

**Iran after the Nuclear Deal:
Which Way Forward?**

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Context and Preliminary remarks

- Sanctions have a long history globally and have been rising in incidence and significance.
 - The MENA region has had the lion's share in the past: Libya under Qaddafi, Gaza, Iraq, Iran, Sudan and more recently the Qatar blockade.
 - **Sanctions are designed deliberately to hurt:** a general presumption by 'sender' countries that '**If they are hurting they are working**'.
 - This is despite the fact that the legal grounds on which they are imposed are at best questionable (especially for unilateral sanctions) and that they act as '**collective punishment**'.
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Main Considerations

- **Do Sanctions work?** What makes sanctions ‘work’ depends on what their real objectives are!
 - There are clearly different perspectives on sanctions: the ‘senders’ (imposers) and the targets. This affects the quality and quantity of information needed for their objective evaluation
 - Tonight, I focus on the Iran Nuclear Deal and sanctions against Iran from two main perspectives:
 - *Before and after its signing (2015)*
 - *After the recent US withdrawal (May 2018)*
 - There is a tendency for senders to under-estimate the costs and over-rate the benefits and for targets vice versa!
 - **Social costs as well as unintended consequences** are often overlooked.
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Outline

1. Economic Sanctions – A Broad Overview

- a) Concept & Historical Perspective

2. Sanctions & The Iranian Economy

- a) Before the Deal (2010-15)
- b) After the Deal (2015-18)

3. Recent Developments – Which Way forward?

a) Economic considerations

- International oil markets
- Macroeconomic impact

b) Political Aspects

- Regional security
 - Iran's internal political dynamics
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Economic Sanctions – Overview

- Sanctions are defined as **deliberate government-inspired withdrawal or threat of withdrawal of customary trade, financial relationship or seizure of assets**
 - An **Economic tool** to force a change in **foreign policy** of a target country or to bring about a general change in its behaviour
 - **History**: first known example is in 432 BC, when Athens sought to choke the economy of the city-state of Megara by excluding its merchants from Athenian controlled territories.
 - **Common justifications**: Sanctions often justified as alternative to war but back then – as often now – they contribute to war rather than averting hostility.
 - Sanctions on the rise especially **after the 1990s**.
 - **1914-1990**: 115 sanctions (an average of 1.5 each year)
 - **1990-99**: 66 sanctions (an average of 7 each year; of these two-thirds are US sanctions).
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Legal Aspects

UN Sanctions – Article 41: CHAPTER VII – ACTION WITH RESPECT TO THREATS TO THE PEACE, BREACHES OF THE PEACE, AND ACTS OF AGGRESSION

- The Security Council may decide what **measures not involving the use of armed force** are to be employed to give effect to its decisions, and it may call upon the Members of the United Nations to apply such measures. These may include **complete or partial interruption of economic relations** and of rail, sea, air, postal, telegraphic, radio, and other means of communication, and the severance of diplomatic relations
 - Other aspects:
 - The principle of proportionality (defined in the **Geneva Convention**)
 - Fundamental human rights law (**Universal Declaration of Human Rights**)
 - The principles of international humanitarian law (**The prohibition of collective punishment** under The Fourth Geneva Convention, 1949)
 - Violations of multilateral trade and investment rules (**WTO rules**)?
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Sanctions – Salient Features

- In most cases imposed by large nations/entities
 - Not so common to see the likes of Luxembourg or Lichtenstein resort to sanctions but the US, EU, UN and the former USSR
 - In 80% of cases ‘Sender’ > Target more than 10 times
 - In 50% of cases Sender > Target by 100 times
 - **KSA + UAE + Bahrain + Egypt GDP = US\$1,363 billion = almost 9 times Qatar’s GDP (\$153 billion, 2017)**
 - **US+EU = 40% of World GDP; Iran = 0.5% so 80 times**

 - Often high profile sanctions serve **important domestic political** agenda too.

