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# The Iranian Empire Cracks, at Home and Abroad

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Iran is under severe internal and external pressure. Economic pressures have pushed the government to increase petrol prices and this resulted in riots and many deaths. During the last decade, the economy has barely grown and income per capita has fallen by an annual average of one percent. In 2019, per capita income is estimated to have fallen by 10 percent. The problems facing the Iranian economy are linked to sanctions and to underlying or structural factors.

Meanwhile Iran's "empire" abroad – Lebanon and Iraq – has come under unprecedented threat. In recent months, Iraq and Lebanon have been plunged into chaos (see Iqtisadi September and October 2019). In both countries the protests have been partly against Iran, which is seen as an outside power interfering in the domestic affairs of those countries. In Lebanon, the pro-Iranian, Shiʿa movement, Hizballah, is part of ruling clique threatened by popular revolt. In Iraq, the Iranian presence is threatened by Iraqi identity, Sunni hostility, and most of all by turmoil within the majority, Shiʿa, community. Iran has used its allies in Lebanon, Iraq and Syria as proxies in its conflicts with Israel and the United States, but this has become increasingly costly.

During 2012-2015 when comprehensive sanctions against it were in place, Iran's economy shrank. Crude oil exports fell by more than 50 percent and its access to assets held abroad was severely limited. In 2015, Iran signed the multilateral nuclear accord, the Joint Comprehensive Plan of Action, (JCPOA) that provided relief through the waiving of some US sanctions and the lifting of UN and EU sanctions. Under UN Security Council Resolution 2231, which enshrined the JCPOA, nonbinding UN restrictions on Iran's development of nuclear-capable ballistic missiles and a binding ban on its importation or exportation of arms will remain in place for several years. Sanctions relief enabled Iran to increase its oil exports to nearly pre-sanction levels, regain access to foreign exchange reserve funds and reintegrate into the international financial system. Economic growth accelerated from an annual average of 1.1 percent in 2012-2015 to about almost nine percent in 2016-17.

US sanctions were re-imposed in mid-2018 and in October 2019 the IMF estimated that Iran's economy will shrink by nearly 10 percent during March 2019-March 2020—a much sharper decline than was projected in late 2018. Iran's crude oil sales fell from 2.5 million barrels a day (mb/d) in 2011 to about 1.1 mb/d by 2014. They recovered to 1.9 mb/d in October 2018 as sanctions eased but fell to below 300,000 barrels per day in October 2019. Iran is therefore losing at least $50 billion annually in revenue compared to 2017.[1]

Global banks largely ceased operating in the Iranian market during 2011-2016 because of international sanctions but they hesitated to reenter after the 2016 easing of sanctions because of concerns that the United States might still sanction their transactions with Iran; the lack of transparency in Iran's financial sector as well as concerns over financial penalties for processing Iran-related transactions in the US financial system. After 2016, Iran was able to obtain shipping insurance as a result of US waivers given to numerous insurers, but from August, 2018, US-based shipping reinsurers no longer have active US waivers, and Iranian shippers have been compelled to self-insure their shipments. The 2011-2016 sanctions regime prevented Iran from accessing the hard currency it was being paid for its oil. By January 2016, foreign currency reserves held in foreign banks were about $115 billion. Iran kept most of its reserves abroad for cash management and to pay for imports, but they were again restricted by US sanctions re-imposed in late 2018.

Sanctions caused the value of the rial on unofficial markets to decline about 60 percent in 2012-2013, when, with the election of Hassan Rouhani, the rial stabilized at about 35,000 to the dollar. The re-imposition of US sanctions caused the rial's value to plummet to 150,000 to the dollar by November 2018. This made it difficult for Iran to import goods and the government banned the import of 1,400 goods to preserve hard currency. The fall in value of the currency caused inflation to accelerate during 2011-2013 to a rate of about 60 percent—a higher figure than that acknowledged by Iran's Central Bank. As sanctions were eased, inflation slowed to the single digits by June 2016, meeting the Central Bank's stated goal. The US exit from the JCPOA caused inflation to increase to about 15 percent by late June 2018, and further to nearly 40 percent, by the end of 2018. According to the IMF, in 2019, inflation is estimated at about 36 percent. (See Table 1) The Statistical Center of Iran (SCI) announced that the inflation rate in the twelve-month period which ended on 21 December 2019 was 40 percent.[2]

