



مركز البيان للدراسات والتخطيط
Al-Bayan Center for Planning and Studies

Iranian Economy following the Withdrawal of the United States from the Nuclear Deal

By Hayder al Khafaji



About

Al-Bayan Center for Planning and Studies is an independent, nonprofit think tank based in Baghdad, Iraq. Its primary mission is to offer an authentic perspective on public and foreign policy issues related to Iraq and the region.

Al-Bayan Center pursues its vision by conducting independent analysis, as well as proposing workable solutions for complex issues that concern policymakers and academics.

Copyright © 2018

www.bayancenter.org

Iranian Economy following the Withdrawal of the United States from the Nuclear Deal

By Hayder al Khafaji*

As the 40th anniversary of the victory of the Islamic Revolution in Iran and the overthrow of the monarchy in 1979 approaches, Iranians will face the beginnings of a new economic era, as the U.S imposed sanctions on Iranian economy on August 6, 2018. Economists point out that the nuclear agreement signed in 2015 has brought significant benefits for Iran's economy, despite the obstacles faced Iran's normalization of relations with western banks.

According to a report, issued by the International Monetary Fund (IMF) on March 2018, the Iranian economy has grown following the lifting of sanctions. Also, it's expected to grow by 3.37% by the end of the fiscal year of 2017/2018.¹

The purpose of this study is to predict the future of Iranian economy following the imposition of U.S. sanctions; identify the direction the economy is likely to take as it enters a new crisis, after would be deprived from the most important source of income, namely oil revenues; and highlight the reaction of the Iranian government and the available policy alternatives that it might pursue to face the American embargo.

In light of the above, this study will assess the Iranian economy, based on different economic and political variables; and possible scenarios for the future of the Iranian economy, as well as, different policy alternatives available to the current government to face economic impact of the U.S. sanctions for the next months and probably years.

1. World Investment Report 2017, UNCTAD.

* Researcher at Al-Bayan Center for Planning and Studies.

Introduction

Following the Islamic revolution in Iran, the Iranian economy has undergone successive changes and developments, whether as a result of internal crises or wars waged against the Islamic Republic of Iran with their economic ramifications, such as blockades or/and various international sanctions of varying degrees and intensities, which reached their peak in 2012 during the era of President Ahmadinejad. The political upheavals over the past four decades of the Islamic Republic have had a noticeable impact on Iran's economy and its human development indices.

When President Hassan Rouhani took office in 2013, the indicators of economic performance were at their worst, with official statistics indicating a negative real economic growth rate and a high inflation rate of 4.6%². But in 2015, the year that the nuclear agreement was reached with the 5 + 1 group, Rouhani's government has started to revive Iran's economy and improve its performance. Following the implementation of the nuclear deal, oil exports have increased, foreign investments have returned, and overall economic performance indicators have improved because of the importance of the oil sector to the GDP growth.

However, no sooner had US President Donald Trump taken office than the decision to reimpose sanctions was announced. The US administration adopted a tough stance towards the Iranian government and decided in May 2018 to withdraw from the nuclear agreement and to impose an unprecedented economic embargo on Iran, spread over two stages: the first stage launched on 6 August 2018 to prevent any economic transaction conducted by US dollars; and the second stage, which comes into effect on 4 November 2018, imposes sanctions on buyers of Iranian oil. The crises over the past four decades have impeded Iran's economic growth.

2. Inflation exceeded the 40% threshold; food inflation reached 57%, Mehr News Agency.

Iranian economy and policy alternatives to Rouhani's government

political manoeuvring has had a major impact on Iran's economy and its economic relations worldwide, which suffer from uncertainty, and despite many countries' willingness to have strong economic ties with Iran, they prefer to maintain minimal economic relations³.

reluctancy has become apparent in the actions of several international companies, many of which have postponed major trade decision over the past five years, where 33% of these companies have attributed the postponement to fears of the re-imposition of sanctions on Iran; while 29% reported rising political risks as the reason behind their decision. Meanwhile, 51% of the participants' companies have considered the refusal of President Donald Trump to ratify the nuclear deal, and the possible negative impact on their companies' investment and trade plans in Iran. On the other hand, 94% have doubted the United States' commitment to meet its economic obligations⁴.

President Trump's announcement that the United States will withdraw from the Iranian nuclear deal, without seeking to change some of its terms, makes Tehran's success in attracting foreign investors even more difficult, but even before the re-imposition of sanctions, Rouhani's government achieved limited success in attracting foreign direct investment (FDI), compared to what had been previously planned by his government.

According to the data of the United Nations Conference on Trade and Development (UNCTAD), Iran has attracted foreign direct investment (FDI) of nearly 50% in 2017, or approximately \$5 billion⁵. However, it is estimated that once oil sanctions kick in, in November 2018, and Iran becomes deprived of the

3. Two Future Scenarios for the Nuclear Agreement; The World Economy Newspaper – Iran

4. Great Expectations, Delayed Implementation, Bourse & Bazaar, January 2018.

5. Tehran Times: UNCTAD –FDI inflows to Iran up nearly 50% in 2017.

international banking messaging system – SWIFT, foreign direct investment will face a decline of about 27%. Iran’s Five-Year Plan for the period 2016–2021 aimed to attract foreign direct investment of \$15 billion a year, but the Plan also set a minimum floor of \$3 billion a year below which this type of investment must not drop,⁶ which is relatively small by the standards of emerging markets.

