# Iran's Modest Economic Changes Since JCPOA Implementation

by Patrick Clawson

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Brief Analysis

## Deeply entrenched interests are impeding reform in Iran, limiting the economy to only modest progress even with sanctions relief.

*July 14 will mark one year since the announcement of the Joint Comprehensive Plan of Action (JCPOA), the nuclear agreement with Iran. This article is part of **a series of PolicyWatches** assessing how the deal has affected various U.S. interests, to be released in the days leading up to the anniversary.*

While European businesses were starry-eyed about the El Dorado awaiting them in post-sanctions Iran, the Iranian people themselves were seemingly resigned to slow progress at best. Yet even that will be difficult given the collapse in international oil prices and the degree to which the Islamic Revolutionary Guard Corps (IRGC) and other vested domestic interests are resisting the reforms needed to fully participate in the global economy.

## Disappointment with the Revolution

The Islamic Revolution's economic performance has long been mediocre, to the profound disappointment of Iranians. The first decade after the 1979 revolution saw inflation-adjusted per capita GDP fall, though life expectancy and education levels rose sharply due to programs initiated under the shah (exactly how much GDP shrank is difficult to measure given how the new regime's controls distorted the economy). From 1990, with the end of the Gulf War and the recovery of oil markets, until 2010, real per capita GDP rose 90% while life expectancy and education levels continued marching upward.

In the first decade of this century, Iran should have had stellar growth given its spectacular oil income and the flood of young people joining the labor force, many with advanced degrees (university attendance rates are higher in Iran than in the United States). Yet while the Gulf Arab monarchies enjoyed record boom times, Iran had solid GDP growth but nothing more. Unemployment rose to an officially reported 11.7%, even though few women look for work. Meanwhile, corruption flourished, fostering a widespread perception that only the politically well-connected could move ahead.

During the past few years, tightening international sanctions ushered in a recession, such that by 2015, per capita income was no more than 50% higher than it had been at the time of the revolution. Most Iranians are obsessed with the United States, so they were no doubt dismayed to find that their per capita GDP had grown much more slowly from 1980 to 2015 than the U.S. increase of 80% over that period. Of course, Iran has done much better than its neighbors to the east and west, Afghanistan and Iraq. But the neighboring Gulf Arab monarchies have done better still: GDP in the United Arab Emirates was around one-third that of Iran in 1979 but is now just as large. Perhaps the most relevant comparison is Turkey, a neighbor of similar size and socioeconomic background. In 1978, Iran's per capita GDP was 30% larger than Turkey's; today it is 50% smaller, a dramatic reversal of fortunes.

## Real Accomplishments, Real Problems

Over the past decade or so, Iran has made some underappreciated progress on diversifying its economy away from oil -- Supreme Leader Ali Khamenei's "resistance economy" slogan has actually been implemented to a significant extent. Iranian authorities have trumpeted the customs data for 2015/16 (the Iranian year ends March 20), which showed imports of $41.5 billion and non-crude exports of $42.3 billion. Even adjusting for approximately $6.6 billion in exported condensates -- a type of oil that neither Iran nor the United States considers crude -- the point remains that the economy has been diversified. For example, Iran now produces more steel than France or Britain, and the auto industry produced 976,835 motor vehicles in 2015/16 despite suffering setbacks in recent years.

If diversification has been a major achievement, investment has been a real problem. While Iran touts its ability to get on with large projects despite sanctions, the fact is that Khatam al-Anbia, the IRGC construction company awarded most of these large projects, has performed poorly on them. The seventy-five-mile expressway from Tehran to the Caspian Sea has been under construction for seventeen years, and the current (optimistic) plan is to complete it in six years by bringing in South Korea's Daewoo Engineering, which has been given a $1.5 billion contract. Similarly, a consultant's report about the Tehran-Qom-Isfahan high-speed railway -- another Khatam al-Anbia project -- concluded that the planned speed would have to be lowered, and that the contract "was not complete in terms of the technical specifications" according to Deputy Transportation Minister Asghar Kashan.

