

Farian Sabahi

The economy of the Islamic Republic of Iran on the eve of the parliamentary elections of 2012

Sanctions, elections and diplomacy

The new punitive measures taken against Iran by US President Barack Obama are focused on financial institutions run by the ayatollahs and the leadership of the Revolutionary Guard as they take in an estimated to \$70 billion a year (2011 figures) for the sale of 2.5 million barrels of oil daily, equal to 60% of the country's revenue and 80-to-90% of its exports. If petrodollars revenues drop, so does available government revenue to fund the country's nuclear program, which despite many delays and setbacks is being pursued, with Tehran insisting that it is aimed at meeting civilian needs.

Obama was able to push through new sanctions in part because Iran is the only topic that seems to earn bipartisan support in an otherwise divided Washington. Iran's menace is also being used to justify the purchase of a NATO missile defence system that will cost member states' taxpayers at least €200mIn. Meanwhile, Saudi Arabia is busy acquiring American F22 and F35 military aircraft worth a total of \$29.4bn and has also promised to open its oil taps further to compensate for the loss of Iranian oil supply. For its part, the United Arab Emirates has nearly completed a westward-bound oil pipeline that will be able to move some 2.5 million barrels per day, a potential temporary alternative in the event that the Strait of Hormuz is blocked. However, this pipeline would not be able to make up for oil streaming through the Persian Gulf.

In such a context, the March vote will see Iranians elect the 290 members of 100-year-old parliament, known as Majles. Although Iran is far from irreproachable from the point of view of democratic values and respect for human rights, the Majles is in some respect a body that's far more advanced than anything else in the region (in Saudi Arabia, royal subjects, all male, have voted only twice in history, and then only for municipal elections).

These days the media often cover the possibility of an attack on Iran. However, as will be seen later on in this paper, an

No. 99 – MARCH 2012

Abstract

The upcoming elections are a test on Ahmadinejad's economic policies. The paper analyses the measures taken by the president in the last few years and the overall economic situation of the country. Although sanction are taking a toll, magnified by structural problems and corruption, macroeconomic indicators indicate that the economy is not about to collapse. Iran is not isolated either: while Tehran has had to scale down business with Europe, economic links are increasingly being forged with China, Russia and Latin America. The author argues that neither sanctions nor a military attack will spark a regime change. Negotiations are the key solution, though only a disinterested mediator will have some chance of success.

Farian Sabahi teaches at the Université de Genève and at the University of Turin, she has authored several books and essays and works as a professional journalist.

(*) The opinions expressed herein are strictly personal and do not necessarily reflect the position of ISPI.

attack would give the ayatollahs and the Pasdaran an opportunity to rally domestic public opinion. The only way to avert war is through diplomacy, which in recent years «has not failed, but was abandoned prematurely by Obama because of pressure from Congress, Israel, Saudi Arabia, and because of mistakes within the Tehran hierarchy, which responded to the Green Movement by initiating a crackdown»¹. However, diplomacy was dismissed prematurely, despite attempts by Brazil and Turkey to mediate the nuclear dispute, with offers of assistance that were snubbed by the United States.

The question at hand is whether the 5+1 negotiations can indeed be revived. The political scientist Trita Parsi, a student of Francis Fukuyama and now president of the National Iranian American Council (NIAC), the largest American-Iranian organization in the United States, insists that «diplomacy requires patience and perseverance, and is not in concert with sanctions». He warns international leaders that abandoning diplomacy would «costs far more than pushing ahead with it, based on the catastrophic consequences of military confrontation that would follow a failure of negotiations».

In any case, Europe can't act as a broker because it is perceived in Tehran as an ally of the United States. In the best Persian tradition, only a disinterested mediator will be able to successfully intervene to diminish the tensions between Washington and Tehran.

