HOW IRANIANS MIGHT REACT TO A NUCLEAR DEAL

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Introduction

AT SOME POINT—WHETHER by the November 24, 2014, target or later—Iran and the P5+1 countries (Britain, China, France, Germany, Russia, and the United States) may reach what the Joint Plan of Action calls "the final step of a comprehensive solution" to the nuclear impasse. How such a nuclear deal will be perceived inside Iran is important for at least two reasons.

The first is the "theory of the case," to use a term popular in the Obama White House: namely, that a nuclear deal will show the benefits of Rouhani's approach to working with the West. It would strengthen Rouhani's hand and, over time, give him more authority over other national security issues over which he now has little say, such as Syria and support for terrorism. The presumption is that, much like his handling of the nuclear file, Rouhani will want to find ways to normalize Iran's relations with the rest of the world. By creating a better climate for foreign trade and investment, such normalization could produce more jobs and higher incomes at home, which would, in turn, further strengthen Rouhani's hand. A "virtuous cycle"—more normalization, better economy, strengthened moderates—could alter the Islamic Republic's political dynamic.

The second reason is the sustainability of the nuclear deal. Any accord is sure to leave Iran with many nuclear capabilities. Were Iran to skirt the restrictions imposed—or openly renounce the deal—it would be able to quickly develop fissile material or even nuclear weapons. To the extent that the deal is seen as bringing real benefits at modest cost, then Iran has good reason to follow through fully. By contrast, if the deal is seen as not bringing much to Iran, Tehran may be tempted to skimp on implementation or to withdraw from the accords, perhaps blaming the West for not living up to its end of the bargain.

To that end, this study looks at two interconnected issues. The first, analyzed in the chapter by Patrick Clawson, is public perceptions about the economic benefits issuing from a nuclear deal. Iranians might attribute to a nuclear deal any changes in the country's economic circumstances that follow, whether or not they actually stem from the deal. If the economy improves, the deal looks good; if the economy stagnates, the deal looks bad. In Iran, as in most countries—including the United States—such a straightforward evaluation has more political traction than a complicated explanation about what actually happened versus what would have happened had there not been a deal at all. Moreover, the public may make up its mind quickly, on the basis of economic changes in the short term.

Clawson argues that because the impact will be mixed, the short-term economic effects will be subject to varying interpretations. Some will focus on the paucity of immediate positive effects, noting that trade sanctions will be lifted only in a phased process and only after Iran has demonstrated follow-through on the deal's provisions. Iran's economic problems are so extensive, going well beyond sanctions, that any improvement resulting from lifting them is unlikely to be politically impressive. Furthermore, the very people who benefit from the current distortions can be counted on to deplore the changes if the economy opens up to freer trade and investment.

In contrast, some in Iran will capitalize on the immediate changes resulting from a nuclear deal. Restoring Iran's access to some $100 billion in frozen foreign exchange reserves held abroad provides an opportunity for a substantial injection into the Iranian economy, particularly in the first few years before the full impact of relieving trade sanctions is felt.

Note that this section looks only at economic benefits; a deal could be perceived as having such extensive noneconomic benefits, such as improving Iran's image in the world, that it commands considerable popular support even though the economic impact is slight.

The second issue, discussed in the section by Mehdi Khalaji, is Supreme Leader Ali Khamenei's political calculations about a nuclear deal. He is increasingly vocal about his skepticism that a good deal is possible, which raises the question of how he will react if presented with a deal he finds inadequate. Khalaji argues that if Khamenei lets a deal proceed, it will not necessarily indicate that he is satisfied with what has been achieved or that he has decided to ignore hardline objections. In this vein, Khalaji examines what happened when past presidents advocated policies to which Khamenei later acknowledged his opposition. His track record suggests that if Khamenei is presented with a deal he finds inadequate, he may nonetheless decide to let it stand if it has strong domestic support. Khamenei may calculate that if the implementation of the deal turns out to be better than he expected, it will work well for the Islamic Republic, and if the effects of the deal prove to be as bad as he fears, then the elite and the populace will realize that the deal was a mistake and will understand why Iran withdrew from the deal.

In sum, a final deal will not be final: it will mark an important new stage in how Iranians view relations with the West. Iranian political forces will continue to dispute whether the deal has been worthwhile and what should come next.

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Economic Benefits from a Deal

REALITY AND EXPECTATIONS

A MAJOR, IF NOT THE MAJOR, motivation behind increased Iranian interest in a 2014 nuclear deal was hoped-for economic benefits. A risk, however, is that a deal would not lead to an expected boom: the greater likelihood is that in the aftermath of a deal, the Iranian economy would perform better than before the deal but not as well as Tehran hopes.

Hopes and Expectations

Through 2011, Iran's economy did quite well despite U.S., UN, and EU sanctions. Indeed, Iran continued to grow in 2008/09 at the height of the Great Recession when all the major industrial economies were contracting; Iran averaged 3.2 percent annual growth from 2009/10–2011/12.[1] (Please note that the dual-dating system used herein is to accommodate the Western year commencing January 1 and the Persian year, which commences on the vernal equinox, usually March 21, known as Nowruz.) This fed the self-assurance of the Iranian leadership, which correctly claimed that Iran was prospering at a time when European and American economies were on the brink of depression. President Mahmoud Ahmadinejad captured the elite's mood, mocking the United States and claiming that its economy was falling apart while Iran's was prospering.

Despite this prosperity, Iranian self-confidence about immunity to sanctions was brutally battered in 2012. The intensified U.S. and European sanctions in 2012/13 hit the Iranian economy hard, to the considerable surprise of the Islamic Republic elite. As the April 2014 International Monetary Fund (IMF) report details, oil export proceeds fell the equivalent of 15 percent of GDP. An equivalent shock to the U.S. economy would be a $2.5 trillion per year loss. Iran also effectively lost access to its considerable foreign exchange reserves because of threatened U.S. sanctions against financial institutions. As a result, Iran lost both a great deal of income and its cushion against bad times. This contributed to a loss of confidence among Iranian businessmen, which led to a further contraction in demand.

The impact on the Iranian economy was huge.[2] Real GDP fell 5.8 percent in 2012/13 and a further 2.5 percent in 2013/14, making a two-year, 8.5 percent drop, or about twice as large as the 4.3 percent fall in U.S. output during the Great Recession of 2007–2009.[3] Added to which, in 2012/13, inflation rose to 45 percent and the rial lost 80 percent of its value on the parallel market.

Against this backdrop, the spring 2013 presidential election focused on the economy. While then nuclear negotiator Mohammad Javad Jalali and other hardliners claimed the economy was not a major issue, all the other candidates—including some who were quite hardline—ridiculed this position.[4] Hasan Rouhani's candidacy took off in no small part because he hammered home the point that improving the economy required a nuclear deal with the West and would be the only way to obtain sanctions relief, attract foreign investment, and secure trade openings for Iran. Rouhani's campaign platform promised better times ahead if he were elected.

After Rouhani's surprising May victory in the elections, the widespread expectation was that nuclear negotiations would resume quickly and that sanctions relief would soon follow. This forecast seemed to be on target, since serious talks with the West, including the famous Obama-Rouhani phone call, began as early as the UN General Assembly meeting. When the "Joint Plan of Action" (JPOA) preliminary nuclear deal, which included some sanctions relief, was reached on November 24, many Iranians believed that better economic times were on the way. The rial strengthened sharply.[5] Many spoke optimistically about economic prospects.

By the time the JPOA was announced, however, the Rouhani team had shifted its rhetoric from quick economic recovery to the depth of the problems. Faced with recent criticism about the slow pace of change, Rouhani responded, "A building destroyed over the last eight years cannot be made right in a few months."[6] As realistic as this may be, the risk is that continuing economic difficulties will create a sour public mood. The challenge for the Rouhani administration now is to convince the public that the economic situation they inherited—rather than the slow pace of recovery—is at fault for continuing problems.

Even if the Rouhani government succeeds at tamping down expectations about speedy recovery, it will face major problems delivering substantial post-nuclear-deal improvement for two reasons: sanctions are only part of Iran's economic problems, and sanctions relief will be felt only slowly and incrementally. These realities will complicate selling the public on the benefits of a nuclear deal.[7]

Sanctions Are Just Part of the Problem

The problems facing Iran's economy are many. In approximate order of importance, these include the benefits of the status quo for the privileged few, missteps by the new team, the republic's addiction to cheap energy, Ahmadinejad's legacy of overspending, and the unrealistically high expectations of the populace.

