to expand on today. As I think Ken phrased it toward the end of his presentation, this is absurdly complex issue. There are certainly many factors that influence the approaches and motivations of all three countries in the EU that we'll address today. Each has its own set of complex domestic issues, motivations, and interests, not to mention their own approaches to policy with Iran, with each other, with regional powers, and, of course, with the U.S. So we hope today to sift through these complex dynamics and shed some light on the major factors, which influenced their respective policy approaches to Iran and the sanctions, the current status and impacts of their policy, and implications going forward, especially for U.S. policy.

So with that, I'll turn it over to Fiona to start the panel comments.

MS. HILL: Thanks very much, John. And thank you very much, everyone, for staying around for the second panel. You've already covered a lot of ground in the first with our colleagues here, and I'd like to start off first by talking about the EU and then I'll move on to Russia.

The EU is one of the, in many respects, the unsung heroes of the sanctions from the United States' perspective here and that's why I'd really like to begin with the EU because they're generally given quite short shrift in discussions about sanctions because we tend to fixate on the U.S. sanctions or sanctions at the U.N. level. And frankly, if it hadn't been for the EU working very closely with the United States, we

wouldn't be seeing a lot of the action that we have been seeing over the last two years. EU has really played an instrumental role in leading the sanctions initiatives with the United States and it's been instrumental as the partner, frankly, with the United States in dealing with Iran over this same period.

The EU generally has the same sets of concerns the United States have, the same kinds of debates that we're having here play out in EU capitals, in Brussels and in other cities: nuclear proliferation, regional security, Iran's role in sponsoring terrorism, and the EU also puts quite a lot of stress on the human rights dimensions in Iran itself. And we can pick upon some of these later if anyone's interested.

Like the United States, Iran also has -- the EU countries, rather, as a whole also have large Iranian diasporas and a very close set of ties with Iran on economic, political levels. There are large numbers of Iranians who used to study in the EU and continue to do so. There are large numbers of current Iranian citizens who live in EU countries because Iran still generally has an open-door policy for its citizens for moving around internationally. And, of course, there are long histories of interactions with Iran dating back, in some cases, centuries. And many of you are well aware of the fact the United States has, in some respects, picked up the mantle of the rather uncomfortable relationship between the country that I originally came from, the United Kingdom/Great Britain and Iran, which Great Britain used to be the Great Satan long before the United States appeared on the scene. Somewhat of an uncomfortable issue there, but nevertheless -- and the Iranians actually have some good reasons for being not so happy with the United Kingdom. Remember all those discussions of the Great Game? Well, they also involved Iran. Rudyard Kipling wasn't just about Russia and Central Asia. Iran had an unfortunate role to play there, usually as the victim of a UK British policy at different points. In any case, we'll move along that way.

All of this notwithstanding, the U.S. and Europe have continued to work very well together. The E3 -- we're always throwing around all these acronyms. There's a P5+1. The Europeans also call it the E3+3. It all depends on whose perspective you're talking about at this period. But the E3, this mysterious grouping of the UK, France, and Germany -- UK and France obviously having their permanent positions on the U.N. Security Council and the Germans having a significant role to play, too -- they've all been critical at the U.N. level. But there's also the role of Lady Ashton, the equivalent of the EU foreign minister, and the European External Action Service, which has been playing a very important role in the direct dialogue with Tehran. While everybody else has been flitting around on the U.N. level, Lady Ashton has actually been meeting, having very serious meetings, the kinds of dialogues that our colleagues were just talking about, with principal players on the Iranian level in many different localities and has exchanged a number of letters. So Lady Ashton also has a role to play there.

The EU has also been very forward-leaning on its own set of sanctions. So we've tended to talk about the U.S. unilateral sanctions, but the EU also has unilateral sanctions, and those have also been mentioned in the context of the last panel. Because the latest package of EU sanctions that were passed this year in January have really hurt Iran. There's always this impression that the EU can't really hurt you. Well, the EU's hurting itself quite a lot right now with the euro zone crisis, but there's a hard edge to the EU soft power. And while the United States has had very limited trade and interaction with Iran over -- well, for several decades now, that's not been the case at sort of the outset with Europe. There's been a lot of trade with Iran.

And the sanctions, which have covered not just energy and oil, have really had an impact, and a number of people have pointed this out. Because the EU sanctions have not just restricted Iran's nuclear program, where they've really done a lot

to hamper Iranian trade on (inaudible) technologies, and a lot of manufacturing goods, but there's also been a series of financial sanctions, especially on electronic payment systems, the SWIFT sanctions. The United States had some experience of that itself a year or so ago. And that's really hurt the operations of Iran Central Bank, and our colleague Suzanne Maloney has done a lot of work on this issue. And they've also obstructed Iranian trade with Europe across the board, so we've really seen a downturn in Iranian trade with Europe as a knock-on effective of these sanctions.

And the most significant sanction has been the denial of European insurance services for the shipments of crude oil from Iran, which many people have been talking about. And that's had reverberations well outside Europe, including on countries like China and India, which I know will also be talked about by Erica and Tanvi. Many Asian oil importers have had to scramble around trying to figure out how they're going to insure their oil cargoes as a result of Europeans denying insurance provision.

Now, all the exemptions that the EU has imposed on its sanctions against Iran, so giving breaks, the kinds of breaks that we've just heard have been given for China and Singapore, on some of the sanctions by the United States will expire this next week on July 1st. So the EU sanctions are actually going to bite even harder than they have already.

And this has not been an easy task at all for the EU. Just to conclude on the comments about the EU right now, given the euro zone crisis it's been very difficult for the EU to maintain unity. There are three countries in particular that have been very hard hit by the sanctions, especially the sanctions on the oil embargo, and those are the three that are the most vulnerable right now as we pick up the papers on the euro zone crisis. They may be doing well in the European soccer finals, but they're not doing so well when it comes to the economy, and that's Italy and Spain in particular, and then also

Greece. So, as you can imagine, it's been very difficult for Brussels to keep up the pressure and the Italian, Spanish, and Greeks have had to scramble to really find out other sources of oil to substitute for their imports from Iran. So this is a very heavy lift for Europe and Europe continues to deserve a great deal of credit from the United States.

So I'll move on quickly to Russia and try not to take up too much time, but I know that there was a question from Randy about, well, what are the Russians up to and then obviously the Chinese, and we can talk about this a little bit more. Now, Russia is actually part of this E3+3 because the "3" are Russia, the United States, and China at the U.N. level. But also, Russia has a different role to play, along with China and India, because of their perceived roles as rising powers with very divergent interests when it comes to the E3 and the U.N. and the United States.

Russia guards its U.N. status very jealously, and the U.N. and how Russia plays in the U.N. factors into Russia's calculations about what it's thinking about when it deals with Iran at this level. Russia traditionally is not a fan of sanctions. I mean, not just traditionally, but period, they're not a fan of sanctions. They're not a fan of sanctions at the U.N. level because they often get targeted against Russia and they're certainly not a fan of unilateral sanctions be they EU sanctions or U.S. sanctions because these do hurt Russian interests. And again, Russia is very well aware that the United States Congress in particular likes to also sanction Russia. In fact, we've got a whole raft of sanctions against Russia that we've just imposed. So Russia has a long history of blocking sanctions at the U.N. level and certainly trying to undermine everybody else's unilateral sanctions. And this goes across the board irrespective of what they're thinking about Iran at a particular time.

Now, you might point out that, of course, Russia went along with the last draft of U.N. Sanctions 1929 back in June 2010. And there was a number of factors at

play there that I'll try to tease out a little bit and we could talk about some more in the questions and answers. And I'm sure it will come up in the context of China and India.

The first factor there was Iran really made Russia angry. Iran and Russia have a long history of interstate relationships and they also have a long history of cooperation to some degree on the civilian nuclear program of Iran, as everyone is well aware. But Iran concealed information about the extent of their nuclear weapons program also from Moscow. The revelation about the secret site at Qom was a revelation also for Moscow that prides itself on actually knowing more about what's happening than everyone else. Well, this time they found out that they didn't and they were particularly angry that Tehran had managed to conceal this from them as well.

In addition to their anger with Iran, Moscow was also trying back in 2010 to calibrate all of its difficult relationships with everyone else, not least with the United States, but also with other key players in Europe, most specifically Germany, which is the key political and economic interlocutor for Russia and Europe. And the Germans were pretty far-reaching on their response to Iran as well and they have been one of the driving forces in Europe in terms of imposing sanctions, and the Germans put a lot of pressure on Russia. They're the biggest importers also of Russian natural gas and also a major importer of Russian oil, so the Germans do have a few levers which they can play with the Russians.

