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Iran Update
Approaching Implementation Day
The Moment of Pragmatic Necessity for Obama, Iran, and Europe

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- For the United States, the nuclear deal with Iran has helped restore America’s image in the region (and in Iran) as a leader engaged and ready to cooperate and work with the Middle East — not one demonising it. While the deal was opposed by the Republican opposition in Congress, Obama and his Democrat supporters held together to make the signing of the deal secure against a vote that would override the President’s veto — ensuring from the perspective of the US that the commitment could be given a chance to go into effect. After Obama completes his term in 2016, the next administration will need to continue diplomatic engagement as the second largest country in the region increases its influence and economic clout. Should the Republicans win the White House in 2016, there are some questions over whether they would renege on the deal; hence it is important for the JCPOA to begin implementation and demonstrate its usefulness.

- For Iran, the nuclear deal will be instrumental in normalising relations and reintegrating into the global economy. Furthermore, the normalisation of relations will encourage the younger generation and the middle classes to seize the opportunities afforded to them by their leaders and build a more open and modern Iran. But while it tries to gain the world’s confidence, Iran will ultimately be scrutinized over how it spends the cash earned from oil sales abroad—whether it invests in domestic growth or spends to fund foreign fighters. Iran has much explaining to do particularly in its underwriting of Hezbollah in Lebanon, whom journalists, some UN member states, and many Middle East analysts deem as Iran-sponsored terrorists, and to a lesser extent of the Houthi Shi’i fighters in Yemen.

- Taking full advantage of the initial lifting of sanctions by the UN and US, European businesses have already positioned themselves to reengage both diplomatically and commercially with Iran, given their geographic proximity, historical experience, and already robust pre-sanctions economic interaction. Europe’s strong humanitarian organisations must increase their engagement with Iran in addressing long neglected issues such as food security for its minority citizens and refugees from Afghanistan and Iraq as well as considerable environmental damage from the mismanagement of natural resources.
Drivers for Change

Now that the nuclear deal with Iran has been finalised with the signing of the JCPOA (Joint Comprehensive Plan of Action) as of 20 July 2015, all UN sanctions as well as most US and EU sanctions will be lifted once Iran’s commitments to dismantle its centrifuges and to halt uranium enrichment activities are verified. Once the unraveling of sanctions and new trade laws take root, however, the US, the Iranian government and European businesses must each play their part in making the deal one that furthers dialogue and cooperation and not one that naysayers see as a dangerous misstep for global security.

Obama’s Vision and Ultimate Pragmatism

At the beginning of his first term in 2008, Barack Obama immediately tried to reconstruct US relations with the Middle East. His speech in Cairo sent shockwaves throughout the Arab world, promising new policies that would build trust and encourage peace in the region. For Obama, the vision of turning from neo-con policy thinking on the region shaped his foreign policies. A Republican-dominated Congress limited the President’s efforts to improve relations with the Middle East and change the Israeli-Palestinian context when Obama communicated to Netanyahu that Israel must stop building new settlements and retreat to its pre-1967 borders. While a conservative Congress actually supported Israel’s President Benjamin Netanyahu over and above their own President, the Obama administration continued to re-engage Iran and brought about a thaw in relations with its government.

Republican senators in the US still stand opposed to a deal that they argue would alienate and weaken Israel. The Republican view rests on the notion of a vulnerable, isolated Israel beset by its larger and belligerent neighbours. This view treats Iran as an enemy that could one day develop a nuclear arsenal that might obliterate Israel on a single order from Tehran. Potential economic gains from dealing with Iran are, in this narrative, trifling compared to the existential nuclear threat.

Some among Washington’s Democratic congresspersons interpret Tehran’s domestic announcements by the Ayatollah more pragmatically as a propaganda drive to assuage some ultra-conservative members of the clergy and hard-liners who continue using their rhetoric within Iran to maintain both their own power and a tight grip on society. For the Obama administration, the tensions within the region are historical and complex—deeply entrenched and ongoing. In order to guarantee at least a modicum of deterrence to prevent possibilities of a destabilising regional arms race, the Administration has chosen to push outreach to Iran and negotiate a halt to its nascent nuclear program.

How Sanctions Pushed Iran to the Negotiating Table

Despite the Ayatollahs’ occasional hate-messages to the West and its continuing repressive jailing of critical reporters—they are in some ways the most pragmatic leaders that Iran has seen since the Reza Shah era. In 1997, then-president Khatami and the Supreme Leader Khamenei both reached out to America for dialogue. The administration of George W. Bush rebuffed those efforts, but the previous Clinton administration had tried to improve relations by distinguishing between the threats posed by Iran and Iraq. While Secretary of State Warren Christopher refused dialogue based upon the ongoing shadow of the Iranian hostage crisis, the Clinton administration did continue the government-to-government dialogues initiated by the administration of George Bush, Sr.