Powerful interests benefiting from existing policies. Putting in place the best policies is a great challenge because those who benefitted by the distortions of the past will lobby to retain their privileges.[8] Reuters cited Iranian-born economist Mehrdad Emadi of the Betamatrix consultancy in London as saying that"foreign investors would face opposition from entrenched, politically powerful interests in Iran which have profited from preferential access to state contracts and hard currency supplies during the sanctions years."[9] Reuters quoted Selmar Welloso of Magnesita, a Brazilian maker of materials for steel, cement, and glass manufacturers, describing the uncertain welcome Iran gives to foreign investors: "Iran needs to decide—do they want to be a Turkey or a Venezuela? At the moment it's not clear which one it will be."

Part of the problem is simple corruption. Gholamali Jafarzadeh, a member of the Majlis special investigations committee, warned, "The corruption is so big that we are scared it could cause social shock….The dimensions of corruption in the cases at the investigation committee are so high that we are scared that if they become public it would cause trauma to the system."[10] In February 2014, the Supreme Audit Court noted that $53 billion in oil revenue had not been transferred to government accounts between March 2012 and March 2013.[11] And a *Financial Times* article stated, "As much as $200 billion in petrodollars is believed to have disappeared during the eight years of Ahmadi-Nejad's rule." Some of this money was diverted by shady figures doing oil trades, about whom Rouhani complained, "Some individuals claimed they could circumvent sanctions, but in fact they circumvented the nation."[12] The *Financial Times* article, however, states that losses resulting from these sanctions evaders could have been "as high as $20 billion," meaning that sanctions evasion was only a small part of the overall corruption.[13] The rot began at the top: a Reuters investigation detailed the ways Khamenei bent the laws to build up his personal fortune to an estimated $95 billion.[14]

As hard as it is to end corruption, overcoming the ardent defenders of each policy that benefits the privileged few at the expense of the overall economy is even harder. Some suspect the rial's recent drop in May 2014 was caused by a large dumping of currency by wealthy businessmen as a warning to Rouhani not to overstep in his economic reforms.[15] Consider the pushback against oil minister Bijan Zanganeh's plan for a new oil contract. Despite his stellar reputation and clear articulation of how the unattractive terms previously offered hurt the development of Iran's oil industry, Zanganeh has been forced to postpone rolling out the new model oil contract until after a road show in London in November 2014, fifteen months after taking office (though to be fair, the first draft was introduced in February 2014).[16] Those objecting to better terms for foreign firms claim that Iranian firms can do the work. In recent years, companies connected to the Islamic Revolutionary Guard Corps (IRGC), such as Khatam al-Anbia, have become a major presence in the oil business, and these companies will loudly denounce a greater role for foreign firms.[17] Zanganeh has said, "I am not afraid of the hue and cry created by [rent seekers] and God willing I will stand against them." He may need that divine aid.

The Rouhani administration has done little to dismantle inappropriate populist policies. Consider the policy of low interest rates, justified as a way to promote industry.[18] The Central Bank of Iran (CBI) set what is in effect the interest rate on savings accounts and bonds (though euphemisms like "participation rate" are used to pretend the system is free of interest) at well below the inflation rate. Theoretically, during the 2012 crisis, the Ahmadinejad government abolished the limits on what banks can pay in an attempt to prevent capital flight, but this had little effect given that strict caps remained on what banks could charge for loans. Rather than abolishing the limits on what banks can charge, the Rouhani government imposed new limits on the rates they can pay; nonetheless, the maximum rate of 27 percent for two-year deposits is not particularly attractive even at the 25 percent target inflation rate (the actual rate may overshoot the target).[19] Besides hurting savers, these low rates create so much demand for bank loans that only the politically favored can secure bank financing, which impedes job creation and discourages entrepreneurs. But the benefits for the well-connected are so great that they have fought hard to preserve the unrealistic limits on interest rates. Furthermore, they have impeded investigations into the frequent failure to repay loans. In May 2014, the Rouhani government handed over to the judiciary details about 575 individuals who had defaulted on $25 billion in bank loans.[20]

A similarly destructive dynamic has kept the exchange rate at an artificially low level for long periods. While keeping imports cheap has been popular, this has promoted imports to the detriment of domestic producers. The low exchange rate has also made taking capital out of the country more profitable: consider that apartments in Dubai are often cheaper than those in Tehran. Simple economic logic suggests that in a country with inflation of 30 to 40 percent a year, the value of the currency cannot keep its exchange rate constant compared to countries with inflation in the range of 1 to 3 percent.[21] For years, the Ahmadinejad government injected billions of dollars into the parallel markets to keep the exchange rate constant at about 11,000 rials per dollar, until the rate became so out of line with economic realities that a simple panic in 2012 caused the parallel rate to collapse to below 25,000 within weeks.[22] Not having learned from this failed effort to stabilize the exchange rate despite the high inflation, the Rouhani government has been advocating the same approach. According to Central Bank governor Valiollah Seif, referring to the 9% drop in value in April of 2014, "The currency's fluctuation in recent days is not in line with positive signs regarding the economy."[23] Mohammad Nobakjht, the vice president for planning and strategic control, has been proclaiming that the exchange rate for the rial during the year ending March 2015 will stay at about 26,500 to the dollar, or only 7 percent lower than in 2013/14. Hopefully, the actions of the Rouhani government will be better than its rhetoric, that is, it will allow the rial's value to fall in line with the higher rate of inflation in Iran compared to that in the United States. Encouragingly, the parallel market rate had already, by May 2014, risen to 33,000 rials per dollar, a 33 percent depreciation that parallels the difference between inflation in Iran and in its trading partner countries.

Missteps by the new team. The Rouhani government has introduced some odd economic policies. In early 2014—before the March 21 Iranian New Year—the government pulled out all stops to persuade the wealthy to forego the cash payments that for three years had been made to every family.[24] Families had to reapply for payments, and popular actors, news commentators, public service announcers, and politicians were mobilized to convince those in the upper-30-percent income bracket not to sign up.[25] Vague threats were made about fines for noncompliance. It was a peculiar request: when in history have people voluntarily renounced free money? Furthermore, when the cash payments were initiated, recipients had been asked to declare their income so that the payments could be graduated, but since the government had no way to verify reported incomes, it had to abandon graduation. The result was that 94 percent of those eligible signed up, making the government look foolish and undercutting Rouhani's claim to popularity.[26]

Another example of botched implementation of an economic reform involved the government's plan to distribute food baskets to the poor instead of increasing the cash payments that had been eroded by inflation. The government failed to inform people of their eligibility nor did it set times to pick up the food. So people had to queue up for hours, learning only when they arrived at the head of the line whether they were going to get food.[27] The obvious alternative would have been to notify each of the 6 million families who receive some form of public assistance—whether pensions or relief payments from the several quasi-official charitable funds—of a two-hour slot when that family was to pick up its food ration, while inviting others to apply to demonstrate their eligibility under a transparent set of criteria. The contrast was sharp between the food basket fiasco and the more complicated problems encountered with the 2007 gasoline rationing program.[28] The Ahmadinejad government—which the Rouhani team derides as incompetent—rather smoothly distributed tens of millions of ration cards, which could be topped up at ATMs each month and, despite some initial glitches, managed to get all of Iran's gas stations equipped with the requisite card readers .[29]

Addiction to cheap energy. Iran consumes more energy than the UK, a country with a much larger economy, and twice as much as Turkey, a country with similar natural conditions, similar population, and larger economy.[30] According to the U.S. government's Energy Information

Administration, Iran uses twice as much energy as the United States and 60 percent more than the world average to produce a dollar's worth of GNP.[31] According to the IMF, the amount of energy consumed per unit of value added to the Iranian economy rose 40 percent from 1991 to 2012.[32] An Iranian economist points out that, valued at international prices, Iran's consumption of oil and natural gas is $124 billion a year; by comparison, Iran's 2013/14 GDP at market prices was $366 billion, which would place oil and gas consumption at the ridiculous level of one-third of GDP, compared to under 5 percent for the United States.[33] Admittedly, valued at purchasing-power parity, Iran's GDP would be higher and the share of oil and gas consumption lower, but this consumption still takes up an extraordinary amount of resources.