The other country that the Russians are factoring in in 2010 has already been mentioned in the last panel, and that's Israel. I think already David Goldwyn and others brought out the fact that Israel's relations with a lot of the major players has changed quite dramatically over the last several years, and that's very much the case with Russia. We've just seen Mr. Putin on a state visit to Russia. You wouldn't send many secretary generals of the Soviet Union on state visits to Israel in the past, and that

just underscores how much the relationship with Israel has changed, the result of a 1 million-plus population in Israel now that is Russian-speaking having immigrated from the Soviet Union over several decades.

The relationships have changed in other ways, too, in that Russia, pretty much like everybody else, is very interested in Israeli technology, be that software, computer technology, but also UAVs, drones that Russia has filed to be able to replicate itself. And I think we'll find out that that's the case in other countries. So Israel is a different factor also for Russia. Israel put a lot of pressure on Russia.

The same with the Gulf countries, especially Saudi Arabia. Given everything we talked about at the last panel, the role of Saudi Arabia, with its hand on the spigot of oil production, is a very important one for Russia. Russia's economy remains very much dependent on oil and oil prices, and it's Saudi Arabia, not Russia, of course, that calls the shots on the international oil stage in terms of being able to affect the price of oil. So Russia is very mindful of that relationship.

And plus, Russia is also a large arms seller to the Gulf and to the Saudis. And again, more levers that the Saudis have to remind Russia of some of their interests.

And then, of course, there's the question of really how Russia factors in the larger relationship with Iran, apart from being angry with Iran about the Qom program, there's the Russian trades with Iran itself, and this is actually much less than people usually factor. There's all this idea that the Russian role in the nuclear program in Iran, the building of the Bushehr reactor, is a significant feature for Russia when it thinks about whether it should support Iran or not. In fact, Bushehr has already been built, the money has already been spent. And where Russia might have been hoping many years ago that Bushehr might be a flagship for the renaissance of its nuclear program, let's just say nuclear programs around the world are not in a renaissance stage right now thanks to the

Fukushima disaster. And, of course, all of the anniversaries of Chernobyl that have been cycling through the news recently, Russia's nuclear program is hardly a great model for the future. And John has been working on these issues for some time and can certainly underscore this. There's not much hope that Russia is going to get more contracts globally as a result of having built Bushehr, so that's just not an issue anymore.

In terms of Russia's arms sales, those have been a priority over the years, but, again, there's been a lot of pressure from other purchasers of Russian arms for Russia not to sell to Iran. And there was the classic case of the S-300 missile defense system that Russia was going to sell to Iran in 2010 that was pulled back, largely from pressure from the Saudis and others who would otherwise be buying from the Russians.

So basically, overall, the trade with Iran has not been as significant as it has been in the past, so that's not really been a factor. It's just the strategic relationship with Iran that remains a key element, and I think we can talk about this more in the Q&A. It's how Russia tries to factor in Iran's role regionally. There's the Syria issue. There's all the different questions that we've had on the table in the last panel that Russia looks at. So Russia's always looking at how is Iran going to play in larger strategic questions and then the interaction with our other topics of discussion here: China and India and how everybody else is going to be factoring in Iran and their relationships with the United States. So it's the strategic element that remains the biggest question for Russia and they always calibrate that on where things are standing at a particular juncture.

So I'll hand over now to everyone else.

MR. BANKS: Erica?

MS. DOWNS: Okay, good morning. I'm going to discuss China. And what I'd like to do in my allotted time is, first, to review quickly some of the factors

shaping China's response to the U.S. sanctions on the Central Bank of Iran. Then I'd like to discuss China's response so far to the sanctions, both at the level of the Chinese government and at the level of China's oil industry. And finally, by way of conclusion, I'd like to say a few words about the 180-day exemption that the Obama Administration granted to China yesterday.

So in terms of the factors that have been shaping China's response to the sanctions on the CBI, these are in no particular order, but I'd like to highlight five. The first one are Chinese views on sanctions. Like the Russians, the Chinese are no fans of sanctions. Like the Russians, they find unilateral sanctions to be more distasteful than multilateral sanctions. And like the Russians, they have a history of being subject to U.S. and European sanctions.

A second factor is energy. China's national oil companies have upstream investments in Iran and they also buy a lot of crude oil from Iran. Last year, Iran was China's third largest supplier of crude oil behind Saudi Arabia and Angola. And China imported north of 550,000 barrels per day from Iran.

A third factor are China's concerns about nuclear proliferation. China, like the United States and other players, does not want Iran to acquire nuclear weapons capability. However, that said, in my view Beijing probably regards a nuclear-armed Iran as less of a national security threat than the United States does.

A fourth factor would be China's relationships with key players on the Iranian nuclear issue, so that includes other permanent members of the U.N. Security Council as well as regional actors, like Israel and Saudi Arabia. I think it's fair to say that of those different actors, the United States is probably the most important because the China-U.S. relationship is China's most important bilateral relationship. And while Beijing, you know, doesn't want to see tensions over Iran increasing friction in the

bilateral relationship, I think it's also sort of tired of repeatedly being asked to play ball on the subject of U.S. unilateral sanctions.

And finally, the fifth factor I'd like to highlight are the corporate interests of a Chinese oil company called Sinopec, who's actually a key player in this drama on the Chinese side. Sinopec is the biggest Chinese buyer and probably the biggest buyer overall of Iranian crude. And almost all of the oil that China imports from Iran ends up in Sinopec's refineries. However, Sinopec also has ambitious plans to expand its presence in the American upstream, and I'll say more about that later.

So how has China responded to the U.S. sanctions on the Central Bank of Iran since President Obama signed them into law on December 31st? I'd like to address this question from both the government level and the corporate level. The Chinese government has been sort of consistent in its response, at least publicly, over the past six months. And the statements that we repeatedly hear from the Ministry of Foreign Affairs in Beijing is that China is opposed to unilateral sanctions; that the U.S. sanctions on the CBI are not going to have any influence on China's energy, trade, and investment ties with Iran; and that the sanctions that China is complying with are the U.N. sanctions on Iran and China's energy ties with Iran, the oil that it buys, the investments that it makes are compliant with those sanctions.

However, when we look at how Chinese oil companies are responding, the story is a bit different. As I mentioned earlier, a Chinese company called Sinopec is the biggest Chinese buyer of Iranian crude. And every year, in late December -- sorry, in late November, early December, Sinopec sits down with its Iranian counterparts to negotiate their oil contracts for the following year. So in late 2011, when Sinopec sat down with the Iranians, new U.S. sanctions on Iran, sanctions on the CBI were already a done deal. And Sinopec knew that and so it sought to take advantage of Iran's increased

impending international isolation to press for lower prices and a longer credit period.

And as many of you know, this contract dispute dragged on until late March and, as a result of this dispute, we saw China's oil imports from Iran plunge. They dropped by more than a third in the first quarter of this year and through the first 5 months of this year they're down 25 percent.

There's been a lot of discussion in the press about what was the driver of this dispute. Was it just a commercial dispute or were there political overtones? And my take on this is that this is really a case of commercial activity creating political opportunity. And what I mean by that is that I think Sinopec had strong commercial reasons to press for better contract terms. As I mentioned before, it's the biggest Chinese buyer of Iranian crude. When oil prices get above \$80 per barrel, Sinopec as China's largest refiner is the one that's most hurt by Chinese state-set controls on refined product prices. And so it had very strong reasons to try to get the Iranians to sell for less and to give Sinopec a larger period to pay for that.

However, I think that this dispute really provided the Chinese government with a political opportunity. And what I mean by that is it provided Beijing with a way to sort of be supportive of the U.S. sanctions on Iran without ever having to admit that that's what they were doing. As you probably know, there haven't been any public requests from Beijing for a waiver. There haven't been any statements that we, you know, support this enterprise and, therefore, we're going to go along with it. And so that's what I meant by commercial activity creating political opportunity.

And I should also mention that I think Sinopec also has strong reasons not to dramatically increase its liftings from Iran. And, in fact, Sinopec earlier this month announced that it's actually targeting reductions of 16 to 20 percent in its imports from Iran over this year. And I think one of the commercial incentives for Sinopec to do so is

what I mentioned earlier, which is that they have big plans to expand in the United States. Earlier this year, Sinopec agreed to invest \$2 billion in shale assets owned by Devon Energy, so that's more than they've pledged to invest in upstream projects in Iran. And there were reports in the *Financial Times* last week that Sinopec's actually looking to buy assets in the U.S. from Chesapeake Energy.

