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INTERNATIONAL POLICY ANALYSIS

Great Expectations

The Iranian Economy after the Nuclear Deal

ROUZBEH PARSI

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- The lifting of sanctions has been a major victory for the Rouhani government, but both the government and Iranian society in general are frustrated by the slow increase in actual business and economic investment. There is a gap between what can realistically be expected in terms of the extent and speed of foreign investment into a market lagging behind for more than a decade – and the hyped expectations following the JCPOA.

- While Iran is on an accelerated path of economic development, major reforms in business practices, state bureaucracy and policies are required to further encourage and enable the foreign direct investment the country needs, for this development to be sustainable. The psychological barrier in the minds of potential investors, caused by restrictions on Iran and problems within the country, needs to be overcome before the risk averse-business sector in Europe will be willing to make serious investments in the Iranian market.

- Should foreign partnerships, especially with Europe, fall short of expectations and should the government fail to undertake the necessary domestic reforms, a golden opportunity to improve relations between Iran and Europe and help the Iranian economy to grow in a sustainable fashion will be lost. The domestic ramifications are serious, as the groups within the elite seeking greater engagement with the world will lose ground. If the economy falters, socio-economically vulnerable groups in society will be adversely affected and the economic prospects of the large group of young educated Iranians, the group most inclined to favour engagement with the outside world, will be harmed.

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After the Deal: It's Complicated

Iran is a country with great potential for economic and political development, which in turn will affect its outlook and position in the region and beyond. However, an intricate alignment of domestic policies and continued support from external partners are needed to fully tap this potential. The Rouhani government's domestic policies, its focus on structural reform and the lifting of sanctions have placed Iran onto a promising trajectory. Alas, the road ahead is long and complicated.

In July 2015, the two-year-long negotiations on the Iranian nuclear programme came to a successful end. Iranian President Hassan Rouhani's negotiation team, led by Foreign Minister Javad Zarif, agreed that Iran's programme be severely curtailed in the coming 15 to 20 years and by ratifying the Additional Protocol of the NPT, remain constrained in perpetuity. In return, the sanctions imposed on Iran by the UN, but more specifically the EU and the US, would be lifted. The political calculation in Tehran at the outset of these thorny negotiations was that they would be worth the huge political risk, if the final agreement resulted in the sanctions being lifted, thus allowing for a jump-start of the Iranian economy. The aim of the political gamble was to yield economic benefits for a beleaguered society, which in turn would translate into greater political support for the Rouhani administration. This would provide momentum to implement other crucial electoral promises made in 2013 and ensure a second term in the 2017 presidential elections. The US and EU see the agreement as a way to ensure – without risking an armed conflict – that Iran will not be able to develop nuclear weapons.[1]

The political and technical complexity of the issues is evident in the detailed and yet at times vague text of the Joint Comprehensive Plan of Action (JCPOA). While all parties have so far fulfilled their obligations, there is an added layer of complication, as the EU has lifted its sanctions while the US has only removed its secondary sanctions (punishing non-US parties trying to conduct business with Iran). The reason behind this is that the enforcement and existence of secondary sanctions can be modified by the executive (President Obama), while the main body of primary sanctions are laws enacted by the US Congress, where the (bipartisan) political majority is very hostile to Iran.[2]

There are two important elements to the actual implementation of the JCPOA: the legal-technical process and provisions, and the political context in which they are set. So far, the main complaints and complications have been caused by how the implementation has been conducted rather than the actual legal fulfilment of the agreement itself. In short, the problem so far is the institutionalised political atmosphere of distrust and fear. Within Iran's political elite, distrust of the US runs high, and no one is more outspoken about this than the Supreme Leader, Ayatollah Ali Khamenei. This is not only a matter of past grievances, but also, for some politicians, part of their revolutionary anti-imperialist credo. Similarly, the ideological hostility towards Iran is rather obvious among a number of American politicians, whether on the basis of their own reading of history or by virtue of their close alliance with Israel and, to a lesser degree, Saudi Arabia. Given historical precedents, this mutual hostility was to be expected.

The more acute and dangerous problem is how it reinforces the fear on the economic side, suppressing business ties that are of vital significance to Iran. The sanction regime against Iran (like many other similar regimes) is very complex and detailed in legal terms, yet the public perception of them is much more expansive. A lot of perfectly legitimate business activities and transactions are avoided because of the mistaken belief that they are illegal, risky, or simply because the associated costs (manpower, finances, legal costs, etc.) are too high to make them worthwhile.[3] In the cost-benefit analysis, the risks are thus erroneously exaggerated, which keeps most companies from conducting business in Iran. And for a long time, these were misperceptions that neither the US nor the EU saw any urgent need to correct. They wanted to squeeze the political elite in Iran using economic means and believed it was working well, partly because of the above-mentioned side effects.

1. On Rouhani's navigating of Iranian politics see Rouzbeh Parsi, »Astute gamesmanship and realistic ambitions: potential success of the Rouhani presidency«. Friedrich-Ebert-Stiftung, 2014, http://library.fes.de/pdf-files/iez/11031.pdf; and »Negotiating Iranian Politics: Rouhani's Reform Agenda«, Heinrich Böll Stiftung North America, Jan 19, 2016, https://us.boell.org/2016/01/19/negotiating-iranian-politics-rouhanis-reform-agenda.

2. On the intricacies of the sanctions regime see Ali Vaez, »Spider Web: The Making and Unmaking of Iran Sanctions«, International Crisis Group 25/2/2013; https://www.crisisgroup.org/middle-east-north-africa/gulf-and-arabian-peninsula/iran/spider-web-making-and-unmaking-iran-sanctions.

3. E.g. the pharmaceutical industry as discussed by Siamak Namazi, »Sanctions and Medical Supply Shortages in Iran«, Woodrow Wilson Center, February 2013; https://www.wilsoncenter.org/sites/default/files/sanctions_medical_supply_shortages_in_iran.pdf.

However, what was an unintended positive spin-off effect in 2011, constitutes a problem in 2016. Now, when the EU sanctions are lifted and the US is no longer supposed to interfere with economic activity conducted with Iran, this perception (among the business sector, banks, and politicians) of the sanctions as more all-encompassing than they actually are, creates unnecessary hurdles for Iran's economic recovery. In addition, the Office for Foreign Asset Control (OFAC) of the US Treasury Department, responsible for sanction enforcement, has been giving conflicting information on how potential infringements of US economic sanctions will be dealt with. Secretary of State John Kerry has responded to Iranian complaints and OFAC has signalled that the US sanction enforcement should not be seen as a hindrance to legitimate business. Yet the bottom line remains that business transactions involving companies and banks with business interests in the United States must either be willing to risk an ex-post facto ruling on the legality of their business with Iran in a US court, or embark on the arduous process of obtaining an OFAC license ex ante facto. Furthermore, many large international companies still remember OFAC's strong-arming tactics before formal sanctions were enforced – and do not necessarily trust that the current situation will endure, instead desiring more formal guarantees to conduct business with Iran.