Iran's economy not about to collapse

The upcoming elections are a critical referendum on Ahmadinejad's economic policies. Iran is said to be more and more isolated and its economy squeezed by the international sanctions in response to its disputed nuclear programme. As mentioned, in the last few months additional sanctions called for by the United Nations Security Council have posed constraints on financial transactions. The Iranian *rial* has lost half its value against the dollar, with subsequent turmoil in the foreign currency and gold markets. Prices for basic foodstuff soared, inflation is officially at 20% and unemployment at 14.6%.

It is not possible to assert that Iran's economy is in really good shape. There are indeed several serious problems, such as structural inefficiency, the major role played by the state in the economy and widespread corruption. Moreover, Iran's main source of foreign exchange comes from oil and gas. As a consequence, government revenues fluctuate with the international prices of these commodities and are thus intrinsically volatile. Nonetheless, Tehran is not as economically isolated as featured in most Western media, and its economy of \$400bn in terms of GDP (2011) is not close to collapse.

According to the World Bank, «Iran is the second largest economy in the Middle East and North Africa in terms of GDP (after Saudi Arabia) and in terms of population - 78 million people (after Egypt). It is the second largest OPEC oil producer; output averaged about 4 million barrels per day in recent years»². The World Bank set Iran's economic growth at 3% in 2010. According to the IMF, nominal GDP grew from \$330.5bn in 2009 to \$360bn in 2010. Moreover, 4% of GDP is currently invested in research and development.

Besides growth, inflation and unemployment, the economy of a country should take into account social indicators, and thus its government efforts to increase access to education and health. 1995

¹ Interview with Trita Parsi, author of *A Single Roll Of The Dice - Obama's Diplomacy with Iran*, Yale University Press, 2012.

² The World Bank, *Country brief. Iran*, September 2012, <http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/MENAEXT/IRANEXTN/0,,contentMDK:20146413~menuPK:312964~pagePK:141137~piPK:141127~theSitePK:312943,00.html> retrieved on 19-2-2012.

to 2008 youth literacy rates increased from 86% to 94%. Girls education is rising significantly; when it comes to university enrolment, at the undergraduate level the number of women is at 65%, and thus twice as high as the number of men, and thus Iran is well placed in eliminating gender disparities. Though women are playing a leading role in the economy of Iran, their market participation and employment rates remain however limited. Also Iranian health indicators are mostly above regional averages³.

Isolation also needs to be appraised. Though international sanctions have increased the cost of doing business and limited access to foreign investments and foreign technologies, according to UNCTAD (United Nations Conference on Trade and Development) foreign direct investment to Iran has increased exponentially from \$1.6bn in 2008 to \$3.6bn in 2010⁴. While Europe is scaling down business with Tehran and the United States gave it up long ago, China and Russia are taking a combined 34% of Iran's oil exports. Iran also invests in Latin American countries. According to the Latin Business Chronicle Research Institute (quoted by Nikolas Kozloff), «between 2007 and 2008 Iran's trade with Latin America tripled to reach \$2.9bn. This is a considerable sum considering that bilateral trade between them was almost non-existent when Ahmadinejad came to power in August 2005»⁵.

Nonetheless, in the Islamic Republic of Iran inefficiencies are structural and, for instance, in some cases workers have not been paid their wages and this has led to large strikes and protests across the country. When it comes to corruption, in Iran there is some popular accountability, as shown by some recent scandals. For instance, in the autumn of 2011 the Economics minister Shamseddin Hosseini was accused of failing to take action over an alleged fraud worth \$2.6bn. He risked impeachment, and saved himself by apologising to the Parliament and pledging to work to prevent future fraud⁶.

The abolition of state subsidies

By abolishing subsidies in December 2010, president Ahmadinejad and the Supreme Leader Ali Khamenei have dared – after a long debate – to implement a bold structural reform formally announced a year ago, on the occasion of Nowruz, the Persian New Year (21 March). According to Ayatollah Khamenei, the past year (ending on 21 March 2012) has been one of economic *jihad*, aimed at abolishing the ruinous system of state subsidies (mainly on food and fuel) which had lasted for three decades. Under the previous system, diesel fuel for domestic consumers was extremely cheap (less than two cents of euro a litre), and petrol was sold for less than bottled water.