While energy prices were raised sharply in 2011, the impact was erased by the collapse of the rial in 2012. Since then, energy prices have continued to be set by the government, rising only once a year and at a rate which barely keeps up with the decline in the value of the rial. The latest rise in April 2014 brought the price of gasoline to 7,000 rials/liter for a rationed amount and 10,000 rials beyond that, or, at the free market exchange rate, equivalent to $.75 and $1.07 per gallon respectively. At such prices, which are well below the $1.80-per-gallon world market price of crude oil without even factoring in the cost of refining and distribution, the amount of potential revenue lost due to low energy prices remains enormous. If gasoline prices were increased to reflect the world market value of oil, then, even without increasing other energy prices such as electricity, natural gas, and kerosene, the additional revenue for the government would provide sufficient revenue to increase spending substantially.[34]

But that is only the start of the problem. The decades of cheap energy have shaped much of the country's economic structure. The petrochemical industry is competitive only because of cheap feed stock and energy. The automobile industry only makes sense if demand for vehicles is artificially boosted by cheap fuel. Much of Iran's economy is built around the low transportation costs made possible by subsidized fuel.[35] Were fuel prices to be raised to eliminate the subsidies, many companies would go bankrupt unless they received assistance with the transition. The original plan to eliminate the energy subsidy was to dedicate 30 percent of the proceeds from higher prices to providing such assistance to industry, but none of that was actually paid.

The 2010/11 subsidy reform did nothing whatsoever to improve energy efficiency. It is worth quoting at length the IMF's recounting of the sad story of inefficiency and politicization of the economy—with profits depending not on business skill but on political pull:

> There was no progress in restructuring enterprises and improving energy efficiency—a key premise of the TSR [Targeted Subsidy Reform]. With TSO [Targeted Subsidies Organization] revenues hardly financing the cash transfers to households, enterprises did not get the originally envisaged direct assistance from TSO resources to adopt more energy efficient technologies. In addition, administrative price controls and increasing input costs must have squeezed corporate profitability. Also, the sanctions impaired enterprises' access to foreign capital and technology. Against this background, adoption of new technologies and reforming the production structure remained low on the enterprise sector's priority list. Nevertheless, in the absence of direct assistance from the TSO, the authorities supported the enterprise sector by granting access to energy at preferential tariffs and tolerating arrears to energy suppliers. The amount of such support reached 1.25 percent of GDP in 2012 according to the TSO's estimates, almost equal to the share of enterprises promised under the original subsidy reform law, were the 30 percent of the revenue from price increases in 2012 allocated to the enterprises. This policy softened the budget constraint on enterprises, and combined with lack of promised assistance to adopt energy efficient technologies, did not provide enough incentives to change enterprises' business model in the first phase of the reform. The business model of the enterprise sector, based on subsidies and preferential credit, stayed essentially the same as they continued to rely on more subsidized energy and loans during the reform. Also, the continued emphasis on the cash transfer program blurred the real objective of the reform—increasing energy efficiency.[36]

Industry is not the only area where energy efficiency has lagged. Faced with the higher oil, gas, and electricity prices, many Iranians have had to be creative. The *Financial Times* quoted a carpenter from the small city of Khoy: "There are many people who pay technicians to make changes in their gas meters which can hardly be detected. This helps bring down a monthly bill as high as 12 million rials [$470] to about 120,000 rials [$4.70]."[37] Indeed, the subsidy reform had no appreciable effect at slowing the growth in Iran's electricity and natural gas consumption; oil consumption dipped slightly in 2009/10–2010/11 but has resumed its upward path.[38]

Legacy of Ahmadinejad's overspending. The Ahmadinejad government exacerbated a long-standing problem of initiating too many investment projects while not completing those begun earlier.[39] The Mehr housing program is a conspicuous example. Massive half-built projects, which would need large sums to complete, dot Iranian cities. The IMF estimates that Central Bank loans for Mehr housing total 471 trillion rials, or 5.2% of GDP.[40] That is an unproductive use of the money, given that these projects do not lead to further growth. In addition, many of the housing projects are poorly executed: they are in the wrong locations, lack the necessary infrastructural connections, and are low quality. Many people have been led to expect they would get the housing more or less free; if asked to pay the full cost of construction, many of the new residents could well resent the low quality or poor siting.

An important aspect of the Ahmadinejad government's overspending was how the subsidy reform was implemented in December 2010. The theory was that this reform would be revenue neutral: higher prices would generate revenue that would then be used to finance payments to encourage energy efficiency and to cover the burden placed on poorer families. The practice was quite different. The government set a high level for the cash payments—equal to 15 percent of the average income for a median family of four—and made them to all families, not just to the poor.[41] The payments were equal to 6.4 percent of GDP in 2011/12. Meanwhile, the government made no payments to encourage energy efficiency and tolerated nonpayment of the higher gas and electric bills, which undercut the energy efficiency goal and reduced revenues. The result was that the TSO had a deficit equal to 1.6 percent of GDP in 2011/12.

It was inevitable that at the first external shock the government would be unable to sustain such high cash payments.[42] And, indeed, as oil revenue plummeted with tighter sanctions, the cash payments were slashed by keeping their nominal levels constant as inflation raged. In the context of the government reducing expenditures (excluding the cash payments) from 19.5 percent of GDP in 2011/12 to 14.8 percent in 2012/13—the equivalent for the United States would be a $800 billion reduction—the real value of the cash payments shrank dramatically.

In addition, Ahmadinejad hired hundreds of thousands of state employees during his time in office. Under the "compassion creator" program during the last three months of his presidency, Ahmadinejad hired an additional 500,000 state employees.[43] The oil ministry was reported to employ 260,000 at the end of the Ahmadinejad presidency compared to 100,000 at the start; the Health Ministry, 400,000 compared to 230,000. In March 2014, Mahmoud Askari-Azad, head of the Rouhani administration's management development and human resources division, announced that the government had 2.9 million active and 1.8 million retired employees on its payroll.[44] This has put a huge financial burden on Rouhani's administration as he attempts to cut government spending.

In short, during the Ahmadinejad era, so much was paid out that Iran cannot afford to keep up that pace. The usual mantra about structural reforms is that they will bring immediate pain but medium-term gain. But it would be a great challenge to put Iran put on even a medium-term path to recovery.[45] Ahmadinejad ran through so much money that Iran has little prospect of being able to match his spending pace any time soon. According to IMF data, during the eight Ahmadinejad years (2005/06–2012/13) Iran exported $608 billion in oil and gas, or $435 billion more than the $173 billion exported during the eight Khatami years (1997/98–2004/05).[46]

High expectations. Another factor that will shape perceptions about the economic benefits of the nuclear deal is one that cannot be readily measured: how realistic are popular expectations? Certainly, Iranians have many reasons to be dissatisfied with their country's economic performance. And the country's economic problems are many, such as the growing problem of unemployed or underemployed university graduates. But the relevant question in any discussion of a post-deal Iran is to what extent Iranians will think that the nuclear deal made things better, relative to the degree to which Iranians focus on the continuing problems. There are no reliable ways to answer that question.

Full Sanctions Relief Will Take Time

In the aftermath of a nuclear deal, most U.S. and even many other sanctions will remain in place and will be phased out over a period of years. After a May 2014 briefing by Foreign Minister Mohammad-Javad Zarif on the nuclear talks, Majlis National Security Committee spokesman Hossain Naqavi-Hossaini said that the P5+1 had proposed phasing out the nuclear sanctions over ten years and that nonnuclear sanctions would be unchanged.[47] While that report may or may not be accurate, the timeline mentioned would fit well with past practice about lifting sanctions on other countries. Because of Iran's poor record of complying with its obligations under international nuclear agreements, the West is likely to be particularly cautious about lifting sanctions on Iran.

The extensive literature on sanctions has shown that lifting sanctions is a much slower process than imposing them. U.S. sanctions on Cuba are more than sixty years old; efforts at reforming them have repeatedly proved to be too difficult politically. And even after Vietnam adopted market-oriented reforms in 1986, withdrew its troops from Cambodia in 1989, and saw the departure of Soviet forces from Cam Ranh Bay in 1990, the United States still insisted that normalized relations would depend on resolving the missing-in-action issue, even though many in the U.S. government knew full well that none of the MIAs were alive.[48]

Barriers to Lifting the Nuclear Sanctions

Broadly speaking, the barriers to lifting sanctions can be ascribed to the following areas: degree of demonstrated commitment, past experiences with Iran, congressional impediments, and Washington's reluctance to speed up lifting of UN sanctions. These areas are discussed at some length in the following sections. Additionally, the barriers to lifting Iran's nuclear sanctions post-deal would be at least as high as some of the examples provided.