This risk aversion has been reinforced by the surprising result of the recent U.S. presidential elections. President-elect Donald Trump has so far only had harsh words for the JCPOA and it remains to be seen to what extent, if at all, his administration will abide by the agreement. The likely presence of individuals in his administration with ideological biases against Iran as well hawkish attitudes in general toward the US' adversaries, is like to further complicate things.

The Economy: A Political Tug-of-War

The growth of the Iranian economy is key to the country's development trajectory, something all political factions are aware of. The key question is how this economic growth will be managed and who will get to take credit for it. Considering the events of the past 18 months, the impression may arise that the Iranian economy is about to go through a rags-to-riches transformation. The more prosaic reality is that the Iranian economy is part of a perpetual domestic socio-political tug-of-war and negotiations.[4] In this equation, the sanctions that have been lifted since the implementation of the JCPOA are but one of many variables. While a number of important positive impacts are already being felt, such as the reduction of the cost of imports and a relative easing of foreign transactions (albeit still with significant challenges), the more fundamental impacts on economic growth and an improved standard of living are yet to be seen. This was to be expected, as even in a best-case scenario, extensive improvements to the Iranian economy were going to take time – and continue being impeded by the many domestic structural challenges in Iran's economy.

One of the key medium-term achievements of the Rouhani government has been the reduction of the official inflation rate to single digits for the first time in over a decade. While this has come about as a result of increased fiscal and monetary discipline, a gradual decrease in liquidity and cutting of state sector costs, a lack of growth has also been a factor. Inflation is a relative indicator, and as such, lower inflation compared to the previous year or the one before that does not mean that the spending power of the average Iranian consumer has now suddenly increased, but instead that overall costs may not be increasing as rapidly.

Crucially, the Rouhani government has managed to increase oil production and exports to pre-sanctions levels at a speed that has surprised most observers. While it is true that going beyond the current production levels of around 3.8 million barrels per day (bpd)[5] will be very difficult without significant foreign investment, the National Iranian Oil Company (NIOC) will nonetheless be able to maintain the current (regained) levels, and as a result also continue regaining some of its global market share for exports. Despite the lower global oil price and continued challenges for Iranian crude oil sales (such as port or navigation restrictions brought about by the Saudis or challenges in insuring tankers), there is a positive forward trajectory, which will provide a much-needed relief for the Iranian economy through increased hard-currency earnings. Even at 30 per barrel US dollars, an increase

4. See Payam Mohseni, »Economic Privatization, Factional Politics, and Regime Transformation« and Kevan Harris, »Social Welfare Policies and the Dynamics of Elite and Popular Contention« in Brumberg, Daniel, and Farideh Farhi (eds.). 2016. *Power and change in Iran: politics of contention and conciliation.* Indiana University Press.

5. On overall oil production increase projections, please see Energy Information Administration (EIA) from January 2016: http://www.eia.gov/todayinenergy/detail.cfm?id=24592.

of a million bpd in oil exports is a significant boost to state coffers, as it would translate to around 11 billion US dollars in additional income. It is often argued that oil is a curse in disguise for a country like Iran, but more often than not the real problem lies in understanding and politically managing the volatility in oil revenue (which has been much higher than price volatility). Oil revenue volatility was 35.5 per cent/year between 1960–78, and 51.1 per cent between 1979–2010![6]

The Troubled Banking and Financial Sector

Despite the generally positive developments for oil production and exports, the Iranian economy continues to suffer from ill health – and nowhere is this more evident than in its domestic financial and banking sector. In addition to the deeper historical reasons for its poor health (such as state dominance, dual exchange rates, ambiguous and poorly implemented regulations, etc.), a number of other issues (in addition to the remainders of sanctions) put pressure on the financial sector.[7] In particular, these are related to concerns raised by the intergovernmental Financial Action Task Force (FATF)[8] and the domestic challenges exacerbated by the isolation of recent years, an over-politicised approach to the banking sector, coupled with the unsustainable liquidity position of some domestic banks.[9]

While the FATF has given Iran somewhat of a reprieve until the middle of 2017, the continued concerns about the deficiencies of the Iranian financial sector, particularly those focused on Anti-Money Laundering and Countering Financing of Terrorism (AML/CFT) regulations, will pose challenges to deeper financial engagements with Iran – and thus slow down the Rouhani government's efforts to improve economic conditions. The FATF noted in June 2016 that it welcomed »Iran's adoption of and high-level political commitment to an Action Plan to address its strategic AML/CFT deficiencies« and decided as a result to suspend »countermeasures for twelve months in order to monitor Iran's progress in implementing the Action Plan.« While this has helped reduce the overall risk picture, the challenges raised by the FATF continue to have deterrent effects on large transactions – and will have a negative impact on international banks' desire to facilitate or finance large investments in Iran.[10]

Domestically, these challenges are linked to the very same transparency and financial reporting issues mentioned by the FATF, but there are also deeper structural issues. The outdated legislative and regulatory framework that governs Iran's banking system as well as outdated business models and overall practices – in particular among state sector banks – continue dragging the economy down. All this is further exacerbated by the lack of transparency (as pushed for by the FATF, and the Basel Accord Regulations outlined below) and skewed competition due to the isolation of the Iranian financial sector. A reform process is underway, but has taken longer than expected. Here, Iran is contemplating updating its Central Bank rules (including issues governing its independence, greater authority over monetary policy, the potential of exclusively setting foreign exchange rates, etc.) as well as an overall »Banking Reform Bill,«[11] which would ultimately also enact the so-called Basel Accord Regulations.[12] Although many Iranian banks are still in the process of implementing the Basel II Regulations (the banking supervision accords issued by the Basel Committee on Banking Supervision), there has since been movement to implement the latest instalment, called Basel III. Basel III is a voluntary global framework put in place after the 2008 financial crisis, focusing mainly on capital adequacy, stress testing and liquidity risks.

However, despite the private sector push – and a relatively broad consensus on the need for reforms in order to

6. The argument is made by Kamiar Mohaddes and M. Hashem Pesaran. »One Hundred Years of Oil Income and the Iranian Economy: A Curse or A Blessing?«, pp.12–13, in Alizadeh, Parvin, and Hassan Hakimian. 2016. *Iran and the Global Economy: Petro Populism, Islam and Economic Sanctions.* Routledge.

7. For an analysis of the deeper structural problems during the 2000s see Sima Motamen-Samadian, »The role of government in the Iranian banking system 2001–2011«, pp.124–149, in Alizadeh, Parvin, and Hassan Hakimian. 2016. *Iran and the Global Economy: Petro Populism, Islam and Economic Sanctions.* Routledge.

8. The FATF is an intergovernmental organisation established in 1989. It currently has 37 members, primarily states, but also a number of other banking and financial organisations as associate members. The aim of the organisation is to combat money laundering and terrorism financing. http://www.fatf-gafi.org.