Sanctions have crippled Iran’s economy, affecting the ordinary Iranian considerably. The government has been in significant fiscal deficit as a result of lost oil revenues. The value of the currency has dropped by an estimated 80 percent, and inflation, depending on source, ranges from 25-50 percent per annum. While the domestic economy continues to function, international trade is sharply curtailed and many foreign products such as popular mobile phones and laptops are

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1 JCPOA stands for the Joint Comprehensive Plan of Action which was signed by all members of the P5+1 group which spearheaded the effort to bring Iran to halt its nuclear weapons program in exchange for lifting sanctions.
either not available or not easily affordable. Consumers have felt the pinch and pushed their leaders to justify their suffering.

**Key Sanctions to be Lifted**

The two most critical areas of sanctions to be lifted are in financial transactions and in unlocking frozen oil revenues. Allowing banking transactions is an essential precursor to revitalised trade; the lifting of sanctions will provide Iran access to the global banking system. Outside of the US, over 230 banks will no longer be sanctioned and will be able to conduct business within Iran and non-US territories. While access to currency will revive trade, Iran’s financial authorities will need to exercise careful monitoring of the money supply. Rouhani has already announced plans to control inflation through strict fiscal policies to address likely problems as increasing cash flow from oil sales and the repatriation of frozen assets enters the country’s financial system.

The US has agreed to lift economic sanctions on Iran’s financial and energy sectors by allowing it to access nearly US$58 billion worth of oil revenue now frozen and escrowed abroad. Another US$56 billion remain under contract and in investment vehicles that may be non-performing or due to expire, but it is not clear whether this amount will ultimately be released. Sanctions will also be lifted on outside participation in and trade with Iran’s automobile, shipping, and insurance industries. Restoration of trade in oil is expected to generate up to US$20bn per year in hard currency.

**US-Specific Sanctions**

The US has a number of other sanctions in place, some dating back to 1979. These will be lifted in part, but complexities remain. Most thorny will be the processes for financial transactions involving the Iranian Revolutionary Guard (IRGC), which controls the majority of the domestic contracts within Iran. The IRGC’s elite Quds Force is currently involved in the fight to prop up the Assad regime in Syria as well as in the training of Hezbollah fighters. Hezbollah is viewed in the US as a terrorist organisation, so financial transfers to them are restricted. The Iranian Revolutionary Guards have maintained control over Iran’s construction, banking, and energy sectors, to such an extent that it would be difficult for financial dealings in these sectors to increase substantially without some re-thinking of this designation. Contrary to its critics’ views, the Revolutionary Guard is something more than just a military force that has clamped down on political rights in Iran. The Revolutionary Guard came into being in 1979 immediately after the Revolution to counter the Shah’s military who wanted to overthrow the clergy who had taken hold of the country. Aside from serving as the state military, the Revolutionary Guard also operates hospitals, schools, and other civil service organisations in concert with other parts of the government. Even if the sanctions are lifted, further work and negotiation may be needed to find a solution around funding that would go to the Revolutionary Guard.

In terms of weapons trade, sanctions will remain on the transfer of ballistic missile technology for another eight years after the implementation. Sanctions on the sales of conventional weapons will remain but will most likely be phased out in the next five years.

**EU Businesses and pragmatism**

Unlike the US, European countries look at Iran less ideologically and more pragmatically. They see a large market of more than 80 million people, just a bit smaller than Turkey. Iran is young, with more than half the population under 35, and women are active in the workforce, earning disposable incomes — which is less common in other parts of the region. Iran is an “upper middle income” country according to the World Bank, and as such, potentially a growth market for European companies. Some commentators see the country as the last large untapped emerging market.

As steps to nuclear inspection and dismantling are completed, the EU will also lift the oil embargo that it imposed in 2012.
As sanctions near their end, European businesses are already starting to re-engage. Germany has already sent representatives from its top companies, including Mercedes-Benz, Siemens, and Volkswagen. Sanctions on the sale of passenger planes and aviation-related technology have been lifted, opening up opportunities for American and European aviation companies as Iran looks to update its old and unsafe domestic air fleet. Some estimates suggest the country needs to acquire 400 civilian aircraft over the next decade. The Tehran based Turquoise Partners Group facilitates foreign investment in Iran and has answered calls from numerous European companies interested in business and trade. Currently, 90 percent of its inquiries originate from Europe.