Hassan Rouhani’s limited success in attracting foreign investment is due to several reasons, such as the legal environment of Iran which is not friendly or convenient to investors, as well as, the difficulties that face banking transactions. Although, following the lifting of sanctions, Iranian banks have been allowed to re-join the international banking messaging system, SWIFT, nevertheless, first tier banks in the West have remained reluctant to do business with Iran. The major banks – which play a central role in processing international financial transactions for second and third tier banks – remain wary of any dealing with Iran.

Despite all these obstacles, President Rouhani’s administration continues to expand its banking network with Asia and Africa, and not just confining itself to European banks. Rouhani’s administration has also been working on banking reform called for by the Financial Action Task Force, FATF, which focuses on transparency, anti-money laundering and terrorism funding. Rouhani’s administration has sought to implement the FATF recommendations, and these measures, which it has adopted so far, have helped to postpone the imposition of countermeasures against the Iranian banking system, whilst bearing in mind that the cumulative effects of past sanctions continue to reverberate through the Iranian economy and the banking system.

The Iranian government continues to address the flaws of its banking system, and once it has resolved these problems, this should act as a catalyst for European and other major international banks to deal with Iran once again. Numerous Iranian

6. Iran approves the Sixth Development Plan to boost investment.

companies complain that many international banks refuse to deal with them because these banks fear that they may become subject to formal procedures or conditions, restrictions or penalties prescribed by the sanctions' regime.

Can Iran rely on its allies to support its economy?

Iran can presumably count on the backing and economic support of its allies, whether from neighbouring countries such as Iraq, Turkey, Russia, or from its EU trade allies; as well as buyers of Iranian oil from Asia, particularly China, South Korea, India and Japan.

However, it is worth asking what kind of support can each ally provide to bolster the Iranian economy in the foreseeable future? The answer will very much depend on the special interests of each of these regional neighbours, and as such it may be premature to predict this.

Renegotiating the terms of the nuclear deal

Iran is not alone in refusing to renegotiate the terms of the nuclear deal. Russia and China share a common stance, but the EU has proposed some amendments, adopting tougher inspection's regime, extending the duration of the nuclear deal, and incorporating complementary agreement covering missile systems and certain security matters in the region. The Iranian government believes that the EU is not being earnest in its efforts to preserve Iranian gains from the nuclear deal. According to Mohammad Javad Zarif, Iran's Minister for Foreign Affairs, "The announcement by major European companies of the possibility of withdrawing from their cooperation with Iran is not consistent with the European Union's commitment to implement the nuclear agreement."⁷ In another statement, Zarif described the three leading scenarios available to Iran in the event of a US

7. Withdrawal by European Companies is not consistent with European Commitment, ISNA News Agency

withdrawal from the nuclear agreement, which are:

The first scenario: Iran also withdraws from the nuclear agreement, end its commitment to the terms of the agreement and vigorously resumes uranium enrichment.

The second Scenario: Iran relies on the dispute resolution mechanism in the nuclear agreement, which allows any of the parties to submit a formal complaint to the committee, formed under the terms of the agreement, to adjudicate on violations of the terms of the agreement.

The third Scenario: as a signatory to the treaty, Iran will consider withdrawing from the NPT (Nuclear Non-proliferation Treaty).⁸

Conclusion

It appears that dismantling the agreement is an American strategy aimed at forcing Iran to re-enter the negotiating process to ensure more favourable conditions for the US government; however, this is unacceptable to the Iranians. The agreement, which President Trump called “the most stupid deal”, also has its detractors amongst Iran’s decision-making echelons. Therefore, any talk of new rounds of negotiations over Iran’s nuclear programme would be unacceptable to Iran’s decision-makers, who also have no confidence in Europe’s ability to manage the fallout from America’s withdrawal from the agreement. Also, there is not an Iranian appetite to enter negotiation over its ballistic missiles too.

On the other hand, the repercussions of the US withdrawal will result in political upheavals in the region, and Iran will focus on bolstering its ties with Washington’s rivals in the region, especially Russia and China. Also, Iran will make it extremely difficult for the US administration to ignore Iran’s interests and role in its handling of any regional crisis.

8. Zarif: there are three possible scenarios for Iran in the event of a US withdrawal from the nuclear agreement

Sources:

1. World Investment Report 2017, UNCTAD, P:224.- http://unctad.org/en/PublicationsLibrary/wir2017_en.pdf
2. Inflation exceeds 40% threshold / food inflation reaches 57%; Mehr News Agency, April 12, 2013. - <https://www.mehrnews.com/news/2024736/>
3. Two Future Scenarios for the Nuclear Agreement; World Economy, Iranian Newspaper - <https://www.donya-e-eqtesad.com/fa/tiny/news-3338186>
4. Great Expectations, Delayed Implementation, Bourse & Bazaar, January 2018.
5. https://static1.squarespace.com/static/54db7b69e4b00a5e4b11038c/t/5a580a2071c10baff710d91e/1515719208299/B%26B_Special_Report_Iran_Economic_Implementation_MD.pdf
6. Tehran Times: UNCTAD-FDI inflows to Iran up nearly 50% in 2017.- www.tehrantimes.com/news/.../FDI-inflows-to-Iran-up-nearly-50-in-2017-UNCTAD
7. Iran approves the Sixth Development Plan to boost investment- <https://www.lexology.com/library/detail.aspx?g=9a25e9cc-44d0-45fa-9a54-905de434fc66>
8. The withdrawal of European companies is not consistent with the European pledge to cooperate with Iran; ISNA News Agency <https://www.isna.ir/news/97023016852/>
9. Zarif: there are three possible scenarios for Iran in the event of a US withdrawal from the nuclear agreement. - <http://tn.ai/1707431>