 - The most comprehensive study by Hufbauer *et al* (2007) have shown sanctions to be **effective one-third of the time (34%)**.
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Iran Economic Sanctions (2010-15)

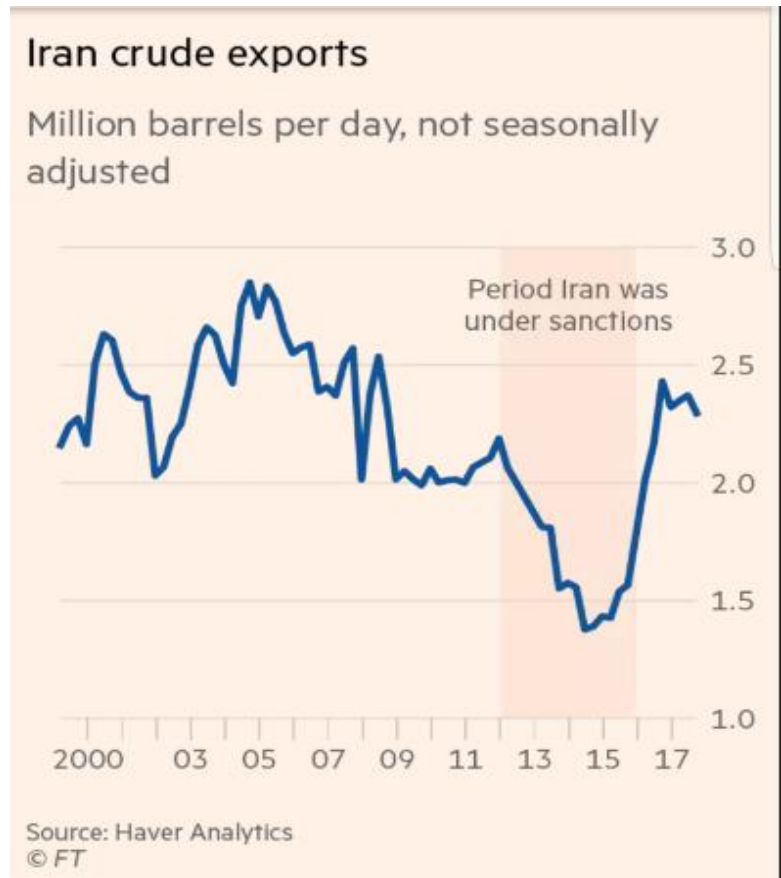
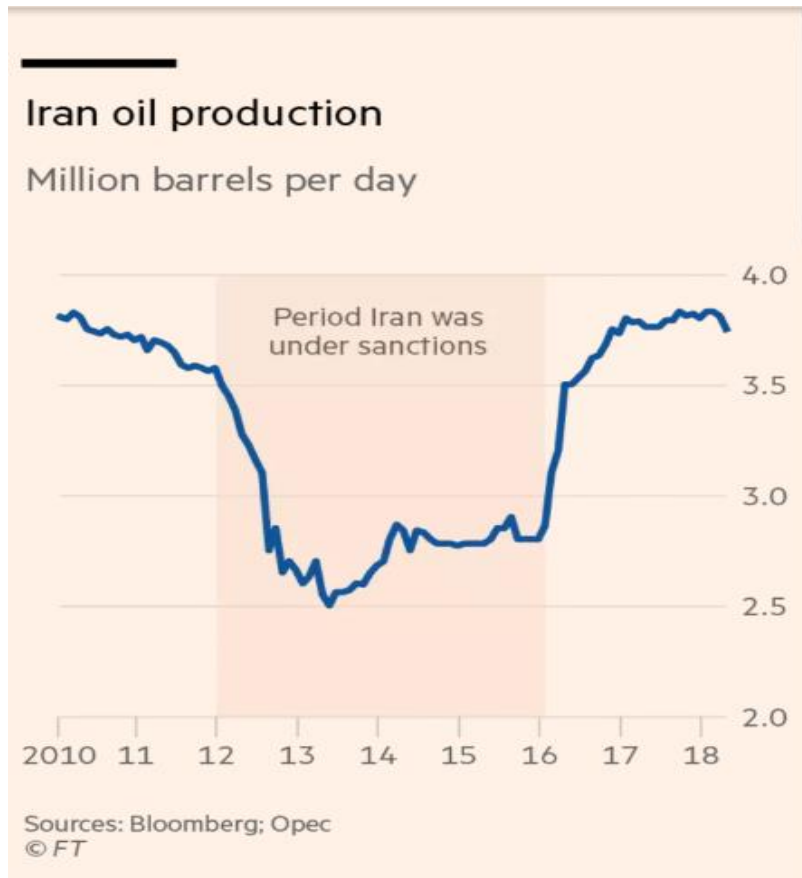
Impact in a Nutshell:

- Sanctions contributed to ‘stagflation’ in the Iranian economy after 2011
- Escalating inflation and unemployment
- Collapse of currency in late 2012
- Serious difficulties with exports of oil and payment for essential imports
- Extensive private sector failures and low capacity utilisation
- Ironically, sanctions encouraged centralising and enlarging the public sector and the *Bonyads*
- Little doubt that economic sanctions had an immense impact on Iran’s economy: the main impact was arguably on [the standard of living of ordinary Iranians](#) who suffered significant hardship
- Joe Biden – Paul Ryan TV debate (12 Oct 2012)

“These are the most crippling sanctions in the history of sanctions period period.”



Iranian Oil and Sanctions





In the Shadow of Sanctions (2010-15)

	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>
■ Oil and gas revenue (m US\$)	118	63	56.3	52.8	26.9
■ Crude oil (m barrels/day)	4.0	3.2	2.8	2.7	2.9
■ CPI inflation (average annual %)	21.5	30.5	35.2	23	11.9
■ Unemployment (%)	12.3	12.2	12.9	14	11.0
■ Real GDP growth (%)	3	-5.8	-1.7	1.5	-1.6



After Sanctions (2016-18)

	<u>2016/7</u>	<u>2017/8</u>	<u>2018/9</u>
■ Oil and gas revenue (m US\$)	49.8	63.7	78.3
■ Crude oil (m barrels/day)	3.7	3.8	3.8
■ CPI inflation (average annual %)	9.1	9.9	12.1
■ Unemployment (%)	12.4	11.8	11.7
■ Real GDP growth (%)	12.5	4.3	4.0



End of Sanctions – Was There a Consensus?

- Optimists painted life after sanctions in terms of big potential gains in several areas:
 - Gas and oil exploration and extraction
 - Iran's need for, and access to, technology and international finance
 - Investment opportunities in tourism, automobile, aviation and transport projects
 - But in practice the benefits of the JCPOA proved to be very slow in coming
 - The US did not lift its banking restrictions for the clearing banks dealing with Iran
 - Iran continued to operate under the spectre of US financial restrictions.

- Others take a different view:
 - “The main cause of Iran’s economic woes... is **corruption, mismanagement and bad policies** by the government, especially during the tenure of the former president Mahmoud Ahmadinejad... the effect of sanctions on Iranian economy has been **exaggerated** and the belief that the lifting of sanctions will jump start the economy and miraculously solve all of Iran’s economic troubles is also disproportionate.”

(Saeed Leylaz, 23/11/2014)



Rouhani Challenges (1)

- The Rouhani administration prioritised external relations as the key mechanism for achieving economic stability and revival
 - Had some success dealing with inflation (down from more than 40% to less than 10%) and resuscitating growth (from negative territory to around 4-5% growth now).
 - Oil price collapse (to less than half from mid-2014 to 2017); some recovery in recent months since speculation started about the demise of the JCPOA
 - Total unemployment rate stands at nearly 13%, while youth unemployment is officially measured at 29%.
 - Unemployment is highest among those with university education, particularly women. While more young Iranian women now enter Iran's universities compared to their male counterparts, Iran's rate of female labour force participation was a paltry 15% last year, down from 20% a decade ago – among the lowest in the world!
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Rouhani Challenges (2)

- The Dec/Jan wave of street unrests a threat to Rouhani's planned economic reforms. The protests erupted despite two years of modest improvement in the Iranian economy.
 - **Job creation will remain a principal challenge** for Rouhani.
 - Some 840,000 people are expected to enter the labour market this year alone, simply stabilizing unemployment in the short term will be a tall order.
 - With more than 40% of the population between the ages of 15 and 34, adding enough jobs in the longer term will be no easier.
 - The recent protests have weakened Iran's reformers by eroding their monopoly on hope and driving a wedge between the government's neoliberal policies, intended to address Iran's economic problems, and its goal of deepening popular support.
 - External factors too have moved in a challenging direction for Iran generally and for the reformist administration particularly.
 - Although the new sanctions are likely to cause less damage than last time (as Iran has diversified more its economy and also its trading partners), nevertheless the hoped-for benefits of a comprehensive nuclear deal seem far away.
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The US Decision to Withdraw