Demonstrated commitment. U.S. and European practice has been to insist on demonstrated commitment to changed policies before providing sanctions relief. For example, the six-and-a-half-year delay between the first negotiations for normalization of U.S.-Vietnam relations and the arrival of the first U.S. ambassador—at which time some sanctions still remained—was due to continued U.S. insistence on Vietnamese action about the MIAs, even though the more the Vietnamese did, the clearer it became that all the MIAs were dead. UN sanctions on Libya were also lifted slowly, based on Tripoli's cooperation with the investigation into airplane bombings; U.S. sanctions were lifted at an even slower pace, requiring lengthy negotiations about Libyan support for terrorism after evidence surfaced of Libyan government involvement in a plot to kill Saudi officials. U.S. sanctions on Myanmar were relaxed and then removed only after Congress was convinced that the new Myanmar authorities were firmly committed to implementing the announced changes in policies on human rights issues. U.S. sanctions on Serbia continued well after Slobodan Milosevic signed the Dayton Accords, with Washington insisting that Milosevic pursue war criminals as proof of his commitment to those accords. U.S. sanctions on Zimbabwe remained largely in place despite an accord between President Robert Mugabe and the opposition because of suspicions—confirmed by subsequent developments—that Mugabe would not actually share power. In short, there is a well-established pattern of requiring demonstrated commitment to implementing announced policy changes before U.S. or EU sanctions are lifted. This pattern will almost certainly hold for Iran.

Past experience with Iran. Waiting until Iran demonstrates its commitment to the nuclear deal is especially likely given past experiences with Iran. The EU-Iran nuclear deals of 2003, 2004, and 2005 were implemented only temporarily and in some cases only in part. That the same Iranian officials—Hassan Rouhani and Mohammed Javad Zarif—were key to those negotiations as well as the current talks will only strengthen the case for waiting until Iran demonstrates its commitment to the agreed deal.

An added reason for waiting until Iran has demonstrated good faith is the long history of Iranian concealment of nuclear activities, such as the construction of the Natanz and later the Fordow enrichment facilities. As long as the International Atomic Energy Agency (IAEA) questions about possible military dimensions remain unanswered, the strong inclination, at least in Washington, will be to delay sanctions relief.

Furthermore, U.S. attitudes about Iranian compliance with mutual agreements continue to be shaped by the Iran-Contra affair of the mid-1980s. From the U.S. perspective, when Washington provided Tehran with the requested missiles and antiaircraft systems, Iran made a mockery of the agreement by securing the release of certain hostages—the "letter" of the agreement—while simultaneously encouraging the taking of new hostages.[49] The strong sentiment in many U.S. government circles is that Iran cannot be trusted to live up to its side of a bargain.

The suspicions about Iranian double-dealing were reinforced by the perception that post-9/11, Iran worked with the United States to establish a new Afghan government while simultaneously providing support to the Taliban to undercut that very same government, and again when Iran urged Iraqis to participate in elections and then provided sophisticated weapons to those fighting against the Iraqi government, which the Iranians helped create. Iran may see these actions as hedging one's bets; to U.S. eyes, they look more like duplicity.

Congressional posturing. Many members of Congress will likely be unenthusiastic about the nuclear deal, while those who are generally unhappy with the administration may welcome an opportunity to extract a pound of flesh. They may be able to forge a broader coalition with colleagues who wish to see Congress exert its institutional authority by requiring the president to seek congressional approval for lifting sanctions, an important rallying point for those seeking a congressional vote on any deal. Congress wants to be able to demonstrate that it matters, that it has a role in setting policy.

Although the usual reason cited for congressional delays is partisan deadlock, Iran sanctions legislation typically commands overwhelming majorities, including one rare 100-0 vote in the U.S. Senate.[50] The greatest barrier to Iran sanctions relief legislation, however, will not be partisan disagreement but deep suspicions about the Islamic Republic, fed by a history of hostility since 1979, the inflamed rhetoric of Iranian leaders, and Iran's track record of opposing U.S. interests and subverting U.S. allies. An added factor has been the vigorous lobbying by parties who are adamantly hostile to the Islamic Republic in comparison to the few voices who call for improved relations, though, in this case, it is by no means apparent how effective such lobbying would be were there not fundamental strategic differences.

Reluctance to hasten UN action. Washington may be reluctant to move quickly to lift UN sanctions out of concern with the difficulty of reimposing them should Iran not fully implement the deal.[51] Moreover, delays can be easily justified by referring to the relevant Security Council resolutions, which require the establishment of "… international confidence in the exclusively peaceful nature of Iran's nuclear programme."[52] That language can be stretched to either hasten or delay lifting the sanctions if Iran has not fulfilled its obligations. After all, it is difficult to have confidence in Iran's purely peaceful intentions so long as Tehran continues to denounce as illegitimate the very existence of a UN member state—Israel.

The United States has noted that the JPOA specifies, "There would be additional steps in between the initial measures and the final step, including, among other things, addressing the UN Security Council resolutions, with a view toward bringing to a satisfactory conclusion the UN Security Council's consideration of this matter." That wording has at least two interesting aspects. First, the phrase "additional steps between the initial measures and the final step" specifies that addressing the Security Council concerns will precede "the final step." That alone is strong justification for deferring action on UN sanctions. Second, the wording "the UN Security Council resolutions" covers more than the nuclear program. After all, UNSCR 1929 states that "Iran shall not undertake any activity related to ballistic missiles capable of delivering nuclear weapons, including launches using ballistic missile technology."[53] The United States has taken advantage of this language to raise the missile issue during the nuclear negotiations. In the aftermath of a nuclear deal, however, it is difficult to imagine Washington using this language to raise additional issues not addressed in the nuclear deal. To do so would look like a bad-faith effort to renegotiate the deal.

An alternative to lifting the UN sanctions is to suspend them. However, the key issue is not "suspension" versus "repeal." What matters more is the character of the action required to reimpose sanctions. If a new Security Council resolution is needed, then reimposition is subject to veto by any of the permanent members. Suspension only has practical significance if sanctions can be reimposed without a new resolution, for instance, by declaration of noncompliance by the secretary-general or by a sanctions committee in which no country has a veto. Presumably Russia and China will strongly resist any such mechanism; indeed, an erosion of the veto power may make all of the permanent members nervous.

While this report focuses on U.S. policy, a word is in order about EU sanctions. Some have speculated that the bulk of initial sanctions relief would come from the EU, with U.S. actions following later. In an important sense, that is true. Because the most biting EU sanctions are tied only to the nuclear program, those sanctions could be lifted even while disagreements persist about terrorism, the missile program, and other issues to which many U.S. sanctions are also tied. (Human rights is a different matter: both the EU and the United States have imposed some sanctions for human rights reasons, but human rights is typically not a factor cited in the U.S. sanctions that refer to terrorism, nuclear activities, and other national security factors.) An additional institutional factor is that EU sanctions are decided by the council, which can act quickly, and do not involve either the European or national parliaments. While the council has the authority to act by a qualified majority, its sanctions decisions to date have all been through unanimous approval by all EU governments.[54] Arguably, securing approval from 28 EU governments is easier than getting a bill for Iran sanctions relief through the U.S. Congress.

Other Barriers to Sanctions Relief

In addition to the difficulties of lifting the nuclear sanctions, two further factors may significantly slow the economic impact of sanctions relief: the nonnuclear sanctions and business reluctance.

Nonnuclear sanctions. Many U.S. and some European sanctions were levied, at least in part, for nonnuclear reasons. The Comprehensive Iran Sanctions, Accountability, and Divestment Act (CISADA) of 2010, the Iran Threat Reduction and Syria Human Rights Act of 2012 (ITRSHRA), the Iran Freedom and Counter-Proliferation Act of 2012, and the Iran-related provisions in the National Defense Authorization Act for Fiscal Year 2012 (NDAA 2012) all make reference to issues other than nuclear proliferation, especially antiterrorism and human rights but also money laundering. These laws give the president (or other officials, such as the Treasury secretary) wide-ranging authority to waive the sanctions, typically if "it is essential to the national security interests of the United States to do so" (ITRSHRA Section 302). A Congressional Research Service compendium of Iran sanctions legislation suggests that essentially all sanctions are subject to waiver.[55]

Consider the two main provisions that impact transactions between non-U.S. financial institutions and Iranian banks: CISADA Section 104 and NDAA Section 1245(d). The former allows the provisions about foreign banks to be waived 30 days after the Secretary of the Treasury "determines that such a waiver is necessary to the national interest of the United States; and (2) submits to the appropriate congressional committees a report describing the reasons for the determination."[56] This waiver will extend indefinitely. NDAA Section 1245(d) is more complicated.[57] It provides for both exceptions and waivers—a distinction that some of those writing about the issue do not make clear. The first exception, in paragraph 2, is for sales of food, medicine, and medical devices. The second, in paragraph 4(D), has to do with financial institutions in countries that "significantly reduce" the volume of crude oil purchases from Iran.[58] Entirely separate from the exception provisions is the waiver provision in paragraph 5, which states:

> The President may waive the imposition of sanctions under paragraph (1) [sanctions against foreign financial institutions that have "knowingly conducted or facilitated any significant financial transaction" with nearly any Iranian financial institution] for a period of not more than 120 days, and

> may renew that waiver for additional periods of not more than 120 days… if the President (A) determines that such a waiver is in the national security interest of the United States; and (B) submits to Congress a report (i) providing a justification for the waiver; and (ii) that includes any concrete cooperation the President had received or expects to receive as a result of the waiver.