9. See for example *Press TV,* August 2016, »Banks become Iran's economic nightmare«; http://www.presstv.com/Detail/2016/08/21/481001/Iran-banking-stagnation-government and British Iranian Chamber of Commerce (BICC) report »Liquidity in the Iranian economy«: http://www.bicc.org.uk/downloads/Liquidity.pdf.

10. See here for the FATF June 2016 statement on Iran: http://www.fatf-gafi.org/publications/high-riskandnon-cooperativejurisdictions/documents/public-statement-june-2016.html.

11. See for example IRNA, 24 July 2016, »Bills on Iranian banking reform to be submitted to the Majles«; http://www8.irna.ir/en/News/82161636/.

12. For a brief description of the Basel Accords, see here: http://www.investopedia.com/terms/b/basel_accord.asp.

enable Iran's re-integration into global financial systems after almost a decade in the dark – there is also strong resistance. Much of this comes from state-owned banks, which not only fear for their overall competitive position, but would also – should regulations be modified – require the greatest structural reforms. Furthermore, there has been considerable political resistance, since greater transparency in banking would significantly reduce certain players' scope of action (including those still under sanctions), in carrying out or facilitating transactions without scrutiny. Reasons of national security and independence are often invoked in this type of debate. The fact that implementing the FATF action plan in full would negatively impact Iran's ability to support organisations – among others Hezbollah (which it does not define as a terrorist organisation) – could also have real geopolitical complications for Iran's ability to project its power regionally.

The overall health of the banking sector is another factor. For a very long time, Iranian banks have been the main source of financing for all economic sectors (through the use of deposits) due to Iran's weak capital (and debt) markets. Additionally, many lenders have very low capital adequacy requirements while supervisory mechanisms are lax. These challenges were exacerbated by the sanctions but were largely caused by the domestic push (in particular during the Ahmadinejad administration) for banks to provide cheap loans.

The sum of these issues means that despite the well-intended reform processes initiated under the Rouhani government and the Central Bank of Iran's (CBI) efforts to clean up the banking sector in collaboration with the IMF and under the FATF's watchful gaze, progress on these issues will continue at a slower pace than the government is hoping for and needs, especially to bring about success in the 2017 presidential elections.

The Politics of Economic Revival: Resistance versus Reform

From the very beginning, the Rouhani administration has been confronted with the near-impossible and delicate task of managing its own and public expectations with regard to the effects of the JCPOA. The government needs to both emphasise the energising effects of the agreement on the Iranian economy and be wary of raising too much hope about how quickly this will positively affect the economic prospects of the average Iranian. Inevitably, there have been disappointments, especially since another difficult task for the government has been to curb inflation and adjust the budget to what its coffers can actually finance. The government pursued an austerity policy that succeeded in curbing inflation, but at the price of decreased investments and a slower growth rate. Thus, in some respects, average Iranians actually experienced a decrease in purchasing power in 2014–15, even though the economy slowly started growing.[13] Hence, the public at large has been underwhelmed by the speed of economic recovery and actual foreign investments (in contrast to MoUs, which are ultimately more about sending political signals) and trade with Iran. It is also clear that the government itself is frustrated by the slow pace of primarily European investment and trade in the wake of the agreement and has expressed their belief that this is partly due to the fear of financial fines or political pressure from the US Treasury.

Economy of Resistance

The Supreme Leader indicated the importance of revamping the economy in a speech in February 2014. A policy launched under the heading ›Economy of Resistance‹ has all the hallmarks of his strongly held belief in independence and self-reliance. In fact, the notion of self-reliance as a revolutionary value and an act of resistance was introduced in 2010 in the context of breaking the grip of sanctions on the country.[14] In that speech he reminded the audience that the Islamic Republic had been the target of sanctions since its very inception and that these new sanctions, like the previous ones, would not break Iran. This constitutes an exhortation and rallying cry to build an economy geared towards domestic needs and capacities to finally make the country self-reliant and much less vulnerable to outside pressure.

In one of his latest speeches[15] on this topic, Khamenei outlined what an economy of resistance entails in detail. Besides increased efficiency in managing the economy and increased self-reliance, he signalled a need to re-

13. GDP per capita (PPP): 2013 –1.63 %, 2014 4.67%, 2015 –0.24 %, 2016 3.69 %. See https://knoema.com/atlas/Iran/GDP-per-capita-PPP-based.

14. Website of Supreme Leader, »Statement in meeting with entrepreneurs«; http://farsi.khamenei.ir/speech-content?id=10077 (2010/9/7).

15. Website of Supreme Leader, »Statement in meeting with national decision makers«; http://farsi.khamenei.ir/speech-content?id=32842 (2016/4/12).

turn to the »20 Year Perspective« that was made official policy in 2005.[16] The 20 Year Perspective (or Vision) is the state's attempt to stake out a path towards where Iranian society and economy should be in terms of capacity and ability. The ambition to integrate Iran into the regional economic landscape is of particular interest in this regard. Iran intends, for instance, to become a transport hub to cater to the energy needs of its neighbours by building railroad and pipelines. In the end, the Perspective document and the economy of resistance boil down to building domestic capacity in order to fulfil the potential of Iran's human capital and natural resources.

The question is whether the resistance dimension is intended to inhibit those clamouring for greater foreign investments in Iran or whether these two objectives are compatible. In a sense, Khamenei is at a consequential crossroads, just like his predecessor Ayatollah Ruhollah Khomeini. By the early 1970s, Khomeini had reached the conclusion that Iran required an Islamic system of governance. For the clergy, taking over the reins themselves was a radical departure from the historical role of advising the rulers. He stressed the supremacy of religion over politics, thus justifying theocratic rule. By 1987–88 he – in essence – reversed this assertion.[17] As the political and theological leader of Iran, his patience with his former seminary colleagues had worn thin; and in a series of statements he declared that the state knew best how to define the needs of Islam and how to protect it in the Islamic Republic. To all intents and purposes he admitted that the revolutionary ethos was being decoupled from its religious foundation – politics, once again, was the *raison d'état*.

Khamenei, in turn, is at a juncture where he must decide what relationship his conception of politics can and should have with the economy that he knows the country needs to rebuild. Will the inherent logic of a capitalist economy that is part of the global system be given leeway? If so, rational decision-making, with profit as the primary goal, will in the long run inevitably challenge and transform fundamental aspects of the Islamic Republic. If, on the other hand, Khamenei insists on a value-driven approach, where the revolutionary ethos – as defined primarily by the hardliners of the political elite – remains the guiding framework, then the economic recovery of Iran will be an arduous affair. In this scenario, it is less likely that the foreign investments needed to fulfil the country's economic potential will be as forthcoming or as great in extent as hoped for. Less growth means more pressure on the state to find ways to alleviate poverty and inequality by redistributing state funds. Recent experience with subsidy reforms has shown the limits and pitfalls of such endeavours.[18]

Labour Law and Its Impact on Workers and the Market

Iran's labour legislation, enshrined in the Labour Law of 1990, is an intriguing legal document. While taking into account the many post-revolutionary ideals of a fairer and more equitable existence for the »oppressed« – e.g. strict rules on forced labour, social security, working hours, etc. – its practical implementation and the many challenges of the often authoritarian approach to workers' rights has sullied the law's otherwise promising potential.