- On May 8 Trump announced US withdrawal from JCPOA stating that:
 - It should never have been signed (it was a bad deal)
 - The US had 'conclusive evidence' that Iran was cheating (continued with its nuclear weapons programme) since signing the Deal (although no new evidence was provided)
 - Iran was even supporting The Taleban and Al-Qaida!
 - There's also a presumption that the nuclear deal 'rewarded' Iran by giving it a lot of cash (one hears of some \$150b), which has allegedly emboldened Iran.
 - On 20 May, Mike Pompeo gave his first major speech as Secretary of State threatening the "**toughest sanctions in history**" on Iran
 - He submitted 12 demands to ensure Iran "**has no possible path to a nuclear weapon.**"
 - The decision has been strongly criticised by the EU leaders and European government officials faced with extra-territorial laws (secondary sanctions) against their companies.
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Likely Impact

- Economic considerations:
 - International Oil Markets
 - Broader Macroeconomic Impact

- Political Aspects
 - Regional Security
 - Iran's internal political dynamics

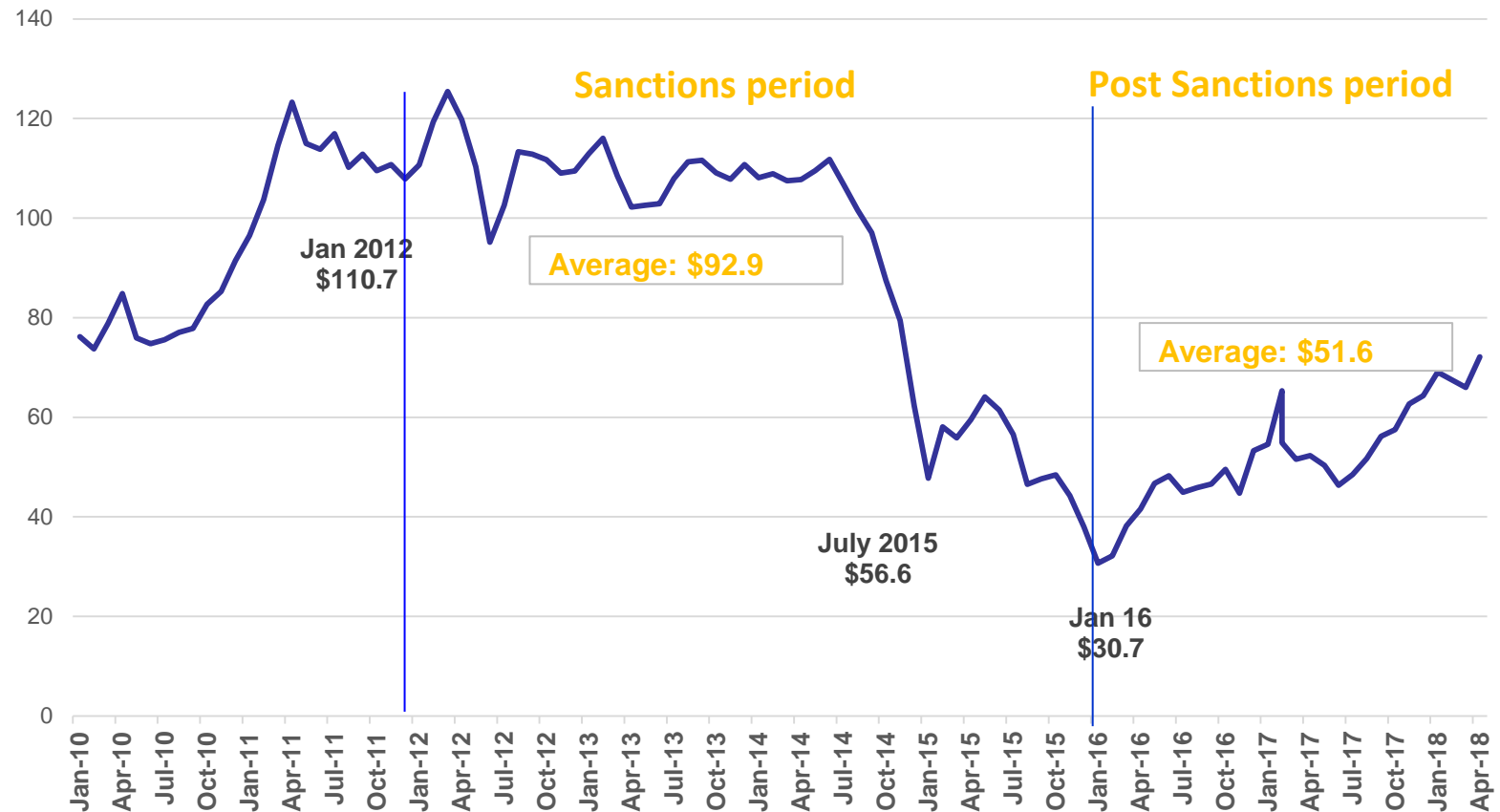


Oil Markets

- Can the oil markets weather the loss of Iranian output?
 - It is estimated that such loss in the fourth quarter of this year could be around 400,000 barrels a day or just over a tenth of Iran's output.
 - This is likely to be exacerbated by Venezuela's declining output
 - In anticipation of supply tightening, oil prices firmed up before the Deal was 'nixed' by Trump in May jumping to \$80 a barrel last month (for the first time after 2014), but have since steadied around \$75.