Statutory authority is different from political reality, however. The question is to what extent Washington will waive sanctions in the aftermath of a nuclear deal, while Iran remains—as it is almost certain to do—the world's leading state sponsor of terrorism with a a poor record at implementing international human rights agreements to which it is a party. The experience with the JPOA is instructive. It became effective January 20, 2014. Among the various actions the U.S. government then took was State Department Public Notice 8610 of January 22, which, among other things, waived the requirement that the president identify those who materially engage in support of the IRGC on the grounds that it would "cause damage to the national security of the United States to identify or designate a foreign person" in connection with oil trade with certain countries.[59] Waiving the identification of those involved in the trade is an expansive reading of the JPOA.[60] On January 20, the State and Treasury departments issued guidance stating that "the USG will not impose sanctions" under quite a number of executive orders with regard to Iran's petrochemical and automotive industries, gold trade, and certain petroleum sales.[61] If these actions are any guide to future policy, the U.S. government may well be prepared to go far in waiving sanctions in light of a nuclear agreement. However, it is difficult to see Washington agreeing to waive, even over time, a great many of the restrictions on trade and investment, going well beyond such obvious things as a ban on exports of arms and strict regulation of dual-use items.

Waivers are subject to revocation at any time. Gary Samore of Harvard's Kennedy School notes, "In my conversations with Iranians, they insist that the existing nuclear-related sanctions be repealed—not just waived by presidential authority—because they don't want to accept long-term nuclear restraints without more confidence that sanctions relief will be permanent."[62] The Iranian government can be expected to make the argument that it should not have to take irreversible actions if the U.S. government doesn't commit to the same level of irreversibility. However, Iran has to move first. Actually lifting U.S. sanctions, as authorized by the various statutes, requires presidential certification that Iran has ceased to engage in the actions that led to the imposition of sanctions, such as "providing support for acts of international terrorism," to quote CISADA Section 401. That section also requires that termination of its sanctions depend upon presidential certification that "Iran has ceased the pursuit, acquisition, and development of, and verifiably dismantled its...ballistic missiles and ballistic missile launch technology." Iran will not do that, and it is difficult to see any president certifying that Iran has done so. Nor is it conceivable that Congress will agree to end sanctions absent such Iranian actions.[63]

On July 25, Undersecretary of State Wendy Sherman, who leads the U.S. delegation to the P5+1 talks with Iran, stated:

> What we have said to Iran and what we've said publicly is that that we would suspend sanctions, not lift them, because we need to see Iran implement whatever it gets agreed to [sic] and comply with those agreements of a period of time....All of those steps need to be taken before we would turn to Congress and ask them to lift the sanctions.[64]

That seems much the most likely course of events.

Business reluctance. The second factor that may significantly slow the economic impact of nuclear sanctions relief is business reluctance. The most serious problem Iran is likely to face is in regard to financial transactions. After years of doing little about rampant sanctions violations, the U.S. Treasury became particularly active about a decade ago at enforcing the sanctions restrictions, which Congress then tightened severely. Even before the recent $8.9 billion fine BNP agreed to pay for violating sanctions, ten other banks have paid $5.4 billion in fines for violating sanctions restrictions, and BNP is said to be offering to pay $8 billion to settle the case against it.[65] Banks have been threatened by prosecutors with even worse penalties than fines: BNP agreed to suspend transactions in U.S. dollars for a year, and New York State prosecutors threatened to suspend or end Standard Chartered's New York banking license—both harsh steps. Dealings with Iran have been cited as a central factor in each case—usually as the central factor.

Not surprisingly, banks have become wary about sanctions violations. In some cases, this has led them to take steps far beyond what federal regulations require. *The Economist* wrote recently about how this is changing the character of international banking:

> "It's a pre-emptive cringe in the face of American regulation," says a senior executive at a big bank. His firm, along with most of its peers, is rapidly culling banking relationships and retreating wholesale from markets, countries and lines of business that might attract the ire of regulators or prosecutors. So widespread is the practice that there is now an accepted term for it: "derisking".… In most cases banks are not ending relationships because they have evidence of malfeasance. They are doing so simply because the costs and hassle of checking on their correspondents outweigh the measly profits they generate.[66]

Consider that Chase Morgan closed all bank accounts from UN missions and many bank accounts from foreign political figures, even when there were absolutely no U.S. restrictions on dealings with these entities. According to the *Wall Street Journal*, only one major New York bank (HSBC) is willing to handle banking for any UN mission.[67] U.S. heightened enforcement of sanctions violations has led Bank of America to close the accounts of Iranians and Iranian-Americans; it is the third in the United States to do so.[68] Bank of America's drastic approach is an effort to dodge navigation of the minefield of U.S. sanctions and avoid hefty sanctions violation fines.[69]

The experience under the JPOA may foreshadow what is to come. Despite the removal of some trade restrictions and despite EU/U.S. commitment to facilitate permitted trade, "Western banks are unwilling to get involved. As soon as the banks see the word 'Iran' in the paperwork, you get it rejected," a European trade source told Reuters.[70] A spokesperson for U.S. agribusiness company Archer Daniels Midland told Reuters that banks would not participate in transactions with Iran "for fear of being sanctioned or fined." In late March, Reuters reported that a U.S. official was talking to banks in an effort to get them to engage in transactions with Iran, but that "they are just not willing to do business with Iran."[71] Farhad Alavi, a sanctions law specialist at Washington-based international law firm Akrivis, told the *New York Times* that "Iran has become kryptonite for banks and shippers and insurance companies."[72] Doug Maag, U.S.-based senior counsel with the law firm Clyde and Co., said, "Parties no doubt shy away from engaging in food or humanitarian transactions with Iran from concern about compliance with restrictions that are not always clear."[73] A *Wall Street Journal* review of sanction licensing records found that even the false appearance of a connection to Iran could delay bank transactions for months or years.[74]

Finance is not the only area in which business reluctance is a real possibility. Again, it is instructive to consider what has happened regarding trade newly permitted under the JPOA. Some observers expected businesses to rush into the Iran market, either skirting or openly violating the continuing restrictions. On the whole, the exact opposite has occurred: Iran has had difficulty carrying out permitted transactions. The *Wall Street Journal* reported that some European businessmen visiting Tehran were wary of handing out their business cards for fear Iran would publicize their names and they would find themselves in trouble with U.S. customers.[75] There have yet to be many contracts between European companies and those in Iran.[76] While the EU and United States removed restrictions on petrochemical exports in line with the JPOA, Iran's deputy oil minister for petrochemicals Abbas She'ari Moghaddam complained in May 2014 that "nothing has changed compared with last year" because banks in Europe refuse to handle Iranian trades and insurers decline to cover Iranian voyages due to a lack of clarity on handling compensation.[77] Ships carrying wheat, soybeans, and sugar—none of which are covered by sanctions—have been stuck for weeks outside Iranian ports because of problems arranging payment.[78] Undersecretary of the Treasury David Cohen seems to have understated the case when he told the Senate Subcommittee on Financial Services and General Government on April 2, "We have not seen companies anywhere—Europe, the Gulf, Asia—trying to take advantage of this...narrow opening, the quite limited suspension of the sanctions, to get into the Iranian market, enter into business deals that would otherwise be sanctionable."[79]

One of the side effects of more vigorous enforcement of sanctions rules is that firms may become leery of any transactions with Iran, even those that are permitted. In part, firms are worried they may be caught up in situations of which top management may not have been aware. The U.S. Treasury Department has designated quite a few enterprises for acting on behalf of Iranian entities or for not exercising sufficient vigilance about the entity with whom they were dealing. In a number of cases, such as that of a prominent Israeli firm, the designation brought considerable negative publicity, even if it was eventually reversed after lengthy negotiations with the U.S. authorities. Firms may also be concerned about the increasingly tough U.S. stance on violations of trade restrictions, including by third-country nationals based outside the United States. Recently, the U.S. Attorney's Office for the District of Columbia demanded that Fokker Technologies Holding BV forfeit $21 million for selling aircraft parts to Iran, among other countries. Some former law enforcement officials believed Fokker employees involved in the dealings should have been charged in order to send a clear message to companies and their subsidiaries against doing business with Iran.[80] Vigorous U.S. enforcement may make firms reluctant to reenter the Iran market even if some, but not all, sanctions are lifted.