Iran's manufacturing sector grew prior to 2011, but its heavy dependence on imported parts left it vulnerable to sanctions. Vehicle production fell by about 60 percent from 2011 to 2013. The automobile sector, and manufacturing in general, rebounded after sanctions were lifted in 2016, but declined again following the US exit from the JCPOA re-imposition of sanctions.

Nonetheless, the imposition, lifting, and re-imposition of strict sanctions do not appear to have affected Iran's regional behavior. Iran intervened extensively in Syria, Iraq, and Yemen during the years 2011-2015 when sanctions had a significant adverse effect on the economy. Iran has remained engaged in these regional conflicts after sanctions were eased in early 2016, and since US sanctions were re-imposed in late 2018. Iran's regional activities have not changed with the imposition of lifting of sanctions but have varied according to the opportunities to expand its influence that have been provided by the regional conflicts.[3]

In mid-November 2019, the government raised the price of gasoline from eight cents to twelve cents a liter (equal to fifty cents per US gallon) for the first fifteen gallons purchased each month. Subsequent purchases were priced at 24 cents. The price hike triggered instant opposition. During the next four days, protests erupted in cities across the country and hundreds and possibly more were killed by the security authorities.[4]

Soon after the price rise was announced, Mohammad Bagher Nobakht, Iran's vice-president for budget affairs, said about 60 million people out of the population of 82 million would be given extra monthly bonuses in compensation.[5]

Energy subsidies cost the Iranian government an estimated $70 billion a year, equal to over 17 percent of national income. Sanctions have reduced Iran's exports of crude oil from 2.8m barrels a day to less than 500,000 b/d, and as a result foreign exchange earnings have collapsed. Oil revenues and taxation on the oil sector constitute 30 percent of government revenues and so the government has come under massive pressure to cut spending.[6]

Table 1 provides an indication of trends in the economy during recent years. The data is based on foreign sources, as the official Iranian figures are not reliable. In 2000-2015, the government had a budget deficit averaging one percent a year; by 2018 it reached 4.1 percent. Over the same period, as a result of the growth of the deficit, government debt rose from 14.4 percent of GDP to 33.2 percent. Inflation accelerated as a result of the fall in the value of the rial which pushed up the cost of imports. Sanctions reduced Iran's ability to buy goods abroad and this also reduced supply, putting pressure on prices.

**Table 1: Iran - Main economic indicators, 2000-2020**

| | **2000-15 annual average** | **2016** | **2017** | **2018** | **2019** | **2020** |
|---|---|---|---|---|---|---|
| GDP growth, percent | 3.2 | 12.5 | 3.7 | -4.8 | -9.5 | 0.0 |
| Crude oil production, mb/d | 3.52 | 3.69 | 3.80 | 3.49 | 2.29 | 2.11 |
| Crude oil exports | 2.10 | 2.015 | 2.015 | 1.88 | 0.60 | 0.50 |
| Total government revenues, percent of GDP | 19.9 | 17.3 | 17.5 | 15.8 | 13.0 | 12.6 |
| Government budget balance, percent of GDP | 1.2 | -2.3 | -1.4 | 2.7 | -4.5 | -5.1 |
| Inflation, percent | 17.4 | 9.1 | 9.6 | 30.5 | 35.7 | 31.0 |

Source: IMF, Regional Economic Outlook, Middle East and Central Asia. Statistical Appendix. October 2019.

