AJC Berlin Ramer Institute

Mideast Policy Center

IRAN WATCH

THE ECONOMICS OF THE NUCLEAR DEAL

April 12, 2018

The May 12th deadline for the Trump administration to waive sanctions against Iran and keep the U.S. in the nuclear deal (JCPOA) is quickly approaching. For months, European diplomats have been negotiating with their U.S. counterparts over additional sanctions in order to salvage the deal. As sanctions are a key instrument used to change Iranian foreign policy, this edition of *Iran Watch* investigates the actual impact of sanctions relief upon the Iranian economy and resulting trade with Europe.

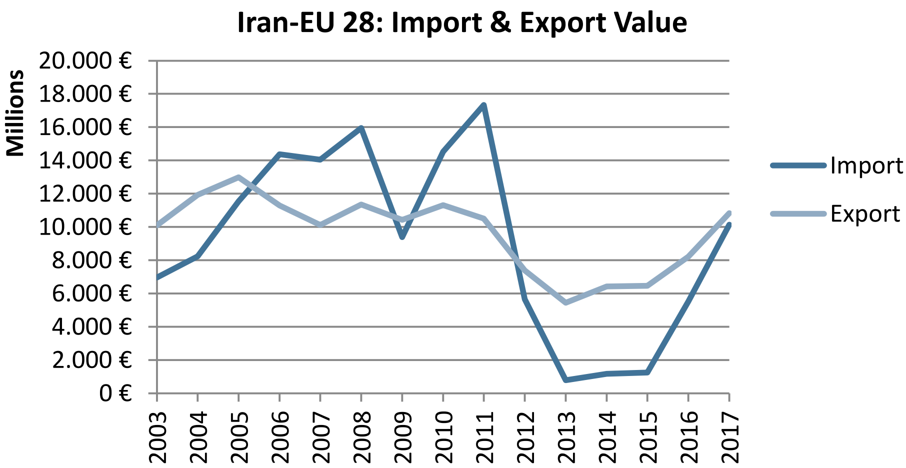
Beginning in January 2014, sanctions against Iran were slowly lifted as part of an interim agreement until the JCPOA’s implementation day on January 16, 2016 when most UN, EU, and U.S. nuclear-related economic and financial sanctions were lifted. The resulting impact upon Iran’s economy has been significant. In 2016, Iran’s economy experienced 7% growth, with oil exports rising near to pre-sanctions level. Despite increased trade and investment from the US and EU, for many Iranians, sanctions relief has not has not brought the economic recovery promised by the government. From December 2017 through January 2018, protests airing economic grievances swept across Iranian cities and small towns. In addition to the many structural deficiencies still plaguing Iran’s economy, many foreign companies are hesitant to invest in Iran, due to the reluctance of major banks to finance trade with Iran and due to concerns about the a potential re-imposition of sanctions on the part of the Trump administration.

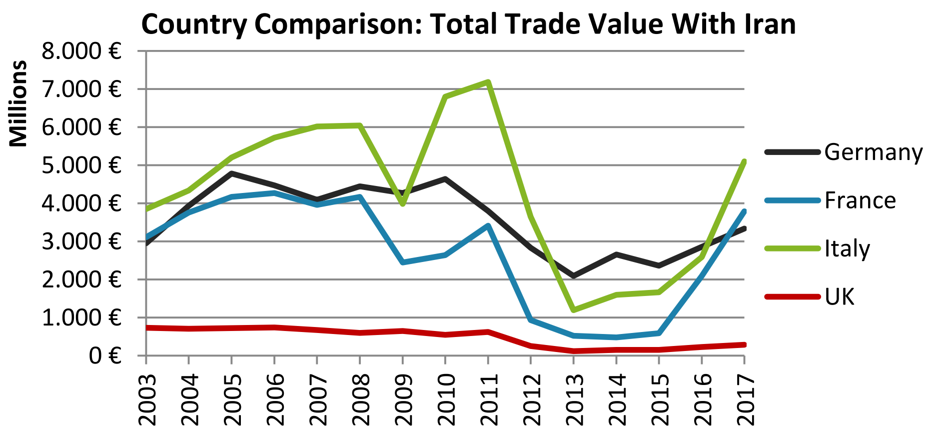
Economic Impact of Sanctions (Relief)

Through the 1990's and 2000's, the U.S., EU, and UN all implemented sanctions (of varying severity) that took a serious economic toll upon the Iranian economy. Between March 2012 and March 2014, Iran's economy shrank by 9%, with crude oil exports (accounting for half of the government's revenue prior to 2012) falling by more than half between 2011 and mid-2013. By 2014, the unemployment rate had risen to around 20%. The former U.S. Treasury Secretary Jacob Lew estimated in 2015 that Iran's GDP was 15-20% smaller than it would have been had international sanctions not been imposed.

Since sanctions began to be lifted in 2014, trade between Iran and the EU has skyrocketed by 236%. After implementation day, numerous high-profile trade deals worth billions of euros, such as Airbus, have been struck (the U.S. airline company Boeing struck a similar deal). Other companies like Volkswagen, MAN, Linde, Audi, Daimler Benz, Munich Re and Kathrein have sent delegations to Tehran. Germany accounts for 27% of all EU exports to Iran and has a significant trade surplus with Iran, exporting expensive industrial machines and high-end goods while importing less costly items such as fruits, rugs, and other exotic goods. From 2013 to 2017, German exports to Iran increased 61%. Italy is the largest importer of Iranian goods (33% of all EU imports), having the capabilities to refine Iran's sulfur-rich crude oil. Greece has similar capabilities and accounts for an outsized 12% of all EU imports from Iran.