Overly cautious firms have put up barriers to Iranians even in situations where the U.S. government has worked to promote access. The Treasury Department's Office of Foreign Assets Control (OFAC), which administers most sanctions, has issued a general license for social media software. In a 2010 press release, the Treasury Department emphasized explicitly that it was authorizing the export of online services "such as instant messaging, chat and email, and social networking."[81] Yet, four years later, Yahoo has been refusing to set up new email accounts for anyone living in Iran, which is a major problem given that 63 percent of Iranians with email accounts use Yahoo.[82] Since such accounts are free, the issue is not one of payment. In May 2014, Yahoo issued a statement: "We are aware that a technical issue prevents Iranians from using SMS to verify new accounts and we are looking into the issue." The issue has existed since September 2013, suggesting Yahoo is taking its time with its look. [83] This Yahoo foot-dragging comes after years of U.S. government declarations about promoting greater Internet access by Iranians. In a 2010 major address, Secretary of State Hillary Clinton announced policies to promote Internet connectivity, saying:

The United States is committed to devoting the diplomatic, economic, and technological resources necessary to advance these [Internet connectivity] freedoms....The State Department is already working in forty countries to help individuals silenced by oppressive governments.[84]

This caution about dealings with Iran has been nurtured by regime actions. It was deceptive Iranian financial practices, not UN sanctions, that led the Financial Action Task Force to issue warnings about transactions with Iran. Writing about HSBC's reported decision to stop financing humanitarian trade with Iran, Reuters quoted "a Western intelligence source" as saying that the HSBC's caution was "completely consistent with our understanding and assessment....It appears that HSBC is very concerned about the apparent lack of transparency in Iranian activity."[85] Iran's deceptive practices may violate laws and regulations about money laundering, which can be a barrier to permitted trade. Reuters quoted "a former U.S. Treasury official now working in the private sector."

On the policy side, Treasury wants the transactions processed but the bank regulators want to make sure there is no money-laundering going on. It sounds like the banks are stuck between sanctions regulations and anti-money-laundering controls.[86]

Deceptive practices extend beyond finance. In May 2014, the UN experts panel on Iran sanctions highlighted how Iran had been ordering banned items by listing the purchaser as the freight forwarding company it was using as a front. In response, the International Freight Forwarders Association (FIATA) has issued a notice to its members warning about the increased use of counterfeit bills of lading in connection with shipments involving Iran.[87] Iran has used other deceptive shipping practices.[88] As sanctions ease, foreign firms may still require convincing that Iran has abandoned such deceptive practices.

Sanctions are not the only impediment to firms becoming active in the Iranian market. Companies have faced other U.S., state, and local government pressure about dealings with Iran, such as requirements to disclose activities to shareholders and bond buyers, divestment campaigns affecting state pension schemes, and even calls to cancel contract awards to firms seen as engaging in inappropriate activities in Iran. Reuters cites:

> An executive at a top European consumer electronics firm, in Dubai to explore the possibility of doing business in Iran, said Western companies would have to worry about the "reputational risk" of investing there even after sanctions were lifted, as they could face pressure from their shareholders and the public.[89]

Grounds for Optimism Nonetheless

Despite all the factors cited above, a nuclear deal could provide a considerable short-term boost to Iran's economy for a number of reasons.

The psychological impact of the deal could be considerable. A nuclear deal could lead local businessmen to direct more of their funds into productive investments instead of the real estate market. And foreign businesses could decide that reentering the Iran market, despite the complications from the remaining sanctions, is a worthwhile risk because of the potential importance of the market in future years. Beginning in early 2014, delegations from France, the Netherlands, Germany, Italy, and South Korea, among others, brought scores of investors to Iran in anticipation of sanctions relief.[90] Some Iranian businessmen, such as chamber-of-commerce president Gholam Hossein Shafei, remain optimistic that a nuclear deal will unlock a flood of trade and investment between Iran and the West.[91] Ali Amiri of ACL Ltd. claims to have lined up more than $100 million in commitments for an investment fund focused on Iran if a deal is reached.

Other equally important grounds for optimism are some fundamental economic strong points that will allow Iran to resume growth even if sanctions remain in place. Iran's economy contracted sharply in 2012/13–2013/14 in part because the authorities were putting in place the kind of adjustment measures the IMF often recommends when faced with an external shock like the loss of $60 billion in oil revenues experienced by Iran. Those measures had the impact the IMF typically predicts: pain followed by gain. The adjustment measures, rather than any change in the sanctions regime, has been the main factor in Iran's current nascent economic recovery.[92]

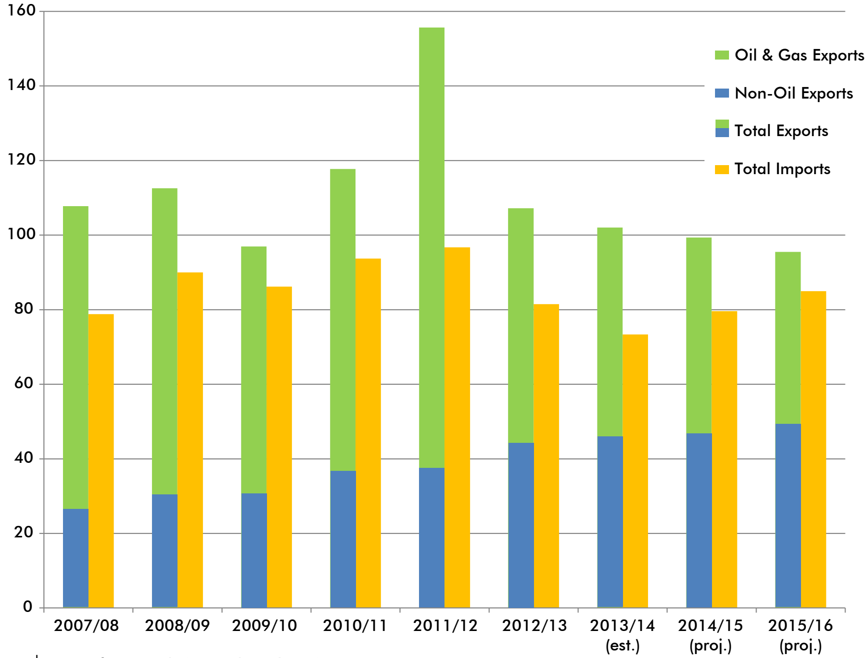
The government contained spending, with the 2014/15 budgeted expenditures down 37 percent in real terms from those in 2011/12 and the 38 percent growth in nominal expenditures much less than the 117 percent growth in inflation.[93] Looked at another way, government spending fell from 19.5 percent of GDP in 2011/12 to a projected 14.9 percent in 2014/15.[94] The projected drop in government spending will be even more impressive if the government is able to achieve its 2014/15 target of cutting the TSO deficit from 1.6 percent of GDP in 2011/12 to zero in 2014/15. In addition to its fiscal adjustment, the Iranian government allowed an equally impressive exchange rate adjustment: it permitted the rial to depreciate in effect by about 60 percent,[95] which, along with the restraint in government spending, caused imports to fall $22 billion and exports to rise $11 billion, making up for half the loss in oil export earnings. Meanwhile, Iran was able to keep up some oil exports, so the loss in export earnings stabilized at about $60 billion—the same level as Iran's precrisis current account surplus. In short, the new sanctions wiped out Iran's previous $60 billion current account surplus, while the adjustment measures restored $30 billion of that surplus.