 - Key to the change in the supply-demand balance will be whether OPEC or Russia will increase output; this cannot be ruled out considering Russia's revenue needs. USA's oil shale output too is likely to increase at higher prices.
 - Given Saudi Arabia's spare capacity (as much as 1.5m barrels a day) and its enthusiasm to assist Trump's ME policies against Iran), it is very likely that it will offset Iran's reduced output (as it did in the last round of sanctions).
 - Given the looming US mid-elections in November, Trump would be keen to stem the rise in petrol prices for US consumers too.
 - So maybe oil prices have already peaked for this year?
 - What does past experience tell us?
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Learning from the Past (Brent Crude: Jan 2010 – Apr 2018)





Macroeconomic Impact

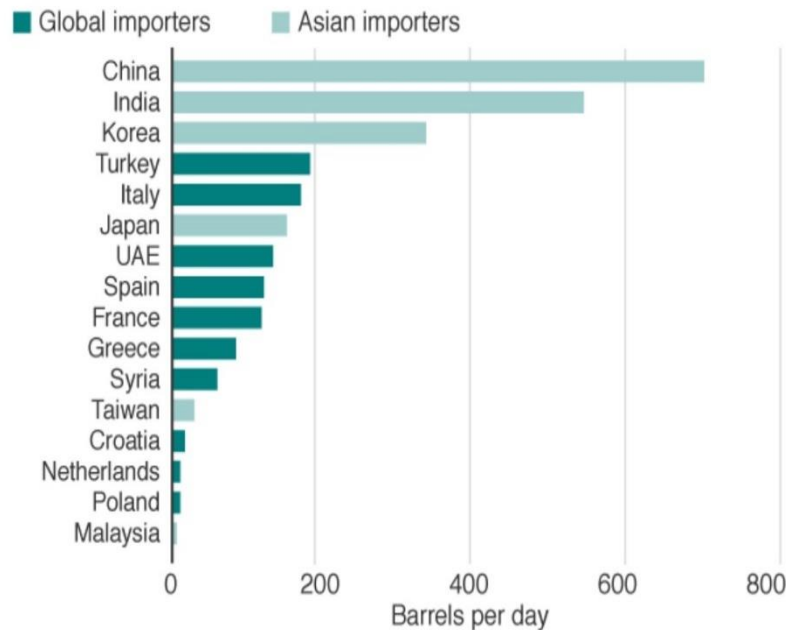
- Following a few years of negative or low growth, Iran's economy was estimated to grow at about 4%-4.5% this year
 - The return of sanctions and associated fall in oil income will weaken both domestic and international investment climate
 - This will dampen growth prospects and although it is not clear that recession will necessarily follow, growth rates are likely to be lower.
 - In anticipation of the demise of JCPOA, Iran's currency took a sharp nose dive since February and the government's supply-side measures to stem its slide have not been very effective to date.
 - Such sharp depreciation of the currency will no doubt add to inflationary pressures again
 - Such weakness in both private and public sector aggregate demand will fail to assist with job creation, which has been arguably Iranian economy's Achilles Heal.
 - Iran will continue to look East for its trading relationships...
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Iran's Trading Partners: Oil and Non-Oil