The obvious consequences of such a market distortion, paid by rising bills for the state, were soaring energy consumption, waste and pollution. Abolishing subsidies meant relieving the government of a financial burden estimated to cost 27% of GDP in 2007/2008 (approximately \$77.2bn)⁷. Since fuel started having a real price, the elimination of state subsidies also meant slashing local energy

³ The World Bank, *Country brief. Iran*, September 2012, <http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/MENAEXT/IRANEXTN/0,,contentMDK:20146413~menuPK:312964~pagePK:141137~piPK:141127~theSitePK:312943,00.html> retrieved on 19-2-2012.

⁴ UNCTAD, *World Investment Report 2011, Country fact sheet: Iran, Islamic Republic of*, p. 1, http://www.unctad.org/sections/dite_dir/docs/wir11_fs_ir_en.pdf retrieved on 19-2-2012.

⁵ N. KOZLOFF, *Iran's Allies in the Western Hemisphere*, in «Middle East online», 8 December 2011, <http://www.middle-east-online.com/english/?id=42937>, retrieved on 21-2-2012.

⁶ *Iranian minister Hosseini survives impeachment vote*, 1 November 2011, <http://www.bbc.co.uk/news/world-middle-east-15545850> retrieved on 19-2-2012.

⁷ The World Bank, *Country brief. Iran*, cit.

demand and thus more oil was left for export. The decision to scrap subsidies was supposed to radically improve the economy.

However, in order to compensate the abolition of subsidies, the government decided at first to give a monthly cash transfer of some \$90 per person aimed at poor families. Doing so, price discounts on subsidised items were replaced by monthly cash payments to 72.5 million citizens while substantially increasing the prices of petroleum products, water, electricity, bread and a number of other products. Since the definition of “poverty” became tricky, after a short while president Ahmadinejad dropped the monthly cash transfers in favour of blanket transfers to families applying for them. This last solution was requested by 90% of the population, nurturing further the culture of dependence from the state.

So far, only Arab countries in the Gulf have put 90% of their citizens on cash stipends and, though Iran is rich in oil and gas, this move will hardly be sustainable in the future. Meanwhile, in Iran the cost of living is soaring. Between June and December 2011 shopkeepers in Tehran «report a 30% rise in the price of milk, 40% increase in cheese and butter prices and a 50 percent increase in eggs»⁸.

The reform, appreciated by the IMF⁹, was put into place for reasons consequent to sanctions, which are inflicting economic pain but might fail to compel Iran to give up its ambitions and could make the authorities more intransigent. In fact, pressed by the lack of refining capacity to meet domestic demand, the government felt vulnerable to a possible cut in petrol imports and decided to be as independent as possible. Such an independence continues to garner support within society, especially when it comes to the nuclear dispute which fans the flames of Iranian nationalism.

Furthermore, though president Mahmoud Ahmadinejad and the Supreme Leader Ali Khamenei are increasingly at odds with each other, sanctions remain a good argument for the leadership in order to blame others for their own mismanagement. Since the US and EU sanctions are actually aimed at regime change, such a situation will hardly incite domestic upheaval as wished by the West.

Nationalism

An attack on Iran will hardly spark a revolution. First, Iran already had a constitutional revolution at the beginning of the nineteenth century and an Islamic one in 1979. Secondly, the opposition is weak and disorganised. The only faction having some strength is financially linked to Israel (and before to Saddam Hossein’s Iraq) and thus lacks credibility amongst Iranians. Bombing Iran would put «the final nail in the coffin of reform and change, and would ensure a hard-line Islamic regime for years to come»¹⁰. Thirdly, the assassination of Iranian scientists and the mysterious explosions at Pasdaran bases, blamed on foreign agents, caused the population to blame the West and the Mossad, the secret services of the Jewish State.