And the head of Sinopec is a man named Fu Chengyu. And many of you may have heard that name before because he was the man who ran CNOOC, or China National Offshore Oil Corporation, when CNOOC made its bid for Unical back in 2005. And so Fu knows from going through that experience how getting on the wrong side of politics in Washington can really scuttle a deal. And so my sense is that he and Sinopec had very good reasons not to take advantage of Iran's isolation and buy up lots of that crude that's sitting on tankers because even though Sinopec is an oil company and not a bank, isn't going to be sanctioned under the sanctions on the CBI, I think he's quite aware of the political optics and how this could play out in a negative way for Sinopec politically.

And finally, by way of conclusion, I'd just like to say a few words about the exemption that was granted to China yesterday by the Obama Administration. It looks like that exemption was granted based solely on the numbers. Some U.S. officials have come out and said the Chinese have reduced their crude imports from Iran, you know, by 25 percent so far this year. In our book that constitutes a significant reduction, so we've given them a 180-day waiver.

In my view that is justified if you look at the percentage reductions and the volume reductions of other countries that have gotten by or gotten exemptions, especially other buyers in Asia, because it is countries in Asia, China, India, South Korea, Japan, you know, that rank or have ranked among Iran's largest crude oil customers. As

I just mentioned, China's imports from Iran are down 25 percent for the first 5 months of this year. That compares to 33 percent for Japan and 16 percent for South Korea. However, if you calculate the volume reductions and if you look at the number of barrels less that the Chinese are buying, the South Koreans are buying, the Japanese are buying, that, you know, China has actually reduced its imports the most, you know, in terms of volume; that their 25 percent reduction in terms of barrels is actually greater than the 33 percent reduction from Japan. And so I think that certainly based on the numbers the administration had a strong case for giving China an exemption.

You know, of course, I suspect there are critics out there who might say, well, yes, but even though there has been this 25 percent drop, China's imports from Iran are now on the rise because the contract dispute has been resolved. And by the way, the Chinese never actually came out and said they were reducing their imports, you know, because they support U.S. sanctions; that, you know, the narrative is that it's been a contract dispute. But that aside, if you just look at the numbers I think there was a case for an exemption.

That being said, and looking forward, as many of you know these exemptions are only good for 180 days. And I think that it might be more challenging for China to secure another waiver in the future simply because China's liftings from Iran area now back at their 2011 levels. In May, China imported 520,000 barrels per day from Iran, and so I think that things might be a little trickier 180 days from now when the next determinations have to be made.

And I'll stop there. Thank you.

MR. BANKS: Tanvi?

MS. MADAN: Good morning. Before I start I just want to repeat an observation I made to Tammy that while women might not have it all, we definitely have

majority participation in this event. (Laughter)

I'm going to cover India and I'm going to do this in three parts: the first, actually address why India is part of this discussion; second, to look at what India's reaction to the sanctions have been; and third, to kind of break down in two parts the factors influencing India's response, both influencing its response to where it's maintaining a relationship with Iran and those factors that have been limiting the extent of India's relationship with Iran.

India is part of this discussion because it's one of the largest importers of Iranian crude oil. It's traditionally been, for the last year or so, the second largest importer, but for a while, because of the Chinese reduction of its imports, became for a bit there in the spring the largest importer of Iranian crude. India in about 2008 or so, Iran used to be the source of about 15 to 16 percent of Indian oil imports. India has reduced this amount to somewhere between 9 and 10 percent this year. The reasons for that -- and now it's Iran has dropped down from being the second largest supplier of crude to India to the fourth largest supplier.

The reasons for that reduction, the Indian government says that it is not a result of just U.S. sanctions or EU sanctions, but sanctions have had an impact on what India can practically do in terms of importing Iranian oil. One has been on the payment question. India's had trouble paying for the crude. They have found a way to deal with this to a certain extent, which is to pay for Iranian crude in rupees. That has had its own problems and India's only paying for about 45 percent of the crude that it gets from Iran in rupees. And there's a problem with what Iran is going to do with those rupees because Indo-Iranian commercial ties haven't been that strong. It's tended to be very much in Iran's favor in the past.

The second has been what has got mentioned quite a bit today, which is

shipping. Most Iranian oil that came to India was covered by European or U.S. insurance companies. They're not going to be able to get that insurance coverage. India is this week grappling with how to deal with that. A couple of suggestions have been or options have been thrown out by the Indian government. The first was for Iranian ships to ship the oil. There are obviously limits on that capacity as well not just capacity in terms of how much can actually go towards India, but also Indian port capacity and the resistance on the part of Indian shipping companies who don't want to give up those routes. The second option that has been explored and just been announced last night was to have Indian shipping companies insured by the public insurance company and the government has asked the insurance company to do that. There's also a question of where that company is going to get re-insurance from, so they're still dealing with that.

The second reason India has managed to reduce how much it's actually importing from Iran, and just to give you a sense, on the basis from last year in May to this year in May, India's reduced imports by about 37, 38 percent. The second reason has been India's policy of diversification, which is not a result of sanctions. It's actually been at least an attempt to -- India's attempt to diversify its kind of sources of food supply. For the longest time it has had limited success in some senses in terms of doing so, but one thing that has happened that has been key for India in the last year or so is that Iraq, which was traditionally a key supplier for India, has come back on-stream. It is not India's second largest supplier once again.

The other aspect is Saudi Arabia is now offering up India more oil as well. So India's actually always not just in energy policy, but across the board, diversification has been a key element in all kind of international policy and it's actually trying to continue to kind of move away from not just Iran, but the Middle East in general. So it's also looking outside the Middle East for sources of supply.

The third, which won't get acknowledge explicitly, but has been the diplomatic aspect of both pressure and persuasion, implicit and explicit, from not just the U.S., but other key parties that India has important relationships with: Israel, Saudi Arabia, and the Gulf states. And I'll talk about this a little bit more in kind of when I talk about the factors influencing India's response. Where things stand right now is India has got an exemption from the U.S., so this will probably come up again in six months, depending on whether India maintains the level of reductions that it has currently put in place. But India currently has got that waiver from -- and so the subject has died down, especially in domestic politics in both countries, which had been a key driver of the discussion.

In terms of the factors influencing the India response to maintaining a key relationship with Iran, the first is the energy factor. India imports about 75 to 80 percent of its oil, and so even 9 to 10 percent of that is fairly key. The Indian economy is currently at a fragile point. It's doing not badly, but it's still not doing the kind of -- it doesn't have the kind of numbers, hitting the kind of numbers that it was even a year or two ago. So the energy question is very key not just in domestic politics, but also for the economy. So Iran will remain a core supplier for India.

Iran allows India to diversify. India has no desire to give up -- to kind of take reliance on Iran for that 15 to 16 percent and entirely shift it over to the Saudis, for example, or to kind of continue to just -- you know, even to Iraq. They would like to keep it even within the Middle East fairly balanced.

Third, Iranian crude is not easily replaceable in terms of Indian refining capacity. It has become more replaceable than in the past, but it still cannot be replaced just entirely and especially not overnight.

And finally, Indian energy companies do not want to -- oil and gas

companies especially, don't want to entirely cede ground to countries like China in the medium to long term. So they want to have a continued relationship with Iran in the energy sector.

The second key aspect of a reason for India maintaining a close relationship is Afghanistan. India sees Iran as a major land route to Afghanistan and Central Asia, especially in the absence of having that route through Pakistan. India's been helping develop the port of Chabahar, incentives for shipments to Afghanistan in spring, and it plans to continue to use that route over the long term, especially in the context of a U.S. drawdown in Afghanistan, that becomes -- and uncertainties associated with that, that becomes more important, that route becomes more important to India. That brings its own questions about how much dependence, you know, or reliance India will have to have on Iran, which it won't like on that front, but that is a question that is going to have to be dealt with in the medium term.

The third is commercial interests. While they're limited, they're growing. There's a lot of interest in Indian companies in actually finding markets in Iran. There is interest in expanding that relationship. What that has been doing is, to a certain extent, you have Indian companies and the Commerce Ministry, for example, arguing that India should actually find a way to exploit this opportunity when other countries are not operating in Iran. That's why you've been hearing different voices in the first six months. There are different bureaucratic positions across the bureaucracy on this question about what to do. The Foreign Ministry, the Commerce Ministry, the Finance Ministry have been speaking with different voices till very recently and they were asked to all come on the same page and follow the government line on this question, but that was one of the reasons you heard very different answers about what India should do with Iran in the long term.

