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Mr. Chairman and members of the Committee on Foreign Affairs, thank you for giving me the opportunity to comment on the past six weeks’ of upheaval in Iran and the consequences of these developments for the United States and our policy options toward Iran. In the aftermath of events that have challenged all that we thought we knew about Iran, it is particularly valuable for the Committee to address this issue and engage in a serious reassessment of the most effective means for Washington to influence Tehran’s policies and its future course.

As requested, I’ll specifically address the economic situation in Iran during my remarks today, but let me first suggest some broader points about the context that we are dealing with in Iran at this stage, because it is that tumultuous context that is the impetus of today’s hearing. The Islamic Republic has entered a new and ultimately unpredictable phase of its perpetually gripping history. The decision to rig the outcome of the June 12<sup>th</sup> presidential elections in favor of President Mahmoud Ahmadinejad and all that has followed in its wake have transformed Iran’s political system, reshaped the political jockeying of its elite decision makers, and intensified the dissatisfaction of millions of its citizens.

As a result, the Islamic Republic today is now forced to contend with an almost unprecedented array of internal challenges that are both complex and interconnected. The outrage over the election manipulation has spawned a genuine if still embryonic opposition movement that boasts at least a symbolic leadership and a compelling popular mandate. The passionate, disciplined street demonstrations that crescendoed in the days after the election continue to percolate and – with further provocations and/or coherent direction – could evolve into a powerful and even a revolutionary force. This is a truly significant development. While Tehran’s democratic pretenses have always been offset by its underlying authoritarian impulses, the modest role accorded to representative rule bolstered the regime’s stability and legitimacy for most of the past three decades. Their elimination and the emergence in their place of a mass-based opposition make the regime’s increasing absolutism unsustainable in the long run.

The other profound consequence for the Iranian regime is the eruption of intense and possibly irreparable divisions among its leadership. At every point in the regime’s nearly 30-year history, its leadership has engaged in fratricidal partisanship, but this elite wrangling has rarely if ever threatened the regime’s survival simply because Iranian power brokers have been bound by decades of interaction, layers of personal and pecuniary ties, and a shared commitment to preserving the Islamic system. But as is

evident by the surprisingly bold defiance of regime stalwarts such as Mir Husayn Musavi, Mohammad Khatami and Akbar Hashemi Rafsanjani, the blatantly rigged election represented a threat of historic proportions even for the revolutionary system's true believers. As a result, these figures and others have engaged in what constitutes the most provocative sort of discourse for any Iranian political actor – they have challenged the authority of Iran's supreme leader, Ayatollah Ali Khamenei, and the sanctity of his office. In doing so, a crucial component of Iran's elite has begun to separate itself from the regime to promote the opposing agenda of a nascent mass-based movement. These elite defections signal the end of Iran's factional bickering as a mundane intramural argument and the opening salvo of a new phase of existential competition within Iran's corridors of power.

There are at least three potential directions that Iran's volatile course could yet take: Khamenei's power grab may well herald the arrival of an increasingly despotic Iranian regime, unconstrained by the niceties of limited electoral institutions or any pretense of popular legitimacy to avoid large-scale repression of its own population. In the throes of its early post-revolutionary civil war, the Islamic Republic's leadership ferociously defended itself and its newly established theocracy against internal threats, both real and perceived, with torture, mass executions, and other unsavory tactics. A reprise of this approach of securing authority may even appeal to the firebrand commanders of the Revolutionary Guard and Basij, whose *raison d'être* remains steeped in hyperbolic threat perception. Such a totalitarian outcome is, sadly, not inconceivable, although it would be inherently transitory in a country that replete with the building blocks of democracy, including a lengthy constitutional tradition and a vocal, well-educated population.