For example, while in theory there is a right of association and collective bargaining for workers, independent unions have been virtually impossible to found (there are instead semi-governmental structures that advocate for workers' right in large companies[19]). Furthermore, wherever successful independent workers' organisations have emerged, they have either been subject to restrictions or, in many cases, outright suppression.[20] Much of this has to do with historical experiences of dissent and rebellion. The elite of the Islamic Republic is acutely aware of the potency of such movements in galvanising public opinion and effectively crippling parts of the economy (because they used the very same tactics of strikes and boycott against the Shah). Thus, any independent movement is viewed through the lens of security, rather than one of workers' rights.

16. Bijan Khajepour, »Decoding Iran's ›resistance economy‹«, *Al-Monitor* 24/2/2014; http://www.al-monitor.com/pulse/originals/2014/02/decoding-resistance-economy-iran.html.

17. Hamid Mavani, »Khomeini's Concept of Governance of the Jurisconsult *(Wilayat al-Faqih)* Revisited: The Aftermath of Iran's 2009 Presidential Election«, *Middle East Journal,* v. 67, no. 2, Spring 2013, p. 209.

18. See Djavad Salehi-Isfahani, »Iran's subsidy reform from promise to disappointment«, Policy Perspective no.13, Economic Research Forum, June 2014; http://erf.org.eg/wp-content/uploads/2015/12/PP13_2014.pdf.

19. See a copy of the Labour Law's section on representation, here: http://www.ilo.org/dyn/natlex/docs/WEBTEXT/21843/64830/E90IRN01.HTM#c6 .

20. See for example, this report by Human Rights Watch from 2012: https://www.hrw.org/news/2012/01/30/iran-new-arrests-labor-activists.

At the same time, while the law has been relatively employee-friendly in its hiring/firing procedures, wages, insurance, etc., it has created rigidity in how business owners may modify their organisations and adapt to changing business realities. This, in turn, has led business owners to look for workarounds to these limitations in order to tilt the balance in their own favour. For example, to avoid the challenges of not being able to lay off »permanent« employees (or incurring significant costs or legal/arbitration challenges as a result), most employers in Iran now employ staff on what is in reality a temporary basis, with contracts lasting a maximum of 360 days, which are technically »settled« at the end of the period, when a new contract is signed for the next year, if needed. This caps the liability of the employer to a one-year period and essentially deprives the worker of the possibility to claim anything from the employer beyond the term of that temporary contract in case of arbitration. Many business owners have lobbied for a change to the law, which would make hiring/firing and overall adjustments to organisational needs easier – and some of the changes currently being proposed would take these issues into account. However, there are also concerns that changes to these elements of the law might entail a further reduction in workers' rights in general terms, further weakening their position vis-à-vis their employers. This especially causes concern at a time when the government is decreasingly capable of guaranteeing a social welfare platform to cover for lost income, unemployment, etc. The flipside of this is that in order for the competitiveness of the economy to increase, more flexibility in hiring/firing is needed as well as the ability to shift resources from one sector to another as the economy develops and changes. In particular, the core of the Labour Law is focused on »workers« and not on an ever more technically advanced and highly educated workforce employed in the services industry (as opposed to factories), meaning that some of the rights and restrictions envisaged in the late 1980s are no longer really relevant. This is also the case when it comes to more agile small businesses – as opposed to large manufacturing entities (or state-owned enterprises) – where decisions are made more quickly and flexibility/fluidity is key to commercial success. The rigidities brought about by initially good intentions, in combination with lower productivity in many sectors (and the majority of state-owned companies) and what have essentially been »jobs for life,« need to be addressed before the law can undergo major changes. Thus modified, it may help restore economic productivity as opposed to just tilting the balance in favour of business owners, at the expense of workers.

Otherwise, these challenges and the workers' inability to effectively challenge their own conditions will continue to lead to serious labour disputes (as witnessed in past years[21]), which in turn prompt security crackdowns and potential human rights abuses, instead of being resolved with normal arbitration mechanisms.

Economic Reform: Tinkering with the Machine

The Rouhani government has been striving to remedy a number of the mistakes made by the Ahmadinejad administration. This included bringing the books in order so that the government and in extension economic and societal players were on the same page as to the basics of the state of the economy (though not necessarily on the question of what to do about economic problems). The relatively independent Management and Planning Organisation (MPO) previously in charge of preparing statistical data for government budget planning purposes was dissolved by President Ahmadinejad in 2007, precisely because this body's data contradicted the government's more ›post-modern‹ approach to accounting. For instance, in 2009 the government lowered the unemployment rate by changing the legal age of employment (adding underage persons to the labour force) and decreasing the minimum number of hours of work per week required to be considered employed.[22] The Rouhani government reinstated the MPO in order to have more accurate and credible data, and promptly adjusted the 2013 budget in order not to increase the deficit.[23] These measures were necessary on a purely technical level but were also meant to show a return to professionalism in the bureaucracy and thus regain the trust of societal actors with regard to the health and running of the economy.

21. For a summary of examples, see Human Rights Watch: https://www.hrw.org/news/2013/04/30/iran-government-trampling-workers-rights.

22. »(Legal Analysis): Children Illegally Counted in Inflated Iranian Labor Statistics«, International Campaign for Human Rights in Iran, 19/1/2013. https://www.iranhumanrights.org/2013/01/child_labor/.

23. The Ahmadinejad government's last budget had a 30 per cent deficit, see Arron Reza Merat, »Rouhani Deals With Ahmadinejad's Economic Legacy«, *Al-Monitor,* 2013/9/11; http://www.al-monitor.com/pulse/originals/2013/09/ahmadinejad-leaves-rouhani-economic-problems.html.

The path followed since then has been one of austerity to rein in state expenditure and reduce inflation. Iran's inflation rate was 30.8 per cent in 2012 rising to 34.7 per cent in 2013, before dropping to 15.6 per cent in 2014 and 12 per cent in 2015 as a result of the Rouhani administration's fiscal policies. According to IMF estimates, the inflation rate will amount to 8.9 per cent in 2016.[24] This of course raises concerns about increased poverty and inequality. Iran's Gini index shows that while Iran has reduced inequality in the past couple of years, the ratio is rising again. The overall record shows that the Islamic Republic has managed to reduce poverty since the revolution but has failed to substantially decrease inequality.[25]

Besides austerity there is a greater need for efficiency in how the state manages its finances. A VAT scheme was finally enacted in 2007. Since then the rate has been incrementally increased from 3 per cent (2007) to 9 per cent in 2016.[26] Tax efficiency is another area with room for much needed improvement. It will have the added benefit of bringing greater oversight into the financial dealings of business ventures and religious foundations related to the Islamic Revolutionary Guards Corps (IRGC).