The final aspect that gets mentioned in the first paragraph of any speech on Indo-Iranian relations by most Indian and Iranian leaders are the historical and cultural ties; I think the cultural ties especially because of India having one of the largest Shia populations in the world. While it's a minority amongst India's Muslim population, it's still a fairly large number. The historical and civilizational ties and even the cultural links, I think they're a bit overestimated. They didn't seem to have worked in mitigating kind of the negative relationships that the two countries had through most of the Cold War and even through the beginning of the '90s. So I think they get overestimated in terms of how much they actually draw the two countries together. I think they do create a certain sense of sympathy in India for Iran, but I think in terms of a decision-making aspect I think they have limited impact and some of the other factors have more of an impact.

Quickly, the factors limiting India's ties with Iran. First, on the energy question, Iran has not been all that reliable. It has given Indian oil companies and gas companies a lot of trouble, so India questions Iranian reliability in the medium to long term. Indian companies have often found that China has been given priority; they have been short shrift. So they will look at -- they won't kind of totally lose their wariness of interacting with Iran.

India's also felt that Iran has gone back on price negotiations under a number of contracts. So there are still issues even on the energy question that make India hesitate to depend more and more on Iran.

Second, is kind of more of a strategic problem in terms of India's relations with Iran creates for other key relationships. I can talk about the U.S. more in detail in Q&A if people have questions, but India's relationship with the U.S. is a key part of its foreign policy. The relationship has become not just broader, but deeper in many ways.

The other country is Israel, which has become, again, a key partner of India. It doesn't get acknowledged that much publicly for domestic political reasons in India, but it has become one of India's largest defense suppliers. So even in kind of a hardcore security interest it's a key relationship for India, one that India does not have any interest in giving up anytime soon.

The third kind of set of third parties is Saudi Arabia and the Gulf states, which are not just key energy suppliers of both oil and gas to India, but is also where a large Indian diaspora resides. They're important to India not just because they're a diaspora, but because of remittances that come from there, so India has an interest in maintaining a relationship with these countries.

Third, on the nonproliferation question, like Russia and China, India does not like unilateral sanctions. It's been a target of them. It does not think that they are effective. Having said that, India has no desire to see Iran go down further the path towards nuclear weapons. It sees that as destabilizing the entire Middle East, which not just because it's a source of energy for India at a time when the economy is not exactly in the best state, but also because of the diaspora and the number of people of Indian origin who stay in that part of the world. India has no desire to see an unstable Middle East. And because of its growing relationship with Israel as well, it does not want to see an Israel-Iran conflict get exacerbated.

Finally, and this is kind of more a question that has come up recently, is the question of terrorism. I think it was brought up earlier in the panel the attack on the Israeli diplomat or the person connected with the Israeli embassy in Delhi in the past few months. While the Indian government tried to play it down, it has acknowledged multiple times that it sees links between that attack and not just -- it has named suspects, Iranians, but Iranians who are potentially connected with the Iranian state. It has very

clearly linked those attacks with the attacks in Malaysia and Thailand and Georgia. This, if this was designed to have the effect of actually making the Indian public question the relationship with Israel has had the opposite effect. It's created a sense of solidarity. It has created a source of tension between India and Iran. But the other thing is India cannot afford to just ignore this because if it takes the stance that any attacks that it sees is directed either from Pakistan or directed by elements connected to the Pakistani state are a subject of much kind of negativity between those two countries, it can't ignore similar attacks that seems to be similarly coming from or linked to another state, in this sense Iran. So that's created another source of tension between India and Iran.

And I'll just stop there.

MR. BANKS: Great. Thank you to each of you for those comments.

One of the themes that seems to come out here is the obvious complexity and variety of interests that each country in the EU has. And Erica alluded in her comments a bit to some of the shared interests with Russia in particular. I wanted to ask a two-part question on where the panel sees emerging or converging interests amongst the countries as well as diverging interests, and how that is evolving and could evolve.

And then related to that, one of the issues that seems to be shared, one of the goals that seems to be shared, is that no one wants to see Iran develop a nuclear weapons capability. That seems to be a shared interest. And, of course, everyone is on board at the moment in a diplomatic approach to addressing that. Are there any lines in the sand across which Iran cannot go for these countries, which would change their policy calculations, perhaps elevating that goal above economic or trade interests or cultural ties?

MS. HILL: Shall we have away at that?

MR. BANKS: Have a go.

MS. HILL: I think what struck me in listening to all of this and I'm sure struck many people in the audience is that China, India, and Russia in particular are all weighing up the same sets of relationships with the same sets of players. With the United States, very similar concerns: the desires to avoid being the target of sanctions themselves, not being big fans of sanctions, but feeling that they have to factor the important trade, economic, and political relationships in with the United States and how the United States plays on the global stage.

And this whole array of other countries that often don't get discussed at events like this: the Gulf countries, Saudi Arabia, obviously all this comes up, but the Gulf overall and then Israel. Israel, in some respects, seems to be a common factor among all of the states with a new dynamic relationship. And I think we have to bear in mind here that each country's sets of relationships do not remain static. If we'd still be thinking about the old Soviet Union, we would never have factored Israel in in the way that we are today, and perhaps that wouldn't have been the case, also, with China and with India. The fact that the Chinese, the Indians, and the Russians are all concerned about what does Israel think and how the relationship with Israel on defense issues will be affected by decisions that they make on Iran is really quite a new phenomenon.

And that also brings up the question of the nuclear weapons capability. I think it's fair to say that all three countries -- China, Russia, and India -- have the same sort of perspective on Iran's nuclear weapons program: they do not want to see Iran acquire a nuclear weapon. But they may also feel that there's not much that they can really do about it. And they have probably a very different assessment from the United States and certainly some of the countries in Europe, but maybe not all of them across the board, about what one can do to deal with this issue.

The Russians, certainly, are much more into thinking about the inevitability of Iran getting a nuclear weapons capability, whether it's the breakout capability or the actual acquisition of a weapon. They're really trying to figure out for themselves whether the Iranians intend to really go for the weapon or whether they just intend to reach that threshold that other states have seemed to have reached where they could get the weapon if they wanted to. So they're trying to figure out is Iran going to take the step of North Korea or are they going to take the step of all the other countries that shall not be named that are really nuclear weapons states, but we don't really say that they are? And the Russians are hoping that it's that latter, that Iran will, you know, simply have it, we'll all know they have it, but they won't really do anything about it and they won't go down the rather insane path that Russians think that the North Koreans have gone down. Do they really have to do this? The Russians are really where the Chinese are on this and hoping that the North Koreans will one day have a change in policy.

So the Russians really kind of then try to figure out then what can you do to try to persuade the Iranians not to, you know, go down that more difficult path, and they really believe that sanctions is not the way to go, that it's really trying to find other ways of getting hooks and levers into Iran and to dealing with them. And just like everyone else, they're frustrated by the fact that their own diplomats and their own behind-the-scenes interactions with Iran don't really seem to get them as far as they think that they should. But they really would prefer that we all basically start to think about that containment option, about how you work with Iran to turn them off and into a different direction.

I think that's probably where we'll find that China and India are really, too. They're trying to figure out how to deal with what they see as the inevitable and try

to prevent the knock-on consequences from this. And they really feel that through their web of relationships -- by dealing with the Saudis directly, dealing with the Israelis, and really dealing with a whole set of complicated and complex sets of relationships behind the scenes; the Russians love to make deals, it's but deals that nobody knows about -- that this is really the way that they can address this.

I think the biggest line in the sand then is not so much where the Iranians are really going, but it's what the Iranians do. And this is where I think you will also find a shared concern about Iranian sponsorship of terrorism. So far, the Russians have actually been quite happy with Iran's interactions with them on the issue of Russia's Muslim population. Unlike India, Russia really doesn't have much of a Shia Muslim population. The bulk of Russia's 14 million Muslims are actually Sunni Muslims. And Russia is much more concerned about the role of Saudi Arabia or even countries like Turkey in terms of their outreach, their cultural and religious outreach to the Muslim population, their building of mosques, their sponsorship of schools. In fact, Iran was Russia's partner in building a state-sponsored Islamic university in Russia's Volga region. The first person to actually visit the school was Khatami rather than any other representative of any other Muslim country.

So there's been a very interesting role that Iran has actually played in helping tamp down extremism in the Russians' view. And the Russians worry that, in fact, Iran might take a different tack at some point. So if indeed there is a stepping up of Iranian-sponsored terrorist acts in countries close to Russia -- Azerbaijan and Georgia, which Russia has been watching quite closely -- or there are more evidence of attacks in India and elsewhere, that might make the Russians extremely nervous because the last thing the Russians want is more radicalization of Islamic groups in their neighborhood. And the Russians are very concerned about how then Iran is going to play out and Syria

and a number of other issues, which is why they're always making these complex calculations. So I think that would be one of the issues that really would get the Russians most excited and most concerned.