Iran's biggest customers

Average exports in thousands of barrels per day from November 2017 to April 2018



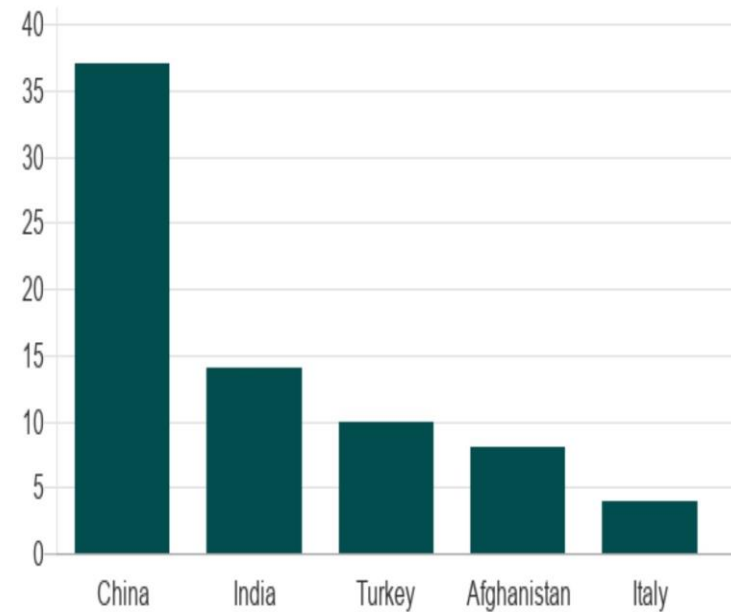
Source: Bloomberg



Source: IMF

Iran exports: Top five destinations for non-oil products

% non-oil goods





Regional Security

- Even more significantly perhaps, the US withdrawal from JCPOA has ratcheted up tensions and increased political temperatures in the region.
 - Iran's growing regional influence and its ballistic missile tests – though both outside the scope of JCPOA – have raised major concerns amongst the US allies including Israel and Saudi Arabia which openly speak of Iran as their common enemy.
 - It is not clear why walking away from an internationally binding agreement over a major security issue (Iran's nuclear ambitions) that has by all accounts been working can address issues relating to Iran's other behaviours.
 - If pushed, it is likely that Iran would shore up support for its regional proxies as a form of deterrence.
 - This could increase the risk of new conflicts with Israel and Saudi Arabia breaking out.
 - At the moment, for Iran's foes Syria is likely to become a focal point for concerted efforts to stem the tide of Iran's influence and growing power.
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Iran's Internal Political Dynamics

- Arguably a gift to hardliners?
 - There is very little doubt that withdrawal from JCPOA will unravel Rouhani administration's major foreign policy plank and stifle his plans for social and political reforms and economic liberalisations in Iran.
 - Now confronted with external adversity, two possibilities might follow:
 - Will this unite the factions in Iran?
 - Will it play into the hands of the hardliners to establish themselves at the helm?
 - Iran's internal situation is also like a tinderbox with ongoing and extensive labour unrests across the country, the disaffected urban youth feeling marginalised, and rampant economic hardship adding to the pains of daily life for many of its citizens.
 - It is likely that in the short term factions might unite but the failure of the nuclear deal will come as a major blow to the Rouhani administration.
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So Which Way Forward?

- Whether JCPOA is dead or just bruised depends just as much as on what others do as Iran does
 - The European resolve to stand up to US administration's unilateral policies and secondary sanctions now under the spotlight
 - But private companies are arguably subject to economic calculus and likely to weigh the benefits and costs of doing business in Iran versus the likely loss of business in the US or even her punitive fines
 - Iran and the US have reversed roles in some ways: last time Iran was isolated vis-a-vis the P5+1 countries; now the US seems isolated in its position but a powerful force nevertheless.
 - Iran is on a **tightrope**:
 - Restart its enrichment programme? – arguably plays into the hands of Iran's foes
 - Continue to put its faith in other partners in the Deal – how long can this go on in the face of hardships to come?
 - The choice is between a rock and a hard place!
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