Beyond bringing the domestic house in order, the other objective is to attract Foreign Direct Investment (FDI) to fulfil Iran's economic and industrial potential. Attracting FDI is difficult as long as investment/ownership regulations, transparency issues, and the banking sector are not reformed. FDI has steadily risen since the negotiations began[27], but is likely to fall short of the government's expectations. The Rouhani administration has publicly stated 15 billion US dollars as the goal by the end of Iran's fiscal year in March 2017, but a more sober assessment would be 8 billion US dollars.[28]

Iran has great human resources (especially compared with the region) but there is the problem of distribution and targeting as in other fields. Presently, roughly 4.5 million people are enrolled in higher education and about the same number will enter the labour market in the next few years. The Iranian labour market is woefully under-equipped to furnish these graduates with jobs, let alone jobs at par with their degrees. Iran boasts a highly educated workforce but it is not necessarily well-trained for actual professional activities, as the educational system focuses mainly on strengthening theoretical understandings of the subject matter. Traditionally speaking, very few opportunities are offered in the educational curriculum to gain practical business/leadership experiences. The business and service sectors especially are in need of professional hands-on training.[29] Perhaps more importantly, there have until recently been significant shortcomings in independent executive training (such as MBAs, business-school driven leadership courses, etc.) for senior managers and not enough innovation in business practices of the kind usually borne out of engagement with the outside world. The demographic youth bulge combined with the expansion of a secondary education system partly to accommodate demand in a culture that prizes education, has created a bottleneck situation that is referred to as an »over-education crisis.«[30] This trend – more than 60 per cent of school graduates are now enrolled in tertiary educational institutions – will wane due to Iran's low birth rate over the coming decades. The low birth rate notwithstanding youth unemployment has never been below 20 per cent in the past two decades (2004 is the only exception). In 2014 it reached a historical maximum of 29.4 per cent.[31]

The Economic Dimension of Iran's Potential for Development

Iran's material and human resources are well known, but it is perhaps worth re-emphasising that beyond the generally well-known figures concerning oil production, population size, etc., this is a country with major mineral

24. IMF World Economic Outlook Database, April 2016,

25. Djavad Salehi-Isfahani, »Poverty, inequality, and populist politics in Iran«, *Journal of Economic Inequality,* 2009 v. 7, pp. 5–28; and »Is inequality rising in Rouhani's Iran?«, *Al-Monitor,* 12/4/2016; http://www.al-monitor.com/pulse/originals/2016/04/iran-rouhani-economic-inequality-rising.html.

26. VAT Set at 9 per cent Financial Tribune 19/3/2015; http://financialtribune.com/articles/economy-domestic-economy/13554/vat-set-9.

27. FDI rose from 1.67 billion US dollars in 2014 to 2.5 billion US dollars in 2015, see Cara Lyttle (20/6/2016), *FDI in Iran soars with sanctions relief;* https://www.ft.com/content/549d0dac-36d6-11e6-9a05-82a9b15a8ee7.

28. Maysam Bizaer, »The myth of no foreign investment in post-sanctions Iran«, *Al-Monitor* 27/7/2016; http://www.al-monitor.com/pulse/originals/2016/07/iran-foreign-direct-investment-fdi-post-jcpoa.html.

29. Maysam Bizaer, »Iran's job seekers lack practical skills«, *Al-Monitor,* 16/2/2015, http://www.al-monitor.com/pulse/originals/2015/02/iran-unemployment-hassan-rouhani-tecnical-training.html

30. Nader Habibi, »Iran's Overeducation Crisis: Causes and Ramifications«, *Brandeis University Middle East Brief* no. 85, February 2015; http://www.brandeis.edu/crown/publications/meb/MEB89.pdf.

31. WEF/UNESCO: 233,700 STEM graduates in 2015 World Bank; http://data.worldbank.org/indicator/SL.UEM.1524.ZS?locations=IR.

resources (it is among the world's top ten iron ore producers, and ranks among the top 20 in most major metals and minerals), a very good land-based infrastructure, and a well-developed telecommunications system (with above 50 per cent internet penetration and the entire country covered by mobile phone networks). It has one of the five highest numbers of STEM graduates in the world[32] and continues to enjoy improving HDI indicators (69 out of 188 in 2015).[33]

It is also a misconception that the Iranian economy is dominated by oil and gas – this has not been the case for many years now. Oil and gas constitute around 10 per cent of GDP and their sale amounts to about a third of the government's hard currency earnings (down from around 23 per cent in 2014).[34] The Rouhani administration in particular has enhanced its focus on improved taxation and VAT – and last year, for the first time in recent history, the tax earnings of the Iranian government exceeded its oil revenue.[35] Needless to say, oil revenues continue to be an important source of cash and are crucial for the broader industrial base – they are an instrument for gas-intensive and petrochemical industries, etc. Interestingly, Iran's economy is perhaps the most diverse in the Middle East – by design in some respect, but partly because the sanctions forced it to diversify in order to survive. It is also a result of an increasing focus on knowledge creation, technological advancement and the attempt to avoid becoming a merely consumption-oriented society – along the lines of the Economy of Resistance strategy.

Automobile Sector: High Stakes for Both Sides

Iran's automotive industry is slowly bouncing back after the sanctions period – which not only hit the industry's ability to procure goods and parts but also affected the very core of some of Iran's most important international partnerships, including with Peugeot and Renault.[36] The largest automotive industry in the Middle East – which at its peak in 2011 produced 1.6 million cars – saw production slump significantly until the JCPOA. It then experienced an annual growth of around 100% during the 2014–15 time period and is now edging its way back to pre-sanctions level[37]. This industrial sector is critical not only due to its large contribution to the GDP (by some estimates up to 7 per cent) but also because it employs between 600,000 and 700,000 people directly and more than 1.5 million indirectly.[38] Existing industrial capacity, the need to both upgrade existing machinery and introduce new production mechanisms, combined with efficiency increases needed in the production process and a large consumer base, make this sector attractive for investment and international engagement. It remains a highly politicised sector, however, with large state involvement as well as significant sensitivities due to its wide-reaching economic impact.

Infrastructure: The Long Way Ahead

Iran's infrastructure is fairly well-developed, especially by the standards of comparably sized emerging economies, including a vast network of ports, domestic airports and a high percentage of paved roads (80 per cent paved roads, including a large network of high-capacity highways). Much of the critical infrastructure was built with Western help before the Revolution, and despite significant development efforts since, there is a large need for capital investment. This is especially the case in the more complex design and operational processes related to ports and airports, as well as the need for more efficient management of the overall transport infrastructure (including urban public transport). In addition, there is a significant need for the modernisation of the aviation fleet, which is hampered by the continued restrictions on the sale of American technology to Iran (this also affects non US-manufactured aircraft and other items, if they contain more than 10 per cent US-origin parts/materials such as the Airbus fleet).