**Investing to Upgrade the Oil Industry**

Direct foreign investment is essential to reviving Iran’s long neglected, but economically crucial oil industry. Iran’s oil minister Bijan Zanganeh estimates that oil output will increase by 50 percent over the next five years. Lifting of sanctions will allow Iran to produce 3.8 million barrels of oil a day, up from 2.8 million barrels. The country also has 60 millions barrels of condensate in floating storage. The hard currency that Iran earns from oil can fund desperately needed updates to oil recovery equipment and unlock its frozen exports, one key reason in the end why Iran conceded access to its nuclear sites and restrictions upon its nuclear activities.

Iran also plans to allow foreign oil companies to invest in extracting its hydrocarbon reserves. When this is carried through, the country plans on expanding production to up to 5.9 million barrels per day. By the end of the year, the country aims to open 45 oil fields to be tendered for development.

European companies have proactively reached out, expressing interest in working with Iran’s oil industry. The negotiation of contracts will take some time, however, as each party works to set appropriate terms of cooperation. It is estimated that updating oil extraction infrastructure will require at least US$200 billion in capital, and currently, without the hard cash to pay for upgrades, Iran will need to offer in-kind payment (oil rights or oil trades) to secure these investments.

**Other Sectors Needing Upgrade**

Other cash earned through oil trade could be invested to upgrade the country’s petrochemicals, agriculture, and healthcare industries. The lifting of sanctions will be particularly important for the revival of Iran’s petrochemical industry, as Germany, UK, and France could be key to funding and advancing the domestic sector. Unable to invest in and upgrade its petrochemical infrastructure, Iran’s downstream industries have suffered, even to the point of gasoline shortages. For example, although Iran shares one of the region’s largest gas fields with Qatar, it has been unable to develop the majority of its portion of the field to develop LNG products. Its petrochemical stations are badly maintained and outdated and cannot modernize without foreign involvement.

Agriculture has suffered in Iran due to poor water management, and this problem may worsen as underground aquifers dry up and climate change increases evaporation rates, leaving Iran with no choice but to import potable water and irrigation water. As it is, with its mountainous, semi-arid terrain, Iran has only a quarter of the world’s average precipitation rate. Iran has been importing significant amounts of meat and produce as the agricultural sector has been severely neglected. The collapse of the rial in 2012 had a harsh effect on the sector as the government cut back investments in the farming sector. Ministries responsible for energy, industry and trade, agriculture, and economy and finance had failed to cooperate meaningfully even before the sanctions, depriving the agricultural sector of desperately needed investment and attention over the past four decades.

Public health is also in decline. There has been an increased rate of obesity and diabetes in rural areas and among the poor. Whereas wealthier citizens can access fresh fruit and vegetables imported to major cities from China and India as well as any produced domestically, those in the rural regions have had to substitute fresh products with processed ones to meet their daily caloric needs. According to the International Food Policy Research Institute, dietary changes have led to
severe malnutrition in Iran. Iodine and iron deficiencies have also led to widespread anaemia which affects women in particular.

85,000 Iranians suffer from cancer and cannot access chemotherapy drugs. 43,000 haemophiliacs cannot access blood-clotting medicine, and the roughly 8,000 Iranians suffer from thalassemia, an inherited blood disorder also have challenges obtaining deferoxamine, to regulate blood iron content. Domestic agricultural output has deteriorated due to shortages and mismanagement of clean water — matters that could be addressed with foreign help once this is permissible.

**Upgrading Iran’s Human Capital**

More money in the economy could also be invested in Iran’s youth, who are tech literate and mobile savvy. Hundreds of companies are vying for a piece of the country’s vast market for services and products. Iran is the country most tech-ready to develop a domestic start-up industry. Iran’s internal environment is stable and large enough to fund and nurture startup businesses. The market is potentially exciting, given a sizeable domestic population and its position of importance within Central Asia.

Already established start-up companies such as Dijikala, an online-e-commerce platform valued at US$150 million, Aparat, (Iran’s YouTube), and Takhfifan, (a Groupon model) have drawn attention from Silicon Valley investors and other tech companies searching for strategic partners abroad. A joint venture between a South African telco MTN and Germany’s Rocket Internet has launched Mozando, an Iranian eBay, as well as Taxi Yaab, Iran’s Uber, and Bamilo, an Amazon-like online book sales site.

Members of the Iranian diaspora who have learned the tech trade could potentially re-engage with their home country and share their expertise. The brain drain threatening Iranian start-ups can also be addressed if the government establishes the proper institutions to train and grow young entrepreneurs.