There are at least two alternative scenarios that would seem more encouraging at least in the short term. The first would entail the negotiation of some *modus vivendi* among Iran's hard-liners and the quartet of moderate leaders – the three mentioned above along with Mehdi Karrubi, the other reformist presidential candidate – who have led the charge against the election fraud. The outcome could entail a range of scenarios with varying degrees of compromise by each side. The maximalist would feature the revitalization of a super-empowered reform movement, complete with new constraints on the office of the supreme leader and a referendum on the political system as Khatami has recently suggested. A less promising negotiated scenario would involve even greater concessions by reformists, yielding an uneasy peace in which, like Mehdi Bazargan, the leader of Iran's original post-revolutionary government who resigned over the 1979 seizure of the U.S Embassy, reformists are relegated to some neutered form of loyal opposition in exchange for self-imposed constraints on regime repression.

Finally, the third potential scenario is the one that at present still seems out of reach but remains the most dramatic threat to the current Iranian regime. Given time and further catalysts, the elite defections and popular resentment spawned in the past six weeks might yet morph into something more powerful and Iran might experience the genesis of a serious, sustained movement dedicated to ousting the current regime in its entirety. Despite the dramatic scenes of mass opposition and regime-sponsored violence, most of the protestors and their *de facto* leadership have taken pains to focus their grievances on

electoral procedures and subsequent miscarriages of justice, and have explicitly avoided an overt challenge to the overarching Islamic system. Obviously, these prospective scenarios are not mutually incompatible; the turn toward totalitarianism may well be the spark that generates a genuine opposition, and the fitful process of elite negotiation can be overtaken by events on the street and the emergence of an unyielding opposition leader, as transpired thirty years ago.

### **The Iranian Economy:**

Among the most important factors shaping both Iran's future trajectory and the tools available to the international community for influencing that course are those related to the Iranian economy. As even the most cursory review of the press coverage of Iran would suggest, its economy has experienced perennial problems of mismanagement that have been exacerbated by the ideological and interventionist approach of President Ahmadinejad. In the past four years, every meaningful economic indicator has suggested serious trouble for Iran – alarms that were sounded well before the global economic crisis. Iranians must contend with double-digit inflation, power shortages, a tumbling stock market, stubbornly high unemployment rates particularly among young people, increasing dependence on volatile resource revenues, and perhaps most ominously for Iran's leaders a rising tide of popular indignation spawned by individual hardship and the broader national predicament.

Ironically, Ahmadinejad owes his unlikely ascent from administrative obscurity to the pinnacle of power in Iran in part to his successful exploitation of Iranians' frustration with their living standards and economic opportunities. While Ahmadinejad's original 2005 election surely benefited from no small amount of electoral manipulation, his election was accepted as a credible outcome by many if not most Iranians because he waged an unexpectedly effective campaign. His messages emphasized the economic hardships and inequities that afflict the average Iranian, and he spoke bitterly about the indignities of Iran's grinding poverty and pointedly contrasted his lifestyle with that of his chief rival, the profiteering former president Akbar Hashemi Rafsanjani. Ultimately, Ahmadinejad's initial election reflected the frustrations of an electorate more concerned with jobs and the cost of living than with slick campaigns or implausible pledges of political change.

Despite this apparent mandate, however, Ahmadinejad governed on the basis of ideology rather than performance. As a result, the president himself bears much direct responsibility for the current state of Iran's economic affairs; his heavy-handed interference with monetary policy and freewheeling spending contributed the spiraling inflation rates, and his provocative foreign policy and reprehensible rhetoric has done more to dissuade prospective investors than any U.S. or United Nations actions. His personal disdain for the technocracy and quixotic economic notions has undermined much of the progress that has been made in recent years to liberalize the Iranian economy and address its underlying distortions. The president has boasted of his instinctive grasp of economic policy, reveled in the reverberations of the global economic meltdown, and scoffed that his government could withstand even a drop in oil prices to a mere \$5 per

barrel. And he spent – taking full advantage of an epic oil boom that reaped more than \$250 billion in his first three and a half years as president. Ahmadinejad traversed the country with his full cabinet in tow, and taking evident enjoyment from a paternalistic process of doling out funds large and small for picayune provincial projects and even individual appeals.