To expand on this point, Iran's foreign trade position is strong despite sanctions (see figure 1). The April 2014 IMF report showed that in 2013/14, Iran imported $73 billion in goods and services and exported $46 billion in non-oil goods and services, meaning that Iran only needed $27 billion in oil and gas exports to have a balanced current account.[96] Ignoring the natural gas trade, it means that Iran would only have to export 740,000 barrels a day (b/d) at $100 a barrel in order to balance its current account. In fact, in 2103/14, Iran exported more crude than that, as well as petroleum products, totaling $56 billion in oil and gas exports and providing it a $29 billion current account surplus. The IMF projects out to 2019/20, and in that year, it forecasts that Iran would only need $28 billion in oil and gas exports to balance its current account—that is, less than a million b/d (770,000 b/d at a conservative $100 per barrel).[97]

It is instructive to compare Iran's foreign exchange requirements with the sanctions relief provided to Iran by the JPOA. For these purposes, assume that there is no leakage in the sanctions regime, such that Iran is only able export the one million b/d of crude oil exports, worth about $35 billion a year, predicted by U.S. officials. That level will be more than sufficient to meet Iran's foreign exchange needs for the foreseeable future. And Iran's situation under the JPOA is actually better than that because, as U.S. officials acknowledge, Iran will continue to earn substantial amounts from oil and gas exports other than crude, especially the $10 billion from the 300,000 b/d of condensates exports that the State Department insists are not counted in the 1 million b/d target. (Interestingly, while the U.S. commitment under the JPOA is only to "pause efforts to further reduce Iran's crude oil sales," the U.S. government appears to be taking no actions to discourage Iran's growing condensate sales.)[98] This highlights how the essential aspect of the sanctions regime is the restrictions on Iran's access to its foreign exchange (discussed below), not the restrictions on the oil trade.

Another considerable Iranian strength is that public finances are not burdened by as much debt as those in most industrial countries. To be sure, as Rouhani administration officials point out, the Ahmadinejad team left public finances in a mess by ordering banks to make loans that cannot possibly be repaid.[99] The April 2014 IMF report, after noting that 2012/13 public expenditures were 15.3 percent of GDP, adds that the expenses of the Targeted Subsidy Organization (TSO) was 6.1 percent of GDP.[100] Without the TSO, the budget deficit was 0.3 percent of GDP; with it, the deficit was 1.9 percent of GDP. While that is not a large deficit, there is the issue of the political loans by the banks—what the IMF delicately refers to as "quasi-fiscal activities." And Iran has a much smaller public debt than the 60 to 100 percent level typical of industrial countries, much less the 130

Fig. 1 IRAN: Foreign Trade in $US Billions†



† Data refer to trade in goods and services
Source: International Monetary Fund Article IV reports on Iran

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to 200 percent of GDP level seen in Italy or Japan. In August 2014, Economy Minister Ali Tayebnia said Iran's national debt is 2.5 quadrillion rials, which is 23 percent of GDP.[101] That fits with what the IMF recent reported, which in its graphs charting the public debt, though not in its tables, includes government arrears that bring government debt to 21 percent of GDP. The IMF forecasts out to 2018, by which time central government debt will have increased by a further 8 percent of GDP.

But Iran has considerable margin for maneuver because its government debt relative to GDP is much less than that of the United States or Germany, let alone Portugal, Ireland, or Greece. Admittedly, the government's debt is difficult to evaluate, given the many financial tricks that were used by the Ahmadinejad team.[102] Conservative assumptions are, first, that not much is left in the two development funds that supposedly receive a considerable portion of oil revenue (the Oil Stabilization Fund, or OSF, and the National Development Fund of Iran, or NDFI) and, second, that the government will have to recapitalize the banking system to make up for the last administration's bad loans and blatant theft. Even under these assumptions, the Iranian government debt would still fall far short of the levels, relative to GDP, in industrial countries.

In sum, Iran is relatively well positioned to resume growth even if the current sanctions remain in place. Not that this is likely to be a source of great satisfaction to the Iranian authorities, since Iran remains vulnerable in the event of additional sanctions: having already implemented substantial adjustment measures, Iran has less margin for maneuver in the event of a new shock.[103] But another way to look at the situation is that Iran is well positioned to leap forward if it were to get substantial sanctions relief.

Perhaps the fastest-acting sanctions relief would be greater Iranian access to $100 billion of Iranian foreign exchange reserves that have been effectively frozen due to banks' concerns about U.S. and European restrictions on financial transactions with Iran. The financial sanctions, in which the freeze is constituent, have been the most effective sanctions, along with associated insurance and shipping sanctions.

The freeze offers a good route for providing Iran with substantial economic benefits soon after a deal enters into effect. The $100 billion in frozen assets is an amount greater than what Iran could earn in two years of additional oil production and sales. Indeed, it would be quite possible to rely on a phased asset unfreeze to provide Iran with tens of billions a year in sanctions relief for each of the next two years without any other substantial change in U.S. sanctions during that period.

Unfreezing assets will be particularly attractive if such a step does not require Congress to vote. As discussed earlier, the president can waive the sanctions against foreign financial institutions conducting transactions with Iran through his authority under CISADA Section 104 and NDAA Section 1245(d)5. Using this route would mean Iran could get great financial benefit from the sanctions relief while Obama would not need to seek congressional approval.

However, delivering the benefits to Iran is not as straightforward as signing one piece of paper. Banks have to be reassured that transactions with Iran are worth the risks, especially in light of the heavy penalties imposed on banks for activities they thought were permitted. BNP is currently under investigation by the U.S. government for doing business with Sudan and other blacklisted countries. Officials from BNP argue that a memo drafted in 2004 by a law firm authorized the processing of some transactions, so long as the employees in the United States were not involved with the process. BNP has been shocked at how large a penalty the U.S. and New York authorities are seeking, since BNP seems to think it was merely pushing the envelope or engaged in modest overreach. Reportedly, BNP has proposed an $8 billion fine, but that offer has not been accepted.[104] This episode will only encourage banks to adopt the "derisking" strategy described earlier.

The need to ensure Iranian access to permitted trade is implicitly recognized in the JPOA provisions about facilitating humanitarian trade, which, as the JPOA text put it, commit the P5+1 to "establish a financial channel to facilitate humanitarian trade for Iran's domestic needs using Iranian oil revenues held abroad....This channel would involve specified foreign banks and nondesignated Iranian banks to be defined when establishing the channel." Such a channel will require an active effort by the relevant U.S. authorities, the Treasury Department, and the New York regulatory authorities at the least. This will not be easy, since U.S. authorities have a long history of only issuing "advisory opinions," which are not legally binding, similar to "letters of comfort" issued by companies. Such advisory opinions may not be enough to get banks to abandon a "derisking" approach toward Iran.

The U.S. government may face a challenge persuading banks to handle permitted transactions with Iran. In response to Iranian complaints in April 2014 about the difficulties of accessing the funds released under the JPOA, Western officials countered that they were "making progress identifying a group of banks that can work with Iran," according to the *Wall Street Journal*—three months into a six-month deal.[105] Licenses for transactions with Iran granted by the U.S. government in the first three months of 2014 were sharply down from the same period in 2013: 230 compared to 390.[106] By July, shortly before the deal was to expire, a number of companies and banks reported being approached by the U.S. government to facilitate the approved humanitarian trade. But Erich Ferrari, perhaps the leading attorney following U.S.-Iran trade, still complained, "Let's say you get a license—what bank is going to process that transaction?" Nevertheless, Parviz Aghili, chief executive of the recently created Middle East Bank in Tehran, reported success at working with foreign banks, which he attributed to the bank's policy of only trading in humanitarian goods.

A hands-off attitude about how banks deal with Iran seems to apply to at least some European governments. William Arnall-Culliford, a British Foreign and Commonwealth Office official working on Iran, was quoted as saying to a business seminar, "What we won't do is tell people whether their proposed activities are in line with sanctions."[107]

If the U.S. authorities go no further than "advisory opinions" and if those prove insufficient to move banks—both of which seem likely—then Iran would have good reason to feel that the U.S. government is reneging on its commitment to facilitate humanitarian trade. Certainly, Iranians will believe that refusal by private banks to handle transactions for Iran will be the result of behind-the-scenes maneuvering by U.S. officials. Indeed, many around the world—including the United States—may come to the same conclusion. In such a case, the risk is serious that perception of the U.S. government as secretly blocking Iran from getting promised benefits would sour Iranians on the nuclear deal. Moreover, many in the international community would agree with Iran. This situation would not augur well for Iran's continuing observance of the nuclear deal nor for international consensus about sanctions were Iran to walk away from the deal.

Presumably, any easing of the assets freeze would be combined with greater access to revenue from its new oil exports. Interestingly, the JPOA does not explicitly cover this issue, saying that the P5+1 will "pause efforts" to curtail Iran's oil exports without mentioning what the P5+1 will do to give Iran access to revenue from such oil exports.[108] Still, Iran has every reason to anticipate that the P5+1 will make arrangements to allow Iran to gain access to revenue from new sales as well as to limited amounts of its foreign exchange reserves provided for in the agreement.[109]

As discussed earlier, providing Iran access to its current foreign exchange earnings, without giving it access to its foreign exchange reserves, would be enough to meet Iran's foreign exchange needs. Iran is still running a surplus in its current account surplus, so if it had ready access to its earnings, it would not need to draw on its reserves. That said, access to the reserves would allow Iran to step up spending and also provide a margin of comfort. Furthermore, if Iran had better access to its foreign exchange—either its current assets or its reserves—it could sell more dollars on the local market, generating rials available to the government (either directly or indirectly via borrowing from the Central Bank). Those rials would ease the problem of financing government operations.