Barriers to success include the heavy regulations and censorship enforced by government that discourages investment in the tech sector. Slow internet speeds are another barriers to encouraging online businesses. While 3G and 4G connections are up to global standards, basic connectivity in public buildings still lacks the speed and efficiency needed for successful business operation and communication. If Rouhani can manage to bring the Ayatollahs on board on loosening regulation in fostering young companies, Iran could take advantage of a fertile environment for growth of start-up businesses. Iranian entrepreneurs remain confident that even with sanctions lifted and competitors entering the market, they can still be competitive at home.

**Room to Change Iranian Geopolitics?**

Despite the sanctions and the resulting deprivation, Iran continues to fund soldiers and proxies abroad, including Hezbollah in Lebanon and the Houthis in Yemen. Iran wants the world to see that it is a true Islamic nation that protects and defends those struggling against repressive states that deny their existence and maintain power through Western support. It also acts to counterbalance what it sees as Sunni and Israeli overreaches in the region.

In Yemen, Iran came to the rescue of the Houthis, a Zaydi Shi’i group, mostly residing in San’a and the northern mountains, where a Saudi-endorsed government ruled by Saleh had neglected to share power and provide the basic services the citizens needed to carry on with their lives. Although the world views Iran as funding terrorists, Iran sees itself as the protector of Shi’i minorities in Sunni-dominated countries. In the case of Yemen, Saudi Arabia’s continued military advances, and particularly its air strikes, have torn the country apart and it may be the case that the Houthis will retreat. At least for the time being, rather than challenging Saudi Arabian forces with equal military might, the Ayatollahs continue to leverage their military connections abroad — and in doing so, Iran is avoiding a direct fight with Saudi Arabia on behalf of Yemen. Whether the fight in Yemen will resolve itself is open to question, but Iran now has a greater range of options to exercise its influence in the region—perhaps even to push for diplomatic negotiations that could encourage fairly elected government with representatives serving the interests of all parties and sects in Yemen.
In Syria, Iran continues to support Asad, arguing that the regime is only fighting against the Gulf states that have been fighting to end his rule. Iran maintains a belief in the regime’s legitimacy, allowing Asad and his followers to stay in power despite bringing the country to the brink of ruin. The only area of cooperation with the US has been to seek ways to root out IS and al-Qa’ida. The Shi’i-dominated government in Iraq has also been working closely with Iran in fighting IS, which may appear positive for US-Iranian cooperation but also promotes further sectarian polarities as the fighting continues.

Conclusion

With the Obama administration’s ability to rally 44 senators to back the Iran nuclear deal, P5+1’s negotiated solution remains intact. Now, these countries and others can begin the long project of rebuilding economic relations with Iran. The agreement has succeeded in getting Iran to halt its uranium refinement program and changed the dynamics in the region.

Given the history of tumultuous relations between the US and Iran, it is difficult for the world to see how the world came to converge on the agreement to lift sanctions on Iran. For Obama, it was a chance to build his legacy in his final term. Energy Secretary Ernest Moniz’s ability to explain the nuclear aspect of the deal won approval from prominent business executives, politicians, and other figures. For the US, the limits and risks of military engagement and its own budget constraints ultimately made this agreement a preferable option to confrontation. While conservatives in the US Congress continue to argue that the deal emboldens Iran to continue supporting Hezbollah, Hamas and other Shia militant groups, America’s Democratic legislators and European (and Asian) business leaders are now preparing to conduct business with Iran. It may turn out that even conservative businesspersons from the US find the market too attractive to shun.

For Iran, the chance to reengage with the world economically and normalize relations after years of being excluded from global trade and investment and the massive potential benefits to its economy were too attractive to pass up. As sanctions lift and Iran transitions into becoming a more functional member of the global trade system, its previous enemies and naysayers may come to engage with a large market that inevitably influences the global economy and regional security.

With larger stakes in the global economy, Iran will have to engage in diplomatic relations and perhaps defend its interests a little less tenaciously, whether in its support of the Houthi minority in Yemen or of Hezbollah. As relationships and interactions with the rest of the world normalize, there is a basis for believing that the country’s leaders will be under greater pressure to focus on economic development and advancement, with less need or rhetorical space to simply demonise the West and blame external actors for the country’s problems. Likewise Israel and the Gulf countries may lose the force behind their arguments that a strong Iran is a menacing one. The Gulf, Israel, and Turkey will have to seriously consider greater engagement and trade with Iran and its market of 83 million people. Informal business ties eventually formalize, and diplomatic ties and dealings could foster greater cooperation and understanding. An agreement born out of pragmatic necessity could well be a catalyst for meaningful and positive changes in the region, if given room to prove itself.