32. See Forbes/Statista report from June 2015, compiled by Niall McCarthy; http://www.forbes.com/sites/niallmccarthy/2015/06/09/the-countries-with-the-most-engineering-graduates-infographic/#11e13cb6455d

33. See here for UN Development Program (UNDP) page on Iran, including HDI statistics; http://hdr.undp.org/en/countries/profiles/IRN.

34. See for example, World Bank statistics for »Oil rent as percentage of GDP« here: http://data.worldbank.org/indicator/NY.GDP.PETR.RT.ZS?-locations=IR and also World Bank, July 2016 »How is Iran reacting to lower oil prices«; http://www.worldbank.org/en/country/iran/publication/economic-brief-july-2016.

35. The National Iranian Oil Company (NIOC) Finance Director Ali Kardor, quoted in *The Guardian,* September 2015 by Hassan Kamali Dehghan »Iran earns more from tax than oil in almost fifty years«; https://www.theguardian.com/world/2015/sep/27/iran-tax-oil-first-time-50-years.

36. See for example, Alireza Ramezani in *Al-Monitor,* »Iran revs up for auto revolution«, April 2016; http://www.al-monitor.com/pulse/originals/2016/04/iran-auto-industry-iran-khodro-peugeot-saipa.html

37. For numbers leading up to 2014, see Organisation Internationale des Constructeurs d'Automobiles (OICA) data; presented here: http://www.oica.net/category/production-statistics/2014-statistics/ Numbers for 2015 and assumptions for 2016 based on conversations with industry sources in Iran.

38. See, for example, ILIA Corporation, »Iran automotive industry outlook 2025, Past to present« from January 2016: http://www.ilia-corporation.com/insights/white-papers/iran-automotive-industry/.

Iran's railways system has been neglected for even longer. Since the Revolution, the length of railway tracks in Iran has only increased from 4,500 km to 5,500 km. Only 11 per cent of all travel in Iran is done by railway. The Rouhani government is trying to finish delayed projects and is investing massively in expanding the network in order to have 25,000 km of tracks by 2025. Besides the obvious huge potential for more efficient domestic transport of people and goods, this infrastructure is key for the overall ambitious objective to turn Iran into a regional transportation hub. This will require the network to be expanded as mentioned above, but existing tracks will also need to be upgraded in order to accommodate high-speed trains, and modern carriages and locomotives will need to be built/imported. The investments required in total are estimated to be more than 30 billion US dollars for the coming decade. Several major European railway companies have already signed contracts worth several billion US dollars for specific projects within this overall plan.[39]

Petrochemical Sector: The Potential High-achiever

The current Petroleum Minister, Bijan Zanganeh, was the main policy architect of the growth and massive expansion of the Iranian petrochemical industry during his tenure under President Khatami. Alongside the then Director of the National Petrochemical Company (NPC), Mohammad-Reza Nematzadeh, he was responsible for an almost twenty-fold increase in the value of petrochemicals production during Khatami's two terms (starting from around 1 billion US dollars in exports in 1997).

Having always prided himself on domestic capacity building and being a strong advocate of using Iran's resources to expand the export of value-added goods, Zanganeh has in his current term also focused on using Iran's abundant gas reserves to promote the expansion of petrochemicals production.

While the sanctions impacted the overall production and export of petrochemicals, they did not dent overall capacity. According to official sources, Iran is now producing around 45 million tons/year, which amounts to about 80 per cent of its total production capacity of approximately 60 million tons/year. Petroleum Minister Zanganeh and others have also stressed their desire to increase production capacity three-fold by 2025, reaching a total of 180 million tons/year.[40]

The growth and expansion of the petrochemical sector, as well as its resilience during the sanctions period, are due primarily to the abundance of gas as feedstock and the increased domestic capabilities for repair and maintenance, ensuring relatively stable production. Nonetheless, sanctions on purchasing Iranian petrochemicals, in addition to difficulties in obtaining spare parts or specialised technology to modernise plants, means that there will be a period of trying to catch up with previous capacity peaks. The petrochemicals industry will remain a critical sector for Iran, not only due to the high-margin exports it entails but also due to domestic job creation, improvements in technology and decreased reliance on revenue from crude oil sales (notably, Iran counts petrochemicals as non-oil export, which is technically correct but still dependent on gas production, though it is not as vulnerable to global oil price fluctuations).

Aviation: High Stakes and Symbolic Significance

Significant sanctions against the Iranian aviation industry, pre-dating the recent nuclear issue, have left the country with one of the oldest fleets in the world – resulting in a plethora of safety challenges and thousands of avoidable deaths in the past decades. The average age of Iran's total civilian aviation fleet is around 26 years, with some of its older Boeing 747 aircrafts delivered in 1976, while the average age of the Turkish Airlines fleet is 6.3 years. Compared to countries with a similar population size, Iran has less than half the number of aircraft in operation as Turkey and around a third of Germany's. [41]

However, the challenges of the Iranian aviation industry are not only due to sanctions – poor management, a

39. Alireza Ramezani, »Iran hopes to get its trains back on track«, *Al-Monitor* 2016/4/7; http://www.al-monitor.com/pulse/originals/2016/04/iran-railway-network-train-development-akhoundi.html, and Julian Turner, »Rapid transit: why Europe is lining up to fast-track Iran's rail revolution«, Railway-technology.com, 2016/6/1; http://www.railway-technology.com/features/featurerapid-transit-why-europe-is-lining-up-to-fast-track-irans-rail-revolution-4893218/.

40. See *Tehran Times,* April 2016, »Iran's annual petchem exports rise to 19 million tons«; http://www.tehrantimes.com/news/300295/Iran-s-annual-petchem-exports-rises-to-19m-tons.

41. Data from Air Fleets, accessed September 2016; http://www.airfleets.net/ageflotte/THY%20Turkish%20Airlines.htm.

lack of prioritisation and generally low investment in this infrastructure have held back the sector's growth and modernisation. While there is enormous potential, as evidenced by the Airbus and Boeing agreements finally cleared by OFAC in September 2016, significant hurdles prevent the modernisation of the Iranian aviation industry, impeding Iran from becoming a transit hub (despite its significant geographical position and distance advantages compared to existing regional hubs in Dubai, Istanbul and Doha).

The Oil and Gas Industry: Political and Economic Game Changer?

In the post-sanctions environment, Iran's oil and gas decision-makers will focus primarily on regaining (and where possible expanding) market shares, in particular the share lost to the Saudis during the sanctions years (which also includes a loss of clout within OPEC), on improving technology transfers and financing of projects through international investments, on improving domestic capacity (including significant contributions to the »Economy of Resistance« discussed above), and on improving their ability to use energy as a tool for diplomacy. The focus on the Economy of Resistance is important here, since it envisions a future where a greater share of economic value will be created (and kept) domestically, while Iran's vulnerability to external price shocks and the whims of international powers is reduced. This means moving away from the sale of non-value-added products such as crude oil or gas in an unprocessed form, moving instead towards commodities such as petrochemicals or materials produced in energy-intensive industries.