⁸ J. MILLER, *Reading the mullahs minds*, 6 December 2011, <http://www.judithmillercom/10829/reading-the-mullahs-minds>, retrieved 19-2-2012.

⁹ D. GUILLAUME – R. ZYTEK – M.R. FARZIN, *Iran–The Chronicles of the Subsidy Reform*, IMF working paper, July 2011, <http://www.imf.org/external/pubs/ft/wp/2011/wp11167.pdf>, retrieved on 21-2-2012.

¹⁰ Interview with Hooman Majd, author of *The Ayatollah Begs to Differ: The Paradox of Modern Iran*, Doubleday, New York, 2008, and *The Ayatollahs’ Democracy: An Iranian Challenge*, Norton, New York, 2010, <http://muftah.org/?p=2709>, retrieved on 21-2-2012.

Nationalism is also one of the keys to understand to recent development in the international arena. First, the entrance of Iranian warships in the Mediterranean via Suez Canal on 18 February 2012, possibly en route to Syria after having been docked at Jeddah in Saudi Arabia. According to Navy chief Admiral Habibollah Sayari, the destroyer Shahid Qandi and its supply vessel Kharq were carrying a “message of peace”. However, their passage was perceived by Israel as a “provocation”¹¹. The main target of this operation was the Iranian population, under increasing Western pressure, in order to boost its moral ahead of the parliamentary elections of 2 March.

Secondly, nationalism can be the key to understand the decision to halt oil sales to British and French companies, in retaliation of the oil embargo which has been decided by the Foreign ministers of the European Union and will be put in place on 1st July. On 19 February Ali Reza Nikzad Rahbar, spokesman of the oil ministry, declared that Iran would sell its oil to new customers, possibly meaning China, Russia and Turkey. Since in 2011 France bought only 3% of its oil from Iran (58,000 barrels per day) and the United Kingdom even less, the decision is not expected to have a big impact. In 2011, the European Union was buying 20% of Iran’s oil exports, with a 100,000 barrels a day share for the French Total, 100,000 for Shell, 80,000 for Hellenic of Greece and 70,000 for the Spanish Cepsa. Meanwhile, Total has stopped buying it and Royal Dutch Shell has cut it sharply. At the moment the biggest customer in the region is the Turkish Tupras with 200,000 barrels a day¹².

La ricerca ISPI analizza le dinamiche politiche, strategiche ed economiche del sistema internazionale con il duplice obiettivo di informare e di orientare le scelte di policy.

I risultati della ricerca vengono divulgati attraverso pubblicazioni ed eventi, focalizzati su tematiche di particolare interesse per l’Italia e le sue relazioni internazionali e articolati in:

- ✓ Programma Africa
- ✓ Programma Caucaso e Asia Centrale
- ✓ Programma Europa
- ✓ Programma Mediterraneo e Medio Oriente
- ✓ Programma Russia e Vicini Orientali
- ✓ Programma Sicurezza e Studi Strategici
- ✓ Progetto Argentina
- ✓ Progetto Asia Meridionale
- ✓ Progetto Cina e Asia Orientale
- ✓ Progetto Diritti Umani
- ✓ Progetto Disarmo
- ✓ Progetto Internazionalizzazione della Pubblica Amministrazione

Le pubblicazioni online dell’ISPI sono realizzate anche grazie al sostegno della Fondazione Cariplo.

ISPI
Palazzo Clerici
Via Clerici, 5
I - 20121 Milano
www.ispionline.it

¹¹ *Iran warships enter Mediterranean via Suez Canal*, 18 February 2012, <http://www.bbc.co.uk/news/world-middle-east-17083791>, retrieved on 19 February 2012.

¹² *Iran 'halts oil sales to France and Britain'*, 19 February 2012, <http://www.bbc.co.uk/news/world-middle-east-17089953>, retrieved on 19 February 2012.