The senselessness of his policies has provoked an intensifying firestorm of criticism from across the political spectrum. At first the critiques were light-hearted. When he once boasted about the bargain price of tomatoes in his low-rent Tehran neighborhood, the president sparked a flurry of popular jokes at his expense and grumbling among the political elite. However, as the ripple effects of the global economic slowdown began to impact Iran and the price of oil crashed to less than one-third of its stratospheric 2008 high, the mood soured both among the regime's veteran personalities and its population at large. In three successive letters, panoply of the country's most respected economists detailed the dangers of the president's policies. Notably, the critiques were not limited to the president's factional adversaries; much of the disquiet voiced in recent years over the state of the economy emerged from sources ideologically inclined to support Ahmadinejad and his patron the supreme leader, including traditional conservatives with longstanding links to the powerful *bazaar* and the centers of clerical learning.

Thanks to his assiduous deployment of economic grievances during his original campaign and his copious and public spending throughout his first term, Ahmadinejad made himself particularly vulnerable to the regime's stumbling in this arena. What particularly galled so many Iranian political figures was the opportunity sacrificed by the malfeasance of the past few years. Iran's oil revenues under Ahmadinejad's first term exceeded eight years' of income during both the Khatami and Rafsanjani presidencies; indeed of the more than \$700 billion that Iran has earned through oil exports in the past thirty years, nearly 40 percent came in during the past four years. Adding fuel to the fire was the lack of transparency over its allocation; having decimated the economic planning bureaucracy and attempted to classify the details of the nation's oil reserve fund, Ahmadinejad left vast ambiguity as to the destination of tens of billions of dollars of his government's spending. The presumption is much of it has financed record consumption, with a disturbingly high import quotient, rather than creating jobs, attracting investors, or taking advantage of Iran's large, well-educated baby boom as it comes of age.

During the presidential campaign, this particular issue and the state of the economy more broadly were hot-button issues for Ahmadinejad's opponents. Musavi, who had pressed for statist policies through his tenure as prime minister during the 1980s, embraced a relentlessly technocratic message centered on the incumbent's failure to manage the economy effectively. Musavi and his rivals pitched the economy as the primary issue in their attempt to connect with voters, equating economic grievances with threats to the country's security. As is his wont, Ahmadinejad was not cowed, and brandished shocking allegations of corruption and patronage as well as misleading statistics in the riveting televised campaign debates with each of his rivals.

The unrest of the past six weeks will only aggravate Iran's economic dilemmas and put durable solutions to the perpetual problems of uncontrollable subsidies, unaccountable spending that much further out of reach. The crisis will likely persuade more Iranians who have the means and/or ability to leave the country to do so, exacerbating the persistent problem of the brain drain and related capital flight. Even in advance of any multilateral action on sanctions, the political risks and generally unpalatable nature of the new power structure will dissuade some investors and reduce the competitiveness of Iran's external links. Should the political situation degenerate further, economic actions by the opposition such as strikes and mass boycotts could further paralyze the Iranian economy as a means of applying pressure to current decision-makers.

However, we should be careful about our assumptions with regard to popular opinions on the economy. Particularly over the past four years, the media as well as policymakers have routinely speculated on the prospect for economic grievances to spark turmoil that might threaten the Islamic Republic. The longstanding distortions that plagued the Iranian economy have been greatly exacerbated by Ahmadinejad's spendthrift, interventionist policies, and in recent years Iranians have had to contend with double-digit inflation and unemployment rates. Analysts often pointed to small-scale labor actions as well as the short-lived protests against the gasoline rationing program, launched in 2007, and other poorly-designed efforts to revamp the government's vast subsidies as the harbingers of mass unrest. They were repeatedly wrong on this count; Iranians grumbled and routinely vented their outrage over the economic conditions, but largely resigned themselves to making do.