Despite increased trade, Iran's economic recovery has been unsteady. In March 2018, crude oil exports were 26% less than the previous year, consumer prices continued to rise at a double-digit rate, and Iran's currency crashed to a new low. Iranian state TV reported that Supreme leader Ali Khamenei himself called upon President Rouhani to speed up the economic recovery and make Iran more self-sufficient.





Sources:
Market Access Database, European Commission
EU restrictive measures against Iran , Council of the European Union
Iran’s Currency Crashing to Two Year Low, Times of Israel, 26.03.18
Iran's March Oil Exports Fall To Two-year Low As Asia Demand Eases, Radio Farda, 10.03.18
Iran's Khamenei says economic progress limited despite lifting sanctions, Reuters, 09.03.17

Structural Problems in Iran

To date, most Iranians have yet to reap the benefits of sanctions relief. Rather, the government is suspected of using most of the $1.7 billion unfrozen U.S. funds to augment its defense budget, including its support for terrorism and its activities in Syria, Yemen, and other countries in the region. Paramilitary bodies like the Islamic Revolutionary Guard Corps, as well as religious institutions, place additional constraints on business, competition, and job creation. According to some estimates, these interest groups control up to 60% of all assets in Iran and pay little to no taxes. Corruption remains as rife as ever, with Iran ranking 130th in the world countries according to Transparency International. The International Monetary Fund (IMF) has urged Iran to reform its financial sector and has called its “highly educated women…an untapped source of growth and productivity.”

President Rouhani, while pushing for financial and economic reforms, calling on state and semi-state institutions to open the economy, is limited in his power due to the structure of the Iranian political system, with theocrats ultimately having the final say. Thus, despite the empirical evidence of increased economic openness leading to economic growth, experts judge Iran to have remained consistent in prioritizing national security over economic interests; the senior revolutionary leadership and other hard-liners have not changed their stance in opposing economic openness, calling western cultural imports a form of “soft war,” and belief that economic independence is key in combating “western imperialism.”

Sources:
Iran Sanctions, Congressional Research Service, 02.21.18
Corruption Perception Index 2017, Transparency International
IMF Staff Completes 2017 Article IV Mission to Islamic Republic of Iran, IMF, 12.18.17
Prospects for Change in Iranian Foreign Policy, Carnegie, 20.02.18

Unmet Expectations

The promise of the JCPOA improving living conditions helped President Rouhani win the 2013 election, with supporters advocating the reintegration of Iran into the international community. However, sanctions relief fed expectations that have not been met, sparking widespread social unrest that erupted between late December 2017 and January 2018. According to Iranian judicial authorities, 25 people were killed and 4,000 arrests were made during the protests.

Iranian officials had expected the JCPOA to bring in $10 billion a year in foreign oil and gas sector investments, but the country has only secured $1.3 billion over a two-year period. With the Trump administration threatening to withdraw from the Iran deal, international companies and banks have remained largely on the sideline. The U.S. still prohibits all dollar transactions with Iran, complicating matters further as the majority of oil trade is conducted in dollars. International banks are also reluctant to provide financing for trade deals with Iran. The IMF forecasts Iran's real GDP growth to reach 4.2% this fiscal year, down from 6.6% last year.

Sources:
Behind Iran's Protests: A Struggling Economy Despite Sanctions Relief, Wall Street Journal, 01.04.18
Crisis of expectations: Iran protests mean economic dilemma for government, Reuters, 01.01.18
In Iran, Protester 'Suicides' Stir Anger and Calls for Accountability, New York Times, 14.01.18
Iran's Energy Resurgence at Risk as U.S. Grows More Confrontational, Stratfor, 09.08.17
Iran's Oil Boom Hasn't Showed Up, Wall Street Journal, 08.03.18

Economic Impact of U.S. Withdrawal

Much of Iran's economic woes remain due to domestic issues and the lack of financial reform, a fact the IMF has repeatedly highlighted. Were the U.S. to withdraw from the deal without providing clear evidence of Iran not upholding its obligations, the EU and other signatories would likely not follow suit. Additionally, because the deal was endorsed by the UN Security Council, Russia and China would protect their interests and veto the reinstatement of UN sanctions at the Security Council. Thus, without international backing, the direct economic impact of a U.S. pullout on Iran's economy may be fairly limited. The greatest potential source of economic damage could be between the U.S. and EU, caused by the imposition of secondary sanctions against European firms that continue to do business with Iran. The EU has gone so far as to look into emergency lines of credit for firms potentially exposed to a tough U.S. sanctions regime. It is this potential impact upon transatlantic trade and political relations on which political analysts have focused.

Sources:
EU may offer credit to firms trading with Iran if Trump pulls out of nuclear deal, The Guardian, 23.03.18
The Impact of the Nuclear Agreement, Council on Foreign Relations, 13.10.17
Anti-government protests now look like an opportunity for Iran's president, Washington Post, 24.02.18