MS. DOWNS: John, I'm going to take your question about lines in the sand in a slightly different direction and link it to the question that was asked at the end of the last panel about U.S. efforts to get China to play ball on Iran and the nuclear issue.

At the beginning of my remarks I had listed a number of factors that I saw as influencing China's response to the sanctions that Obama signed into law on December 31st. But if we step back further in time and look at China's response to other U.S. unilateral and U.N. sanctions on Iran, and what the U.S. has done to get China to cooperate, you know, there are, I guess, a couple of other factors that I think are worth highlighting in terms of sort of getting China to move some on this issue.

And one is I did want to elaborate on sort of the U.S.-China relationship. As many of you know, when President Obama took office he identified nuclear nonproliferation as one of several global issues that he wanted to work with the Chinese on to address. And so that elevated, I think, the importance of the Iran issue in Chinese foreign policy because the U.S. is such an important bilateral relationship to China and because President Obama was saying this is one of the issues that, you know, I want to work on in our relationship. And certainly, if you look back -- and, you know, as time has gone by more and more information about, you know, the efforts of the Obama Administration to get the Chinese to sign on to 1929 and to partially comply with CISADA -- with the Comprehensive Iran Sanctions, Accountability, and Divestment Act -- that was implemented in 2010, you know, we can see that Iran was often the top item or one of the top items on the agenda for bilateral talks. And so I think that the importance that Obama placed on working with China on the Iran nuclear issue did, you know, help spur China's

position and, ultimately, China's support for 1929.

The other factor, and this gets back to Israel, we've all be talking about the role that Israel plays in influencing different countries. And I do think in China there is concern about a war in the Persian Gulf and the instability that that would create and the negative impact that would have, you know, on China's interests. And so I do think that that's a factor that's out there as well. And so I think that, you know, perhaps -- I mean, one way to put it perhaps is the more concerned the Chinese are about some sort of military action in the Persian Gulf region, perhaps the more willing they would be to support sanctions, however distasteful they find them, and other measures.

But I think as Fiona mentioned, I think that, you know, there is sort of a struggle to figure out what to do next. On the one hand, you know, as I mentioned earlier, there's this shared disdain for sanctions. Over the years that I have done interviews on this subject in Beijing, one of the answers I've often gotten when I've asked about, you know, what could be done, if you don't like sanctions what could be done, one of the answers I've often gotten is, oh, this is a problem for the U.S. and Iran to work out; that, you know, Iran views the U.S. as a big threat to its security, so that the U.S. needs to solve this problem. And that might partly have been a dodge, you know, a way to avoid answering a question that, for whatever reason, they didn't want to talk about, but I think there might have been some truth to that. Although there might have been a change, you know, as Ken Pollack was mentioning on the earlier panel, you know, that, in his view, is a real wake-up call when, you know, the Chinese said to the Iranians that the U.S. is giving you everything you want for rapprochement and we think you should take it, and then they didn't.

MS. MADAN: In terms of convergent interests I think Fiona and Erica have covered most of them. There is some discussion in India from especially the left

and, to a certain extent, the center left, both looking at the sanctions as well as the situation in the euro zone these days about having the BRICs do more together in terms of actually creating an alternate or at least supplementary kind of economic order where they actually act on these issues, both economically and politically, in a coordinated fashion. That hasn't gained as much traction for various reasons. India doesn't have any desire to give up reliance on a Western system for a system that would be dominated by Russia and China, which are less transparent, and, at least in the case of China, there are political issues involved that need to be resolved. There will continue to be discussion about this, however, because people really see this as a source of kind of constraint on Indian freedom of action is how to actually deal with this situation. And there will be discussions with Russia and China given the similar experiences.

The other thing that is actually not so much a convergent interest, but I think a shared view in all three countries: they don't like the public pressure. I think private pressure for them allows them to undertake certain action because they can argue it differently, at least in India's case, to its public. Public pressure from the U.S. actually makes it harder for the Indian government to do things that it would otherwise want to do in terms of restraining the relationship with Iran because it needs to prove, at least to its opposition parties, that it is not doing this because of U.S. pressure or it hasn't sold its soul to the U.S. So in that sense, I mean, it's something we've discussed before, there is kind of a shared view about what U.S. public pressure really does for the government's freedom of action.

On the nuclear questions in terms of red lines, India feels that it's not part of the nuclear discussions. It feels, unless it's in a bilateral sense, it feels that it has limited leverage. And in many ways, India doesn't want to get involved. A former diplomat writing in an Israeli newspaper I think ended his article or op-ed saying India

should just keep its head down, and that's pretty much what has been the attitude is let's not get involved. We want the diplomatic process to continue, but there are already a lot of actors involved.

I think Fiona's point about if there are further terrorist attacks that are seen as originating or being sponsored by Iran on Indian soil, that will be more of kind of a red line in that sense. And it'll be hard for the Indian government to continue to underplay kind of an Iranian connection with that.

MR. BANKS: Okay. I think we could turn to audience questions at this point. This gentleman over here.

MR. DEAN: With the introduction of the third energy policy --

MR. BANKS: Just wait for your mic. And if you could identify yourself, please.

MR. DEAN: Mike Dean, Johns Hopkins University. With the introduction of the third energy program in 2011 by the EU, you know, which emphasized European diversity as well as on bundling of gas resources and energy resources out of Russia, it seemed to be that Europe was on a movement which was very pro-American in the sense that the Americans were trying to push them into less dependence on Russian oil and gas. To what extent do these sanctions against Iran, which was going to be one of the potential alternatives, especially in the southern stream and Nabucco pipelines, to the whole European thrust to less dependence on Russia? Is this a reversal of course for the future?

MS. HILL: Do you want to take another question or should we --

MR. BANKS: Why don't you go ahead and answer?

MS. HILL: Yeah, and that's obviously a pretty critical question for Europe and it gets to the heart of, you know, my last comment that it's actually quite a

heavy lift because the Europeans have been very serious about these attempts to shift the sources of supply for energy. This has also included, of course, more emphasis on renewable and trying to reach their various climate change targets, all of which have really taken a hit because of the nuclear decisions that were made in Germany in the wake of the Fukushima disaster in Japan, when, of course, Germany made that huge step almost immediately afterwards in deciding to curtail its own civilian nuclear program. So all of the calculations that the Europeans had been making for the years prior to rolling out this strategy that you're referring to were all thrown on their head.

However, as we also know, the oil and gas markets have changed rather dramatically. And on the last panel, of course, you had David Goldwyn and others who have been looking at this in real detail. There's now the question of shale gas not just in the United States, but globally, and there's a question, also, for the Russians and the Chinese. And there is some expectation now that there still will be this opportunity to diversify away from Russia because of the new sources of energy.

Of course, there's the question of the environmental impact, which always has a huge political salience in the European context, but there will be more opportunity, in fact, for diversification. Poland and Ukraine look likely to have a large deposit of shale gas. There's also the question of tight oil. There's even the prospect of exports from the United States sometime three to five years down the line that many people are looking at. The Chesapeake Energy reference that Erica made, the Chinese, the Russians, everyone's now looking into these whole changes in natural gas markets. But nonetheless, in the short to medium term, the sanctions on Iran are a major problem that they have to contend with.

There is the question now of looking further afield. Iraq obviously is still an issue there. You're seeing now a lot of Turkish energy companies now taking a bigger

role in Iraq, in the Kurdistan region of Iraq. Obviously a lot of political questions riding on that, too, and seeing whether Iraq and some of Iraqi natural gas can be brought to market more quickly. There's also questions now of Africa, Tanzania. Some of the European oil majors and energy majors have just made new finds off the African coast. There's the Eastern Mediterranean, another contentious issue; of Israel, Lebanon, Cyprus, where, you know, the Turks and others have been rather alarmed at how that has moved across.

So the bottom line in all this is the international oil and gas markets are in considerable flux. There are new sources of production, new sources of supply. It's the short term where the Europeans are really hurt by everything and are scrambling around trying to figure out how to address this.

Over the longer term, when we get to thinking -- and Suzanne and others have looked at this in great detail -- about how do you try to put some carrots on the table for Iran, it obviously is this issue of how do you get Iran back in the game. Because one of the points that could be made to the Iranians is the longer this goes on, the less likely Iran is going to be able to come back in a major way as an oil and gas supplier because the markets will move on and look for other opportunities. And so that is one small point of leverage that we actually do have in thinking -- particularly the Europeans really have with Iran. But, of course, it's an issue that is quite complex.