Instead, what drove the Iranian people into the streets in record numbers and established the nascent stirrings of a popular opposition to the creeping totalitarianism of the Islamic Republic was a purely political issue – the brazen abrogation of their limited democratic rights. This should not imply that Iranians view their economic interests as somehow secondary to their political aspirations, but rather that three decades of Islamic rule have generated the conviction that Iran's representative institutions and its citizens' limited democratic rights represent the most effective tools for advancing their overall quality of life. With the brazen manipulation of the election, Iranians saw not simply the abrogation of their voice but the continuing hijacking of their nation's potential wealth and their individual opportunities for a better quality of life.

This reflects a remarkable transformation in the way that Iranian view their leadership; although Ahmadinejad, like Ayatollah Khomeini before him, prefers to emphasize the regime's ideological mandate, the population as well as much of the political elite have come to identify the responsibilities of their leaders as primarily oriented toward the provision of opportunities and a conducive environment for the nation's growth and development. Neither Ahmadinejad nor Khamenei can meet this test; their functioning frame of reference remains the fierce passions of religion and nationalism.

### **US Policy Options:**

The events since the June 12<sup>th</sup> elections have changed Iran in profound and irreversible fashion, and it would be fruitless and even counterproductive to proceed as though this were not the case. The United States must adjust both its assumptions about Iran and its approach to dealing with our concerns about Iranian policies to address the hardening of its leadership, the narrowing of the regime's base of support, the broadening of popular alienation from the state, and the inevitability that further change will come to Iran, most likely in erratic and capricious fashion.

But the turmoil within Iran has not altered America's core interests vis-à-vis Iran, nor has it manifestly strengthened the case for alternatives to the Obama Administration's stated policy of diplomacy. The worst of these prospective alternatives, military action, remains fraught with negative consequences for all of our interests across the region, including the revitalization of the peace process and the establishment of secure, independent states in Iraq and Afghanistan. Even as an option of last resort, military action would leave us and our allies in the Middle East markedly less secure and would likely strengthen rather than derail Iran's nuclear ambitions.

There may be some who see the past six weeks as a vindication for the prospects of regime change in Iran. I would argue that this is precisely the wrong lesson to take from the recent unrest. Every element of the past six weeks' drama in Iran has been wholly internally generated, and even the whiff of any external orchestration or support would have doomed its prospects. Even today, with a burgeoning opposition movement, America's instruments and influence for effecting regime change are almost nonexistent.

As a result, and perhaps alone among the panelists today, I remain a supporter of an American strategy of engaging Iran. As profound as recent events have been in splintering the Iranian leadership and creating the seeds of an opposition movement, engagement remains the only path forward for Washington. It will require an effort to negotiate with a particularly unpleasant and paranoid array of Iranian leaders. Still, the Obama Administration's interest in engagement was never predicated on the palatability of the Iranian leadership – indeed, until very recently the conventional American wisdom tended to presume a second Ahmadinejad term – but on the urgency of the world's concerns and the even less promising prospects for the array of alternative U.S. policy options.

The upheaval in Iran does not inherently alter that calculus, but it does seem likely to exacerbate the potential pitfalls of implementing engagement. One of the lines floated by the administration – that the consolidation of power under Iranian hard-liners will create incentives for a quick resolution of the nuclear standoff – is certainly conceivable, but given Tehran's uncompromising rhetoric and resort to violence, it sounds suspiciously like wishful thinking. More probable is the opposing scenario – that the United States is going to have to deal with an increasingly paranoid and dogmatic Iranian regime, one that is preoccupied by a low-level popular insurgency and a schism among its longstanding power brokers.

How will Washington draw an even more thuggish theocracy to the bargaining table? What incentives might possibly persuade a leadership that distrusts its own population to make meaningful concessions to its historical adversary? How can the international community structure an agreement so that the commitments of a regime that would invalidate its own institutions are in fact credible and durable? Finally, what mechanisms can be put in place to hedge against shifts in the Iranian power structure, an outcome that seems almost inevitable given the current volatility of the situation?