There is a conflict among Iranian decision makers over economic-development strategy. On one side are hardliners, led by Supreme Leader Ayatollah Ali Khamenei, who want to restructure the economy, so that it can better withstand international isolation. They claim that the economy has shown signs of recovery. After declining by 70 percent in 2018, the Iranian rial has gained one-third of its value and remains partly convertible. Official data also suggests that during the third quarter of 2019, a record 24.75 million Iranians were working, a 3.3 percent year-on-year increase. About 800,000 jobs, one-third of which were in manufacturing; and the unemployment rate was 10.5 percent, its lowest level in seven years.

These developments suggest that restrictions on oil exports may be forcing Iran to diversify its economy, a kind of reverse Dutch disease.* The hardliners have argued that US sanctions are helping to create a "resistance economy," which is less reliant on foreign trade, and especially on that with the West.

The reformists argue that the employment recovery is unlikely to survive more than a year or two under the sanctions regime which is depressing foreign investment and blocking Iran's access to the technologies required for economic restructuring. In 2018-2019, investment in equipment, which has historically averaged about 30 percent of the GDP, fell to 14 percent of GDP, barely enough to restore the existing capital stock.

Iran's public sector, struggling to cover its current expenditures, is in no position to offset the loss of foreign investment. The private sector, for its part, faces a credit crunch, because Iran's banks are now largely insolvent.

In a rare comment from a member of Iran's elite, First Vice President Eshaq Jahangiri stated that Washington's onerous sanctions are tightening the noose around the economy. "The Americans have in the true sense blocked the key bottlenecks of our country's economy," Jahangiri said at a conference in Tehran on 2 December.

"Even allies fear buying Iranian oil" due to US pressure, he said and this has forced Iran to get its crude shipped abroad by unconventional ways. He took pride in the fact that despite the closure of all the roads, Iran has managed "to stand on its own feet." That said, Jahangiri is not a member of the group favoring a closed, "resistance" economy.[7]

The 2020-2021 budget plan has just been presented to parliament and it reveals some of the problems that the leadership faces. It proposes government spending of 5,638 trillion rials, or $43 billion at the current free-market exchange rate. In current rial terms, this is an eight percent increase over the previous budget but allowing for inflation, spending is planned to fall by about 17 percent. The government is trying to cushion the blow to the poorer and middle classes. Public salaries will increase by 16 percent; welfare and development spending will remain largely unchanged. The

* The so-called "Dutch Disease" is a situation in which the availability of natural resources reduces imports and pushes up the value of a country's exchange rate, as happened in the Netherlands in the 1960s.

November fuel subsidy reduction cut subsidy spending by 74 percent, but the plan to increase cash transfers may move two million lower-income Iranians out of poverty. This will cost billions.

The Rouhani government made several assumptions that could prove overly optimistic. The head of the government's budget office said economic growth of two percent in 2020-21 is forecast. This is significantly higher than the estimates of the World Bank and the IMF.

The estimate for oil revenue appears even more over-optimistic. Last year, oil sales accounted for 29 percent of government revenues. In 2020, the government is assuming oil will only provide nine percent. The budget assumes that Iran will export 1 mb/d at $50 per barrel, yielding just over $18 billion. The estimated price is conservative, but the projected volume of sales may be optimistic, given US sanctions. Iran is exporting about 400,000 barrels per day at $63 per barrel, although Iran has been forced to sell crude at a steep discount to encourage buyers. As sales were secret, monthly revenue from oil sales was difficult to determine. In the past Iran has used oil exports to pay off debt or for barter, rather than earn revenues from sales. Without major US sanctions relief, Iran has no clear path to achieve exports of 1 mb/d. Even if Iran sold oil at $65 per barrel in 2020, it would still need to export about 770,000 barrels per day to achieve the anticipated $18 billion in revenue.[8]

Iran's empire has been created to help defend the Islamic Republic but the cost maintaining it threatens the economy and thus social stability. The regime has, once again, quelled unrest with the use of force. Not only were demonstrators attacked by the security forces but many others were massacred.[9] Meanwhile, forty years after the revolution, the regime's grip on power appears unshaken.

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