MR. BANKS: I just might add on the European shale gas, the three countries that are typically cited as having major reserves are Poland, Ukraine, and France. France has banned fracking, so they've taken shale off the table. And I just read recently that Exxon pulled out of Poland. Some of its exploratory wells had not yielded very much. So there's some question about what is commercially really available in Poland. And as far as Ukraine is concerned, I think there's some questions regarding its investment climate and what's happening politically there. So there's some I would say

shakiness going on with regard to the initially exuberant response to shale gas in Europe.

Right here.

MR. MASERA: Hi. My name's Aaron Masera. I'm with the European Parliament Liaison Office. So as you can imagine, my question will be to Dr. Hill.

With the European Union sanctions does it show a more cohesive and lasting effect of the ultimate long-term goals of the Lisbon Treaty? And will this create a more diplomatically aggressive European Union that will work more with the U.S. towards the Middle East region in the future?

MS. HILL: Ah, if only I'll last to that point. I'll try to answer this quite quickly. The EU sanctions has been one area where indeed Europe has proven itself to be cohesive. Unfortunately, I don't think one can really extrapolate from there across the board. My colleague at the Europe Center, Justin Vaisse, who many of you will have heard speak, engages every year in a project with the European Council on Foreign Relations, the EU Foreign Policy Scorecard, which you may have seen. We had a roll out of that relatively recently. And this is one area where the EU gets really high marks. Let's just say they don't necessary reach the same marks on many other issues.

This has actually proven to be one area where the EU has been able to work together so well because there's all the shared common interests that we've talked about. Well, certainly, of course, it's been very difficult, as I said at the outset, for Spain, Italy, Greece, and some other countries really to get on board here. And some of the big European energy companies -- ENI, the Italian company, for example -- have really taken a hit as a result of this. This has been very problematic for them. Total, the French company, has always been very interested in upping its involvement in Iran. So this has been very difficult, but the strategic perspective has really played out here.

And it has really shown, I think, the strengths in many respects of the

Action Service and Lady Ashton. This has been one area where she has not missed an opportunity to really engage and where there's been really high marks from others within Europe, which hasn't always been the case for poor Lady Ashton. She's often been berated, in fact, for trying to take action on other issues. In this case she's got a lot of support and she's also had a lot of press in Washington, D.C.

Unfortunately, I don't think that this is something that really plays out on a number of other issues, so it shows a very good example of what can be done when Europe shares the same perspective. And it could be a model for the future, but right now it doesn't seem to have that much potential given all the complexities and so many other issues for really being able to be the basis for a more aggressive policy across the whole of the Middle East and North Africa. And I think we're seeing in, you know, Syria and many other instances where there's a lot more confusion and contention about what should be done. Iran has just been one of those issues that has managed to really provide a very good focal and unifying point for Europe.

MR. BANKS: This gentleman right here.

MR. SHABAZ: Jose Shabaz, (inaudible) University. I have a question for Dr. Hill.

Amongst the factors that you mentioned for Russians to change policy and go along with the American side, I didn't hear, I don't know if it was purposely or not, a couple of other things that, you know, have been mentioned a lot, the reset policy by the Obama Administration as well as not going along with the, you know, anti-missile barriers in Poland. Do you think those are also main factors or you just didn't see any significance in them?

Secondly, also, I wonder if you see any change of strategy or policy as a result of Putin's presidency. In other words, all along I've been hearing and reading that,

you know, the Russians accept civilian nuclear activities by Iran, but I was surprised that you mentioned that their red line is even no capability at all for Iran. So is that because of this new presidency or it's always been like that or I misunderstood?

If I may also ask a Chinese question is that, you know, Ms. Downs, you mentioned that the Chinese, because of their prime place they put on the relationship with Americans, they have not taken advantage of the discount they could get from (inaudible). But you also said that, you know, the next 180 days will be challenging for the Russians. So in the context of what they have not taken any advantage of this time, why would you say that they would perhaps reverse and, you know, take another action? Thank you.

MS. HILL: Yeah, just quickly on the issues of missile defense and other factors in the reset, I'll be honest that I don't think that those were actually the major motivating factors for Russia, and I differ in many respects from a lot of other analysts on this perspective. I actually see that it was this complex of pressures that were put on Russia, including from the United States, but actually with a very strong of Germany, Israel, Saudi Arabia, and many other countries that engage with Russia behind the scenes that were really decisive in Russia's calculations about 1929 sanctions in June of 2010.

Now, of course, you know, our administration is going to take credit for that; every administration does. And I'm sure at home the Saudis might have done if, you know, they'd been asked these questions. The Israelis, the Germans, and everybody would have done so. Everybody likes to think that it was the results of their efforts and their efforts alone that had an impact. And it's not that the relationship with the United States was not consequential, it certainly was, but the Russians have always viewed the reset policy as being much more the U.S. decision to reset the relationships rather than

theirs.

And just as Tanvi and Erica have pointed out on let's just say the allergy that other countries have for political pressure, the Russians would certainly never admit that it was U.S. public pressure that was a decisive factor on anything. They always come up with other reasons for that.

Missile defense remains a major irritant for the Russians. That's a whole separate set of conversations. But it's certainly true that the Russians did have an interest in joining the United States and that reason because also of the relationship there, but it was all of these factors together. The United States relationship with Russia on its own would not have been sufficient to sway Russia's calculations back there in 2010.

And that also brings up the other question that you asked about, the change of policy with Putin. And I perhaps wasn't as clear when I was making the distinctions about Russian red lines as I should have been. The Russians have always thought that Russia should have the perfect right for a civilian nuclear program, as many other countries should do.

And I also was trying to make the point that the Russians also feel that it's inevitable that Iran will get the capability to produce a nuclear weapon and that there's not much that Russia or anybody else can do about it. They look at many other countries who have gone in that direction and they were not able to stop them. India is one case in point; Pakistan; North Korea; there's also Japan, South Africa, and Israel, and other countries behind the scenes who have enrichment capacity that they have developed.

Russians think that, you know, the Iranians should have a degree of their own independent enrichment capacity. What they don't really want to see is for Iran to actually get the bomb, to actually physically make one and test one in the North Korean --

and that's what I was trying to get across. They are really just also hoping, like everyone else, that the Iranians won't do this and they're trying to dissuade them from going down that path. Although Russia, like everyone else, has not really figured out how you dissuade a country from doing this. They just want to make their preferences felt very strongly.

And there's no real change with Putin about this. Putin has always made it clear that when it comes to these kinds of issues, he was always in the driving seat anyway. The United States is well aware back in 2010 that even though Medvedev as president may be more forward-leaning, more willing to make it kind of clear that Russia was basically working in closer association with the United States, the decisions on this issue were really residing, also, with Putin. What Putin -- the difference will be is he will not to make it clear that he's working with the United States. He will be much less forward-leaning than Mr. Medvedev.

And the infamous hot mic episode, if you might recall, when Mr. Obama was assured by Mr. Medvedev that he will transmit to Vladimir -- this is always underscoring that Vladimir was always very much in charge of this and many other issues. It's just he would prefer it not to be known that he's being transmitted to. So basically, as I mentioned, with Mr. Putin he likes to do things behind the scenes. He likes to make deals. He has ways of making those deals enforced. He would just prefer not to be talking about them in public and that's the real distinction. Medvedev was a more open personality and his presidency was somewhat more open, and that's what made the reset look much nicer because he was a warmer, friendlier version of Mr. Putin.

And as you saw during -- well, we couldn't fail but see thanks to the various newspapers juxtaposing the pictures of Mr. Obama and Mr. Putin so much uncomfortable together. That's how we're going to be looking in the future. Mr. Putin

doesn't necessarily look very comfortable either with Prime Minister Singh or even his Chinese counterparts during his last meeting. He's just not a comfortable person to be sitting next to. So I think that's -- and having sat next to him once at dinner I can assure you that it's not the friendliest of settings.

So I think that, you know, we shouldn't read too much into all of this, but that's the way that Mr. Putin operates. He likes to keep things close to himself and he will hope that the United States will understand that moving forward.

MS. DOWNS: On the question about China-Iran oil trade, when the sanctions were signed into law after that happened, there was a lot of concern I think here in Washington about what the Chinese would do. Would the Iranians offer them discounted prices? And in response, would the Chinese take advantage of that to import even more crude from Iran than they did last year? And so far that hasn't been the case, that unnamed Sinopec officials have, you know, told Reuters that they've turned down offers to buy more at discounted prices and, you know, they've also said that they were targeting reductions of 16 to 20 percent of imports from Iran over 2012. And I don't see Sinopec -- my personal view is I don't see them taking advantage of, you know, additional discounts the Iranians might offer, simply because Sinopec has its eye on getting into and expanding in the U.S. market.