These hurdles are not insurmountable; the context for the successful 1980-81 diplomacy that led to the release of the American hostage was at least as challenging as that of today. Most of the tentative American relationships with the revolutionary regime had evaporated with the demise of Iran's Provisional Government, and instead U.S. negotiators faced an implacably anti-American array of Iranian interlocutors, whose authority, credibility, and interest in resolving the crisis remained an open question throughout the dialogue. Moreover, Tehran's ultimate goals seemed unclear, possibly even unknown to its leadership, who often employed the negotiating process as a means of prolonging the crisis rather than resolving it.

A successful agreement to end the hostage crisis entailed months of intense work and many false starts, but a variety of tools – including secret negotiations and the involvement of a third-party mediator and guarantor for the eventual agreement – helped facilitate an outcome that both sides abided by. There are no guarantees that the hard-won success of the negotiations that ended the hostage crisis can be replicated today; if anything, the stakes are higher and the Iranian political dynamics are less promising at least in the very short term.

Perhaps the critical factor in the success of the hostage negotiations was the Iraqi invasion and Iran's desperate need for economic and diplomatic options to sustain the defense of the country. In a similar respect, any U.S. effort to negotiate with Tehran may benefit from the identification of incentives and counterincentives that can similarly focus the minds of leaders and expedite the path for negotiators. This is the proper role for an effort to coordinate with U.S. allies on an intensification of sanctions should engagement fail to resolve our concerns about the nuclear program. In particular, we need to step up our dialogue with Beijing, whose interests with respect to Iran diverge substantially from those of the Russians and whose investments in Iran reflect a long-run effort to secure prospective opportunities rather than a short-term calculus of maximizing profit.

Still, we should be careful to presume too much with respect to the efficacy of sanctions. There are no silver bullets with respect to Iran. While Tehran is certainly capable of change, economic pressures alone have only rarely generated substantive modifications to Iranian policy, particularly on issues that the leadership perceives as central to the security of the state and the perpetuation of the regime. In general, external pressure tends to encourage the coalescence of the regime and even consolidation of its public support, and past episodes of economic constraint have generated enhanced cooperation among Iran's bickering factions and greater preparedness to absorb the costs of perpetuating

problematic policies.

The diminution of revolutionary fervor and the arguably less compelling public interest in the nuclear program would surely complicate any effort to persuade Iranians that economic deprivation is an acceptable price to pay for defending what the leadership has portrayed as its national right to technology. However, the global context differs as well; Iran today is not nearly as isolated as it was in the 1980s, the considerable economic opportunities offered by Europe and conceivably by the U.S. are no longer irreplaceable. And the underlying cause of most of Iran's contemporary budget crunch relates to its own mismanagement of epic revenue flows, rather than punitive multilateral measures.

As a result, sanctions, while nominally successful in raising the costs to Tehran of its provocative policies, could fail in their ultimate goal of gaining Tehran's adherence to international nonproliferation norms and agreements. This analysis should not imply that sanctions and other external economic pressures have no value in altering Iran's pursuit of provocative policies. In retrospect, the rare successes relate less to the actual financial cost to the Iranian leadership, which is ultimately survivable, than to the perceptions, timing, and utility in swaying a small but critical constituency. This is where our efforts should focus – on ways to alter the calculations of those influential actors. Efforts to block the import of refined gasoline are unlikely to have such an impact; they will be mitigated by Iran's porous borders and long history of smuggling petroleum products, and those with access to power are likely to retain access to fuel. We need to engage in discussions with our allies about smart sanctions with broad international support

Finally and perhaps most importantly, any forward-looking U.S. policy needs sufficient dexterity to adjust to the inevitable changes that will buffet Iran over the forthcoming months. Iran is in a period of great flux, and there simply can be no certainty about the final outcome of the current dynamics. As events inside Iran shift toward either compromise or confrontation, Washington must be ready to respond accordingly.