Iran and the Unsustainable Sweet Spot

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A few weeks ago, I ran into a former colleague and Trump Administration official working on the margins of Iran policy. He told me confidently that "Operation Economic Outcast" was the Iran policy sweet spot. The past six months showed the limits of open conflict, but the Administration also wasn't going to accept a one-sided deal that acquiesced to Iranian demands to toll ships transiting the Strait of Hormuz. There were limits to the economic campaign – Treasury Secretary Scott Bessent acknowledged he was not going to blow up the global financial system (meaning the campaign likely won't meaningfully target China) – but instead the US was prepared to implement a methodical sanctions campaign to supplement the already painful US Navy embargo. With Iran's grip on the Strait of Hormuz diminishing, time was on the US side. Iran would either collapse, be forced to capitulate, or, as my former colleague noted, just become poorer and weaker over time.

A few weeks later, the sweet spot doesn't look as sustainable, and the endgame it is supposed to deliver looks murky at best. In the past two weeks, the US destroyed ten Iranian oil tankers following Iranian missile attacks targeting US warships and commercial vessels. The IRGC claimed to have struck multiple vessels and important US air assets in a missile barrage against a US air base in Jordan. In parallel, the Houthis seized the strategic Yemeni port city of Mocha and an island in the Bab el-Mandeb Strait, further threatening Red Sea shipping. Finally, last Friday Saudi Arabia shut down the East-West oil pipeline for repairs following multiple drone attacks against the crucial alternative to the Strait of Hormuz. Taken together, energy prices have spiked, Trump readily acknowledges the conflict won't be resolved before the midterms, and his advisors have reportedly warned him the war could extend through the end of his term in 2029.

The Basic Facts

All of this is a reminder of two simple, but consistently overlooked, aspects of the war and broader Iran pressure campaign. First, Iran gets a say in how this war ends. Trump entered the war believing that it would be easy and that he could control the timing. He repeatedly claimed the war was a minor excursion and would take only a few weeks. Six months later, we are no closer to resolution than we were when Trump launched the war on February 28. The same miscalculation seeped into the Islamabad negotiations in April. The terms Iran claims to have put on the table – an open Strait of Hormuz (albeit with murky logistical details) and a significant pause on uranium enrichment – were deemed insufficient and summarily rejected by Vice President JD Vance. In retrospect, these were far better terms than what the Trump Administration agreed to in June or what is likely possible now.

The same principle applies to Operation Economic Outcast. I wrote last month that we have entered the end of the cost-free pressure era. Iran's willingness and ability to impose reciprocal costs through the Strait of Hormuz and target Gulf energy infrastructure have forever changed our ability to implement pressure without repercussions. If anything, I am surprised Iran hasn't responded more directly and forcefully to date. Iran hasn't attacked Gulf energy infrastructure since March. Still, it retains this capability – and if economic or military pressure reaches a certain point once again, Iran will escalate long before it capitulates.

The second consistently overlooked aspect is that the Iranian regime is really good at surviving. Last week, economist Esfandyar Batmanghelidj wrote an important piece outlining Iran's strategies for surviving the economic pressure campaign. It's not that the pressure campaign isn't hurting Iran – it is – but the government is shifting the pressure from the government to the people by driving down consumer consumption. Iran is also using the pressure campaign as cover to implement costly and unpopular fuel subsidy reforms at the same time. Iran has long sought to undertake these reforms, but they are highly unpopular and have led to popular discontent in the past. Now, using the US pressure campaign as an excuse, Iran is trying again. Fuel subsidy reform doesn't come without risk for the regime, but if completed effectively, it could address a systemic inefficiency the regime has long wanted to overhaul.

This is just the latest example of the regime's uncanny ability to adapt, fight back, and repress its own people when necessary to survive. In the 1980s, Iran survived a devastating war with Iraq despite being isolated internationally and severely outgunned. It has consistently used a vast Basij volunteer militia network to repress domestic dissent. And it has already shown, earlier in this war, that it can survive the decapitation of its most important military and national security leaders with minimal disruption to regime cohesion.

To be clear – this is not a system that is thriving. Inflation is at an all-time high. Iran brutally murdered thousands of its own citizens in January to repress large-scale protests, and Iran foolishly overplayed its hand when it resumed attacking ships in the Strait of Hormuz while the US-Iran Memorandum of Understanding was still in effect. But as much as the United States or Israel might wish that the Islamic Republic would either collapse or capitulate, there is a very low chance of this happening. Even if my former colleague was right and "Operation Economic Outcast" is still in effect at the end of Trump's term, regime collapse or capitulation won't happen without massive escalation and adaptation from Iran.

The Same Prescription

My analysis of the state of play in Iran has not changed over the past month. There are no good options for ending the war or addressing the broader array of challenges that Iran presents. A potential resolution is further complicated by the Houthi gains in Yemen. As much as the Trump Administration might believe economic pressure is the Iran policy sweet spot, it is neither a panacea nor likely to succeed. Hoping the regime falls in a few months – or even a few years – is neither likely nor an effective strategy. The best bad outcome is still a short-term agreement to end the war and open the Strait. Unfortunately, it's just not clear that Trump recognizes that yet.