But my comment about how it might be difficult for China to get another exemption 180 days from now wasn't because I thought Sinopec's going to buy larger volumes of discounted crude, but it refers to the fact that this contract dispute that is largely responsible or almost entirely responsible for the reductions in China's buys from Iran that we've seen this year, that ended in late March. And because it takes 21 days for oil to get from Iran to China, we didn't get a first look at what the volumes of the new contract would look like until last week when the data on China's oil imports from Iran in

the month of May came out. And that shows that China imported 520,000 barrels per day, so on par with what they were importing last year.

And so if December rolls around and for the months of, you know, June through November the data shows that China's been buying 500,000 barrels per day, that imports have increased over 2012 and they're on par with 2011 levels, then I think that makes it obviously a lot more difficult for the Obama Administration to give the Chinese an exemption. So that was my point.

MR. BANKS: Yes, sir.

MR. SALIFI: Hi. Randy Salifi again. I was hoping to just drill down a little bit specifically on the negotiations that just took place with respect to China and Russia and their role in the last two sets of negotiations, both with respect to philosophy and with respect to practice. And then sort of bridge that into whether you actually think the Chinese are willing to effectively play ball, cut oil purchases, and support an effort that will attempt to force the Iranians to take actions and impact with respect to, you know, some type of change of behavior. Because the fact is that most sanctions really will not work unless a world-class player have a dominating role.

And then I was hoping just to get one brief view from China and from Russia on whether they believe Israel is serious. Is it the view that Israel will really take action or is it the view that's a lot of hyperbole and a lot of smoke? And what's the perception of if Israel does take action the day after?

MS. DOWNS: I can start with China. I think a useful way to answer your question is to look back to China's response to CISADA, to the U.S. unilateral sanctions that we implemented in 2010, and also related to the unilateral sanctions that the EU and other countries implemented after 1929. And as you may recall, after -- and that had been my understanding is that had been one of the Obama Administration's objectives

for 1929, that 1929 wasn't just an end in itself, but it was supposed to serve as a platform so that other countries would feel comfortable implementing unilateral sanctions.

And so my sense is that, you know, when that was over, obviously the administration was quite pleased that all these different unilateral sanctions had been implemented, but there was a real concern about China, and specifically about what the Chinese oil companies were going to do in the Iranian upstream. Because, on the one hand, yes, the Europeans and the Japanese and everyone else was now pulling out as a result of home country sanctions, but there was concern that that just opened up the playing field for the Chinese and where the Chinese company's going to take advantage of this, you know, once in a lifetime opportunity to dominate the Iranian upstream.

And so to prevent that, a message, you know, was sent I think very clearly from the Obama Administration to not just the Chinese government, but to Chinese oil companies that, you know, basically a red line in sand for us is you backfilling, you taking over oil projects that were abandoned by the European companies, that were abandoned by Japanese companies. And my take on that is that that message was received loud and clear and there are reports out there that in response to that the Chinese government instructed Chinese oil companies not to backfill and to slow down in Iran, and certainly history bears that out.

Fast forward two years and what have we seen? What we're seeing is the Chinese companies, they haven't backfilled, and they've continued to slow walk their existing projects in Iran. There have been reports, you know, over the past year and a half about the Iranians threatening the Chinese companies, saying you're way behind scheduled, you've not kept to the development schedule that's stipulated in the contract. If you don't hurry up, we're going to take this contract away from you and give it to, you know, domestic Iranian companies.

Now, I have no idea how seriously the Chinese companies take that threat. You know, I think when that threat was made to Total, the French company, when it was made to Impax, you know, that if you don't hurry up, we're going to take your contracts away and give it to the Chinese, I think that was a much more credible threat to those companies because the Chinese companies were waiting in the wings. But I don't know that any of these Iranian firms necessarily have the capital the Chinese companies do. And, you know, of course, I think part of the reason for the Iranian government, I suspect that one of the reasons of wanting Chinese companies there is to send the message that we're not internationally isolated, you know, that Shell and that the U.S. and the -- not the U.S., sorry, you know, the Japanese and the European companies may leave, but we still have, you know, friends in high places. And that hasn't certainly worked out for the Iranians, that there's not a lot going on. There are still reports of Iranians threatening the Chinese companies.

And so I think that's sort of a good example of how, you know, the U.S., in my view, has been able to get China to tacitly cooperate on Iran. And again, you know, as with India, this is something that I think the Chinese prefer to do quietly behind the scenes. You're never going to see anyone from the Chinese government come out and say, you know, we told Sinopec and CNPC slow down in Iran to support the U.S. And that's the message I was getting about the Chinese response to these latest sanctions in Beijing earlier this month, that some of my colleagues there were saying, you know, if you want to know whether we're going to cooperate or not, look at the trade numbers, look at our import numbers, but don't you ever expect anyone from the Chinese government to come out and say that these drops are a result of U.S. pressure or a decision on the part of the Chinese leadership to play ball on U.S. sanctions.

SPEAKER: Israel? China and Israel?

MS. DOWNS: Oh, China and Israel?

SPEAKER: Does China believe that Israel is serious about bombing?

MS. DOWNS: I mean, that's a great question. I don't know. I mean, I think it probably changes over time. I don't have a clear answer right now. What I can tell you, though, is that if you look back in the run-up to 1929 and sort of that, there were a lot of trips made to Beijing by officials from Saudi Arabia, by officials from Israel. Israel reported in the press. You had, you know, the head of the Israeli Central Bank. You had, I think, the head of Israel's military intelligence. And so I think, you know, one of the messages that they were delivering was that, you know, there needs to be movement on Iran, and I think that played into the Chinese calculation.

You know, it's hard for me to separate and I don't know that you necessarily can separate them out, but I think that the pressure from the U.S., you know, the pressure from Saudi Arabia, which I can also get into, and there's actually a lot more out there in the public domain on the pressure that the Saudis put on the Chinese, you know, vis-à-vis the Israelis. But my general sense, and again, this is something you don't see as much sort of out there in public Chinese discussions, but just my sense from following this issue over the years is that the Chinese government and, you know, the Chinese oil companies, they all want to see conflict in the Persian Gulf. And so my sense is that if things get to a point where they feel like conflict is more likely, you know, I think that's sort of one of the factors that might facilitate, you know, sort of a greater willingness to cooperate on some of these other ideas that the United States has, however distasteful they might be in Beijing.

MS. HILL: I mean, Russia is in a very similar position. And Randy, I think you were trying to get at this question before when you asked this about, you know, the sort of philosophy and practice behind everything.

In 2010, as I was mentioning in response to the other kind of questions, the Russians did start to think that Israel was really serious. It's not so clear they think that that is the case right now. And it comes, you know, back to Erica's point about, you know, their gauging of kind of the outreach that they get from the perspective of Israel. Because in 2010, the Israelis really put a full court press on the Russians. Netanyahu went on a not-so-secret visit to Moscow to meet with Mr. Putin, you know, behind the scenes. And remember, Mr. Putin wasn't actually the president at that particular juncture. He was the prime minister.

There was also a host of outreach by various other figures behind the scenes. Given there's 1 million Russian speakers who are in Israel right now, there are all kinds of links that you would never have thought of before. Natan Sharansky, the famous dissident who, you know, we all remember the episode of him walking across the bridge and really kind of mocking the Soviet Union opening up the doors for all of the Soviet youth who wanted to leave. His brother, who became a United States citizen, had gone back to Moscow again and was repeatedly, according to some high-level Russians that I spoke to, also acting as a liaison. So there are all these kinds of linkages, people that you would never have thought of, engaged in passing messages: senior Russian officials, people close to Putin going and visiting Israel; Russian oligarchs who have holdings in Israel as well as in Russia; and then in the United States, passing messages back. So Mr. Putin got them. And just like his Chinese counterparts, the last thing he wants to see is any Israeli action, which would just upset the entire balance of power in the Middle East.

And this is where it gets back to your first question about practice and philosophy. And it would be interesting to hear the Indian perspective on this because the Russians have a very different view of Iran from the Europeans and the United

States. They don't look at Iran as a theocracy. They look at Iran as an ancient state and an ancient state interlocutor dating back to the Persian Empire for the Russians one way or another. And I think that's what Tanvi was touching upon when you were talking about the cultural and historic links.

And the Russians don't think that, you know, the Iranians for one second think like Europeans or the United States. Maybe they don't even think like Russians. And they know that they've had centuries of trying to deal with them and trying to figure them out, and they haven't entirely got there yet. But they don't believe that the way that we've chosen to deal with them is the right way to go about it. Sanctions is just, you know, it basically is a loss of face. And the Russians are trying to figure out how they can get leverage with the Iranians and also make it seem that whatever the Iranians decide to do, it looks like they've decided to do it and that they have saved face and even gained face.