This does not mean that crude oil sales will be abandoned – since it is a source not only of significant hard currency but is also of geopolitical access/clout – government revenues will, however, gradually move towards even less overall dependence on these exports. In the medium term, Iran will primarily seek to regain portions of the European market that it lost due to the sanctions, as well as to expand relations with Asian buyers who continued buying Iranian oil, as well as aggressively continuing to sell its large quantities stored in tankers and on-shore storage facilities. As evidence of this strategy of regaining market share, in August 2016 Iran saw its highest exports in five years, exporting around 2.1 million bpd of crude oil (excluding condensates, which tend to average around 300,000 bpd) according to loading/off take figures analysed by Reuters, with the majority of this going to Asian buyers and exports to Europe gradually increasing.[42]

Over the coming 12–18 months, Iran will continue to forge strong relationships (and in some cases re-engage) with strategic buyers, in particular in the EU and East Asia. It will also re-engage with international oil companies (IOCs) to ensure investments in new contracts – although this process has now dragged on for years, hampered by significant political resistance, domestic bickering and oftentimes non-factual debates about the terms of the new Iran Petroleum Contract (IPC). The IPC seeks to address some of the shortcomings of the previous buyback contracts,[43] in particular when it comes to an improved risk/reward structure for international investors, but it also involves more incentives, for instance, enhanced oil recovery. The objections voiced against it focus on losing sovereignty/control and have largely been nonsensical, or based on ideology rather than a factual reading of the contractual framework. Some concerns, however, about joint venture structures and how Iranian resources will be used, etc., are genuine and have been addressed by the government. At one point, the debate became so acrimonious that Supreme Leader Khamenei had to intervene and reassure critics that he was involved in the review process.[44] These attacks and criticism notwithstanding, the Rouhani government has pushed (and will continue pushing) for an increased engagement of foreign investors in the oil and gas sectors – knowing that the scale of investments and the technology needed to take Iran beyond the current levels of production cannot be achieved without outside help.

Interestingly, the gas sector has weathered the storm of the sanctions relatively well, even managing to increase output during the past decade and to some extent achieving spare capacity (which has also partly been due to reduced domestic demand due to a slowing economy).

42. See for example, Reuters, Florence Tan and Osamu Tsukimori, September 2016, »Iran crude exports hit five-year high, near pre-sanctions levels«; http://www.reuters.com/article/us-iran-oil-exports-idUSKCN11M0XL.

43. In the Iranian case, buyback contracts mean that the National Iranian Oil Company (NIOC) gives (assuming that the field production and oil prices are satisfactory) a pre-defined share of the actual profit from an oil field, and costs incurred in the process, to the oil company that develops the field. In essence, the oil company never owns the field.

44. See for example, this speech by Ayatollah Khamenei (in Persian) about the revision process of the IPC 04/07/2016: https://www.youtube.com/watch?v=SPinZRrW92Q.

Going forward, according to Energy Information Administration (EIA) estimates, the strongest growth in Middle East gas production leading up to 2040 will come from Iran, where production will increase from a reference point in 2012 of 5.6 trillion cubic feet (TCF) to 12.42 TCF in 2040. In comparison, Qatar produced 5.5 TCF in 2012 and it is estimated it will produce around 8.4 TCF in 2040.[45]

In terms of exports, Iran will prioritise pipeline exports to nearby states because the technical and financing barriers are lower, but also because long-term gas supply agreements offer a means to increase its influence in neighbouring countries, especially Iraq, Afghanistan, Pakistan and Turkey. Iran will also look at European markets as a mid-term goal, but until 2020–22 there will not be enough spare capacity to cover any relevant portion of European demand, or justify the infrastructural investments needed to transport Iranian gas all the way to Europe. The crisis in Syria and tense relations between European countries and Turkey will also slow down existing blueprints for pipelines connecting Iran and Europe. Although Iranian decision makers continue to make statements about wishing to export LNG, etc., the fact is that such technologically and financially complex export mechanisms simply do not make as much sense for Iran as they did in the early 2000s, especially given the significantly increased regional demand that can be met using pipelines. In addition, gas will perhaps be the most crucial cornerstone of making the Economy of Resistance a success – as a feedstock for petrochemicals and other energy-intensive industries and to ensure power generation for Iranian homes and factories should international pressure intensify.

The Environment and Sustainable Growth

Iran's environment is under serious threat in every sense. In Yale University's Environmental Performance Index for 2016, Iran ranked 105 of 180 countries.[46] Water shortages and air pollution constitute the biggest structural problems. Several of Iran's cities (Ahwaz, Kermanshah, Sanandaj) are among the top 10 most polluted in the world. The problem is exacerbated by unstable weather conditions (global warming) and urbanisation. Growing cities and an ever-increasing volume of cars create both congestion and pollution. In 2002 there were 6 million vehicles in Iran, in 2013 that number was 26 million. Congestion in urban areas is primarily dealt with by building more roads rather than finding more sustainable solutions, such as more rapidly expanding public transport. The automotive industry, as discussed in the sections above, is an important part of the national economy, but its expansion is in conflict with the country's environmental needs. In addition, gasoline remains a very cheap commodity in Iran despite several recent price hikes and quality control of fuel is sorely insufficient. These factors compound the problem of pollution. According to city officials, 48 per cent of all air pollution in Tehran stems from cars and 22 per cent from motorcycles.[47] Iran is also among the top 10 countries of road accidents with at least 19,000 people killed every year since 2001 (peaking in 2005: 27,759 traffic-related deaths). The damage from these deaths is estimated to equal 5–8 per cent of Iran's GDP.[48]

Agriculture consumes most of the potable water in a country plagued by increasing water shortages. Iran overuses its surface water while chronic rain shortages mean that the water bodies are not sufficiently replenished. Instead, many Iranian cities have resorted to pumping up water from underground aquifers. This water source takes between centuries and up to several thousands of years to replenish. At the present rate, 12 out of 31 Iranian provinces will have no underground water left in 50 years. There are many factors aggravating this situation. Efficient use of water and prudent consumption are not widespread values or habits (domestic use in Iran is 70 per cent above the global average). The emphasis on agricultural growth in the preceding decades (to meet the food consumption of a growing population) has had the effect that this sector today consumes 90 per cent of all water in Iran. The use is not efficient (irrigation efficiency is only 33 per cent) since very little wastewater is recycled. Only 40 per cent of the population is served by complete and efficient wastewater treatment plants.[49]

45. See Energy Information Administration (EIA) International Energy Outlook 2016, from May 2016, Chapter 3, Natural Gas: http://www.eia.gov/forecasts/ieo/nat_gas.cfm.