## Post-JCPOA Outlook Depends on Who's Looking

Iran's oil output is up by about a million barrels per day, more than most had expected but in line with the regime's predictions before Implementation Day this January. The government has also increased exports from about 1.3 million barrels per day to 2.3 million. Breaking with tradition, it has used aggressive price discounts to win back oil markets. In addition, it has had great success resolving insurance problems for its tankers: the International Group of Protection and Indemnity Clubs increased the level of reinsurance for shipping Iranian crude from $80 million pre-JCPOA to $830 million as of April 15.

But the oil export increase has been largely wiped out by the drop in the price of oil. Exporting 2.3 million barrels per day at $50 brings $115 million a day, less than the $130 million that came from exporting 1.3 million barrels at $100, the going rate before the price collapse. Iran's 2016 oil export earnings will likely be about the same as they were in 2015. Although nuclear sanctions have ended, low prices and incomplete production recovery will keep export revenue at one-fourth the level seen in 2011 ($115 billion).

And while GDP will probably grow by 4% this year, much of that is from the increased oil production; non-oil output is unlikely to reach 3%, and even that figure depends on the government sustaining spending despite the potentially massive budget deficit. President Hassan Rouhani's priority is keeping inflation in single digits, so he is unlikely to resort to the past practice of printing money when funding falls short. The government is making implausible claims that, despite little growth in oil earnings, it can raise enough for its needs from non-bank borrowing and non-oil revenue. Indeed, the security services are scheduled to get a 90% boost in the budget before adjusting for inflation. Many unusual sources are being tapped to fund such expenditures -- e.g., of the $19 billion security budget, $1 billion is to come from selling citizens the right to avoid conscription, and another $1.7 billion from a January settlement with the U.S. government of a thirty-five-year-old claim about arms sales to the shah.

It should also be pointed out that GDP only measures what is happening to the national economy; it does not necessarily translate into what people on the street are feeling. The 2016/17 budget continues the erosion of the family cash benefits that former president Mahmoud Ahmadinejad introduced when subsidies were cut back; they are now a mere $15 a month per person. Corruption was the bane of the Ahmadinejad years, but complaints have not diminished under Rouhani, who was expected to run a tighter, more technocratic ship. The past month has seen a scandal about incomes as high as $60,000 a month for politically well-connected managers at government-owned companies, at a time when workers at some state-run factories have not been paid in months. In a June 18 speech to university professors, Khamenei upbraided those who want an "Iranian Wall Street," saying the United States has "peaks of wealth as well as valleys of misery, chaos, poverty, and deprivation " -- presumably an argument that whatever inequalities exist in Iran, America's are worse.

Iran's basic economic problem is that cronyism is deeply embedded in the system, so reforms come slowly. Its **problems reconnecting with the international financial system** are symptomatic of how little it has done to prepare for reintegration into the world economy. Tehran apparently does not recognize that the world has changed over the past decade, and that the Islamic Republic must bend to fit the times.

Besides banking, the oil sector has also been greatly affected. Rouhani swept into office pledging to attract international oil companies (IOCs) to invest in Iran, but his team has not been able to make the changes needed for that to happen. The committee drafting the Iran Petroleum Contract finished its work in February 2014, but due to infighting, the document has yet to be published, much less approved by the Majlis. The hardliners insist that its terms be modified to meet their populist objections, oblivious to the fact that IOCs have slashed investment everywhere because of the oil price decline. The model contract may finally be released this year, but that will just be another phase in a long process -- while the Oil Ministry predicts that a headline-grabbing deal could be announced in the next few months, it would be an agreement in principle, not a contract. The National Iranian Oil Company, which negotiates contracts with IOCs, has a difficult relationship with the Oil Ministry, whose top official just replaced the NIOC chief. Moreover, the first contracts are unlikely to be for investment; instead, they will probably focus on infrastructure work by oil service companies (e.g., for gas compression facilities and trunk pipelines).

So far, Iranians seem prepared to wait for the fruits of the JCPOA. Cynicism appears to be the prevailing popular mood -- cynicism about reforming cronyism, and also about the international community's willingness to see Iran prosper. Ideally, Washington could persuade the people that their country's main economic problems stem from their government's policies rather than from U.S. hostility, but that is utterly unrealistic.

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