That's the way the Russians operate, too. They think that this public pressure is counterproductive. They'd rather do things behind the scenes, figure out what hook they can get into really the Iranians. They thought actually Bushehr was a hook. They kept dragging it on. It took forever to construct that plant, and it wasn't because they were trying to get more money. They were trying to draw it out because once it's constructed, it's into operation, you've got nothing over them anymore.

The S-300s, they were constantly going to send them; they never did. And then, of course, they had to cancel the sale entirely because they were also trying to play with us. They were trying to persuade the United States it was better to, you know, keep going through with the pretense that they were going to send them in many respects because that would give them something to talk to the Iranians about. Well, eventually, you know, you can't keep pretending forever. So the Russians are always

trying to find some way of getting some leverage, but of being able to talk to the Iranians on their own terms, behind closed doors, and to give Iran the chance to basically make the decision for themselves.

And that may be, also, the way that the Indians are trying to play this. I'm not sure that the Chinese have the same perspective because actually they don't have a long history. In spite of being an ancient kingdom, they don't necessarily have a long history of dealing with the Persian Empire the way that the Indians and the Russians do.

So, I mean, Tanvi, is that a similar way that the Indians think about this?

MS. MADAN: Yes. You will never, for example, hear the phrase in a media discussion amongst, you know, a policy debate that Iran is not a rational actor. It's very much seen as kind of an old civilization. In some quarters we even hear the argument that why should India object if they really do get the bomb as a civilization power. Now, this is a limited question and the official Indian view on this has always been, unlike India, which was never signatory to the MPT, Iran is and should undertake its obligations under the treaty. And so the Indian government draws a distinction between kind of India's going nuclear and Iran potentially going nuclear.

But you do hear among some sections that it's an old civilization. It's one of the largest countries in the area. It has an old history and, with India, a history of kind of linkages. And it's very much seen as kind of somebody you could do business with and that will react not just pressure, but persuasion as well. But, again, not necessarily done publicly, using various kind of carrots and sticks, and in a manner that allows kind of the Iranian leadership to have some sense of security as well.

I think the idea that does get traction in India is this idea that these sanctions and pressure are seen by some in many quarters as U.S.-directed regime

change. And in that sense, there is more sympathy about that not being Indian policy and not wanting to be associated with that.

MS. HILL: Yeah, I would say that that's probably the case definitely for Russia and China. And it's the issue in Syria, in fact, that we're dealing with, that none of these countries want to see regime change forced from the outside. They'd much rather it happen internally.

MR. BANKS: I think we'll take one more question. We're kind of coming to the end. Yes.

SPEAKER: Since I'm one of the last persons with a question, I'll kind of make it a combination with two or three questions, I guess kind of put it -- maybe put it in perspective.

My question is if the real issue is the Middle East as today regarding Iran, our relationship to the West as a whole, is having Iran as a nuclear (inaudible)? As we know, the Iranian government have been -- not that I want to defend them, don't get me wrong, I don't like them. I want to make sure I point out this, I'm not a friend of the Iranian government here. But the fact is they have been putting proposals the last 15, 20 years, at least I'm not naïve to -- regarding the power of the nuclear stuff, you know, Israel had. I'm not naïve. It takes time, I understand that. Why at least when you're saying let's just make at least Middle East as a nuclear -- zero tolerance for nuclear activity, at least talk about it? Hopefully, all this can be resolved by itself down the road. It takes time, I understand that. But I'm asking the major powers putting so much energy, why even think about the back channel, at least talk about this?

The next question is if you compare the relationship of the Western power and East, probably at that time like a Cold War between Soviet Union and the West, and the problem is you've got U.S., Soviet Union, and China was a part of the

Soviet Union. As Mr. Pollack mentioned that the Chinese were saying we don't understand why Iranians basically take their offer of American, which (inaudible) to Chinese, which would get the (inaudible) diplomacy in 1972 and also the Carter Administration in 1979. Deng Xiaoping come in power with economic development (inaudible) the last 30 years. I don't want to compare either one with the Soviet Union, but is that maybe why they can do the same thing? That (inaudible) it still doesn't work.

And the last question is, if the whole thing is basically -- maybe you could go out in China, Europe, and India, it's basically what you face in the world today, a shift of power. Not 50 or 100 or 200 years. It's a half a millennium shift from West to the East, and the power was there for millenniums before. I mean, that's the (inaudible).

MR. BANKS: I think the first question was regarding a nuclear-free zone. I don't know if anybody wants to take a crack at that. I think that was the first question.

And then your last question was referring to whether or not we're seeing some sort of a shift of power --

SPEAKER: Half a millennium shift.

MR. BANKS: -- going on at the moment.

MS. MADAN: Just on kind of the Indian view, India is not on strong footing arguing for -- because a nuclear-free zone would require Israel to give up capability. India is not exactly on strong ground making that argument. And it does feel that Israel has a right to be concerned about its own security and so it would have a very hard time kind of making that, and that's partly why it doesn't want to get involved.

MS. DOWNS: Yeah, I think the Chinese don't want to see Iran get a nuclear weapon, but they also don't want to see the Saudis get a nuclear weapon or Turkey or, you know, the Japanese or anyone else who might see, you know, Iran acquiring a nuclear weapon as a license for them to do so as well.

MS. HILL: Yeah, I mean, Russia has always been very happy being at the top of the nuclear club. And obviously clubs aren't particularly exclusive if everyone's got one. So, I mean, that's kind of part of the motivation. I mean, one of the primary claims that the Russians still make for a larger role than just a role as a regional power, but of some maintenance and, in many respects, their superpower role from the Cold War is precisely because of being in this exclusive club of being one of the major nuclear weapons countries. And obviously the dilution of that status has always been something of a concern.

The Soviet Union was not exactly thrilled that China, you know, broke out of that. But obviously you'd probably prefer that the UK and France and other countries didn't go down that path either. But there is now a sort of sense of inevitability here that then, you know, as we were saying, that major powers who want to have that capability are going to go out and get it.

The Russians over the last several years have actually been much more concerned about other states than they have been about Iran ultimately getting a nuclear weapon. I think no matter, you know, what they think about this, they actually think that given the state structures of Iran, the fact that Iran is in their view a rational actor even if it's in its own specific rational has not been one that the United States and the Europeans have actually grasped, is that they would have probably pretty good command and control over it. They're much more worried about the North Koreans for obvious reasons. And then they're much more worried about Pakistan for similar kinds of reasons. They don't feel that the Pakistani military has a particularly good grip on this and they worry about the disintegration of the Pakistani set. And they've basically made this public repeatedly.

So Russia has concerns about proliferation. I think where they do

become concerned about the risk of knock-on effects from Iran's acquisition or a nuclear weapon is the impact that this may have on the thinking of others about acquiring it, other much less, in their view, stable states. The idea that then, you know, there'll be more Pakistans and North Koreas out there in the Russian view, and they are very concerned about that. That's one issue that they do have a genuine interest here.

So it's a complex issue, but it's not that the Russians, like the Indians or the Chinese, necessarily think that Iran's acquisition of a nuclear weapon means that everything else is going to erupt. They don't necessarily trust everyone else to behave in a certain way, so there is a great deal of concern there.

MR. BANKS: Okay, with that --

SPEAKER: (inaudible) power shift?

MS. HILL: The power shift, well, the Russians have obviously been quite interested in playing the perception of power shift as much as they can, whether everybody else likes it or not, thanks to Mr. O'Neill's conception of the BRICs. The Russians have liked to have taken that BRIC and holding it quite tightly themselves. Just like the idea of having their U.N. status or being in an exclusive nuclear club, the Russians like the idea that they might be in a new exclusive club of power shifts, with everything moving in the direction of the BRICs -- Brazil not so much in Russia's interest, but anyway, Russia, India, and China -- and they're playing that to the hilt.

So whether, you know, the shift is real or not, the Russians are going to try to make sure that it is. We're seeing the Russians stepping out now onto larger stages. They blew off the G-8, but they were very eager to go to the G-20, and it wasn't just because it was in Los Cabos, which is much nicer this time of year than Washington. It's because it's a much larger environment in which you can play. And the Russians are certainly playing up the idea that the real locus of power now is really with the Russias,

Indias, and Chinas of this world and not elsewhere. And so you can be sure that they're very much appreciative of every article that is written on this topic at the moment.

MR. BANKS: Great. And with that, we will conclude. Thank you very much for attending today and have a great weekend. (Applause)

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