46. GLOBAL METRICS FOR THE ENVIRONMENT, http://epi.yale.edu/reports/2016-report.

47. Mehrnaz Samimi, »Iran's Struggle with Air Pollution«, LobeLog 2016-03-07; http://lobelog.com/irans-struggle-with-air-pollution/.

48. »Road Traffic Injuries in Iran and their Prevention, A Worrying Picture«, UNICEF, no date; http://www.unicef.org/iran/media_4783.html.

49. David Michel, »Iran's Environment: Greater Threat than Foreign Foes«, Iran Primer, 2013-10-28; http://iranprimer.usip.org/blog/2013/oct/28/iran's-environment-greater-threat-foreign-foes and Massoud Tajrishy, »Wastewater Treatment and Reuse in Iran: Situation Analysis«, UN Water workshop on Safe Use of Wastewater in Agriculture November 2011, p. 5.

The investments required to change behavioural patterns and to install the technological solutions (wastewater treatment, for instance) are enormous. Simply reducing water consumption is calculated to require 8 billion US dollars in investments.[50] Besides direct financial investment, there is also the problem of squaring an environmentally sustainable economic development strategy with the more traditional and consumer-oriented approaches and needs.

Consequences of Failure: Immediate Effects and Long-term Trajectories

Before addressing what needs to be done in order to achieve a result beneficial to Iran and its partners, it is important to address the consequences of failure. If the alignment (FDI, closer cooperation with the EU) and painful reforms necessary (banking sector, anti-corruption measures, etc.) do not happen, the economic windfall will not materialise. Iran's society and economy are in general more resilient than they have been given credit for. Yet in order to be able to continue muddling through, the economy will require more dynamism than was previously required. Iran is under pressure both environmentally and socially and this will not change in the foreseeable future. To manage these pressures will require decent economic growth and investment. If Europe does not become the partner Tehran wants and needs, the partnerships and investments from Asian countries like China and India will become more important. Those relations have so far not been on the scale necessary to carry sustained economic growth, nor is the political elite in Iran particularly interested in becoming totally dependent on them.

If neither Europe nor Asia rise to the occasion, the very foundation of the outreach from inside Iran will be seriously undermined. The groups preferring a self-contained Iran, in economic as well as political terms, will be able to argue that there is no one to reach out to and thus self-reliance (an extreme version of the Economy of Resistance) is the only viable option. The narrative of a beleaguered Iran will be entrenched and leave little room for reform, whether in domestic or foreign policy. This scenario would be detrimental for all parties – including the very groups clamouring for it.

50. Bijan Khajepour, »Iran's water crisis reaches critical levels«, *Al-Monitor,* 2015-5-1; http://www.al-monitor.com/pulse/originals/2015/05/iran-water-crisis.html.

The Economic Dividend: Economic Success Improves Political Relations

A more nuanced view of Iranian economy is needed, covering both its structures and strictures. It is a far more diversified and complex economy than generally perceived. This complexity entails both great potential for growth (human resources and natural resources) and serious structural problems and bottlenecks (out-of-date financial systems, corruption, bureaucratic inefficiency). *Sustainable* growth will require more streamlined and long-term investment in the institutions and in Iranian society in general. A further challenge is the environmental footprint of economic development. Iran's environment has been degrading at an alarming rate in the past decade with pollution and inefficient use of diminishing water resources. Technological transfer and investments into more environmentally friendly technologies combined with a more aggressive environmental policy are crucial for reversing this trend.

While the Iranian economy is capable of growth on its own, this is not nearly enough to sustain a viable expansion to absorb the growing educated young labour force and maintain the state's social welfare systems. Realising the true potential of the Iranian economy will require massive foreign direct investment over a longer time period. In the short period since the implementation of the JCPOA, FDI has risen. Yet investment levels must still increase substantially to make a serious impact. Besides the economic arguments for increasing FDI, the equally urgent political argument is that it will bolster and sustain the opening of Iran towards Europe. If there is an economic dividend as a result of the JCPOA and an attempt to integrate Iran into the world economy, this strategy will be vindicated within the political discourse and the country's elite. This is crucial, as the historic precedent and narrative of such attempts has often been one of disappointment and betrayal. Reversing this experience will have a positive effect on the willingness of the political elite to continue pursuing a policy of integration.

The singular most important element in rejuvenating Iran's economy is resolving, or at least ameliorating, the political conflicts within the ruling elite. While the political elite of the Islamic Republic has a well-developed ethos of consensus-building, far too often this amounts to weakening the impetus for necessary decisions and resolutions. Consensus seems at times more like inertia. The juncture Iran is at now, with such great promise, needs careful nurturing and strategic management in order not to be squandered. The very real conflicts within the elite and society cannot be reduced to straw man arguments of revolutionary fervour fuelled by paranoid fear of the outside world. It is in Iran's national interest to engage with the world on an equal footing and develop its economy in cooperation with partners, thus generating greater prosperity for its people.

Policy Recommendations

For Europe

- It is imperative to begin viewing Iran in a more nuanced manner, both in terms of its economic diversity and the opportunities it holds, as well as the dynamism of its political structures. The latter manifests itself not only as underlying currents of reactionary hardliner politics but also through a vibrant and forward-looking society eager to regain its rightful place in the community of nations.

- Increased trade and foreign direct investment are key here, in particular in areas where Iran needs additional technology, skills and managerial training. Increased trade and investment will not only lead to improved dialogue and a better understanding, but also create the frameworks necessary for the Rouhani administration to solidify its more pragmatic agenda

- Engage broadly with stakeholders, not just those in government now but also those who may resist further engagement. It is crucial to address the continued risks of operating in the Iranian market, but also to begin the process of dialogue needed to address some of the more fundamental challenges posed to Iran's future economic and social development, including issues such as human rights and financial reforms.

For Iran

- Speeding up the reform of the financial/banking sector as well as relevant laws/regulations governing transparency and efficiency. While shock therapy is not the best solution for many of Iran's structural ills, delays due to attempts to reach an elusive consensus will result in lost opportunities. Especially at a time when Iran is essentially playing »catch-up« in a fast-moving, competitive and technologically sophisticated global economy, any lack of forward movement is essentially a step backward.

- Broaden the scope of engagement with the EU to better understand the ways in which policies are formed, the limitations faced by European counterparts, but also how to best leverage the short-term »low-hanging fruit« opportunities for trade and investment of existing relationships with the EU.

About the author

Dr Rouzbeh Parsi holds a Ph.D. in History. He is currently a Senior Lecturer in the Department of Human Rights at Lund University, Sweden, and the Director of the European Iran Research Group (www.eirg.org), a network of European-based academic and policy experts on Iran. Between 2009–13 he was a Senior Analyst at the EU Institute for Security Studies, specialising in the domestic political developments of Iran and their foreign policy implications.

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Responsible:
Dr Ralf Hexel, Head, Middle East and North Africa

Phone: +49-30-269-35-7420 | Fax: +49-30-269-35-9233
http://www.fes.de/nahost

Orders / Contact:
info.nahost@fes.de

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