The Balancing Beam

The economic impact of a nuclear deal is difficult to forecast. One plausible outcome is that the impact will be small: foreign firms will be hesitant to do business in Iran because of continuing restrictions and an unwelcoming business environment (much bureaucracy and even more corruption); trade restrictions will be lifted at a glacial pace; and international banks will be highly cautious about handling transactions with Iranian customers. Another plausible outcome is that the impact will be immediate and large: firms will be eager to enter a large new market; Iran will find banks willing to handle transactions involving the billions in assets freed up; and optimism will lead Iranian businesses to invest and spend more.

But even the optimistic outcome is likely to produce results that fall short of the unrealistic expectations many Iranians have held. It is hard to see Iran enjoying the high growth rates of other regional states, and unlike the last five years, Iran's growth rate may well be lower than that of the advanced industrial countries. Even countries like Greece and Portugal are likely to have higher growth than Iran. It will therefore be difficult for Iran's leaders to say that whatever the problems in Iran, the situation is better than in the West.

In short, critics of the deal may have an easier time than the supporters. Since both the Rouhani campaign rhetoric and much public discourse assume that economic improvement will follow quickly from an opening to the West on nuclear matters, the risk is that failure to achieve hoped-for economic results will be seen as a product Western failure to hold up to its side of the bargain.

That said, the crucial test for benefits of the nuclear deal will be their political impact, not the technical economic effects. Much will depend on noneconomic factors, such as the impact of the deal on Iran's prestige in the region and perceptions about how well Iran did relative to the United States and Europe. For the large portion of the Iranian public concerned about greater opening to the outside world, the impact of the nuclear deal on restrictions Iranians currently face while traveling abroad or accessing foreign software will be significant. But that book is yet to be written.

Notes

1. All data from the IMF Article IV report of April 2014, or, for years earlier than those covered in that report, the IMF Article IV report of August 2011. Iran's real GDP at factor cost grew 0.6 percent in 2008/09 and 3.5 percent in 2009/10, the two worst years of the Great Recession.
2. Though not as huge as claimed in the July 22, 2014 State Department "Summary of Understandings Related to the Implementation and Extension of the Joint Plan of Action." That document states, "Iran's economy is now around 25

percent smaller than it would have been had it remained on its pre-2011 growth path." In fact, Iran's real GDP in 2014/15 is 94 percent of its 2011/12 level. For that to be 25 percent smaller than the pre-2011 growth path, that growth path would have had to have been 5.5 percent growth; such growth would have lifted 2014/15 GDP to 117.5 percent of the 2011/12 level, in which case the actual 2014/15 GDP of 94 percent of the 2011/12 level would be 25 percent less. But GDP growth in 2009/10–2011/12 averaged 3.3 percent, so the continuation of that growth path would have meant that Iran's 2014/15 GDP was 17 percent higher than it actually was. Of course, a 17 percent shortfall is still a huge loss, but it is not a 25 percent shortfall.

3. The cumulative Iranian GDP contraction was 8.4 percent compared to the 4.3 percent decline in U.S. GDP from the fourth quarter of 2007 to the second quarter of 2009.

4. Nicely described in Abbas Milani, "The Ayatollah's Point Man," *Foreign Policy*, June 12, 2013, http://www.foreignpolicy.com/articles/2013/06/12/the_ayatollah_s_point_man_jalili_iran_presidential_election.

5. While the Tehran Stock Exchange (TSE) index also rose, that is a poor indicator of economic performance in Iran. Trading on the TSE is thin and subject to manipulation, so the TSE index often moves entirely independently of how the Iranian economy is performing.

6. *Pardis* (Atlanta), April 2014, p. 7. Author's translation.

7. Jason Rezaian, "In Iran, Diminishing Hopes for New Year," *Washington Post*, March 20, 2014, p. A4, available at http://www.highbeam.com/doc/1P2-35827313.html.

8. Thomas Erdbrink, "To This Tycoon, Iran Sanctions Were Like Gold," *New York Times*, October 5, 2013, p. A1, http://www.nytimes.com/2013/10/05/world/middleeast/to-this-tycoon-iran-sanctions-are-like-gold.html?pagewanted=all&_r=0.

9. Andrew Torchia, "Iran Hopes for End of Sanctions Boom but Investors Still Wary," Reuters, June 25, 2014, http://reuters.com/assets/print?aid=USKBNOFO18820140625. Those are Reuters' words, not a direct quote. The same article is the source for the Welloso quote which follows.

10. Arash Karami, "Iran Official: Revealing Extent of Corruption Could Cause 'Social Shock,'" *Al-Monitor*, May 29, 2014, http://www.al-monitor.com/pulse/originals/2014/05/iran-corruption-social-shock.html.

11. Cited in Najmeh Bozorgmehr, "Rogue Trader," *Financial Times*, June 6, 2014, p. 6. The $200 billion figure she cited compares to $680 billion in Iranian oil exports during the eight Ahmadinejad years. She also writes, "Some economists estimat[e] as much as $500 billion was lost through corruption during the last decade," but this refers to a very broad definition of corruption, including poorly used bank loans and privatization at prices below what might have been obtainable.

12. Bozorgmehr, "Rogue Trader." The case that caught the public imagination was that of Babak Zanjani, who upon his December 2013 arrest claimed he was worth

$10 billion, that he had transferred $17 billion back to Iran, and that the $2.7 billion the Oil Ministry claims he owes is stuck in foreign banks due to sanctions.

13. Instructively, there were no allegations of involvement in the oil trade on the part of Afarid Khosravi, the businessman hanged in May 2014 for embezzling $2.8 billion.

14. Reuters, "Assets of the Ayatollah," November 2013 (multipart series), http://www.reuters.com/investigates/iran/#article/part1.

15. Andrew Torchia, "Politics, Markets Complicate Rouhani's Rescue of Iran Economy," Reuters, May 1, 2014, http://www.reuters.com/article/2014/05/01/us-iran-economy-strategy-idUSBREA400FL20140501.

16. "Iran Targeting Crude Output Hike Alongside Upstream Opening," *Middle East Economic Survey (MEES)*, April 18, 2014, p. 6; "Iran Lays Groundwork for $100Bn Oil Sector Investment," February 28, 2014, p. 2; and "New Iran Contracts: First Glimpse Within Weeks," February 14, 2014, p. 2.

17. Benoit Faucon, "Oil Companies Facing Challenge in Iran," *Wall Street Journal Europe*, May 27, 2014, http://online.wsj.com/news/articles/SB40001424052702303749904579579552501935932. This article is the source of the Zanganeh quote.

18. The IMF April 2014 report, p. 8, explains, "In early 2012, the MCC [Money and Credit Council] allowed banks to determine deposit rates. But this failed to translate into greater flexibility and link with inflation, as lending rates for transactional contracts remained subject to officially-mandated caps."

19. Najmeh Bozorgmehr and Monavar Khalaj, "Grim Economic Outlook Blights Iran's New Year Festivities," *Iran Times*, March 20, 2014, p. 6. See also Bijan Khajehpour, "Iranian Currency on Downward Trend," *Al-Monitor*, http://www.al-monitor.com/pulse/originals/2014/iran-rial-trend-currency-value.html. This article also analyzes the trends in exchange rate discussed below.

20. "575 Defaulted on $25B[illion] in Bank Loans," *Iran Times*, May 16, 2014, p. 5, http://iran-times.com/575-defaulted-on-25b-in-bank-loans/.

21. Djavad Salehi-Isfahani, "Will Iran's Inflation Rebound?" *Iran Times*, Text and Context, April 25, 2014, p. 9, available at http://djavadsalehi.com/2014/04/06/will-irans-inflation-rebound/.

22. Bijan Khajehpour, "Iranian Currency on Downward Trend," *Al-Monitor*, http://www.al-monitor.com/pulse/originals/2014/iran-rial-trend-currency-value.html.

23. *Iran Times*, "Rial Value Falls 9% in Nine Days," April 25, 2014, p. 1, available at http://www.thefreelibrary.com/Rial+value+falls+9%25+in+nine+days.-a0368282344.

24. "Government Decides to Pay Welfare to All Applicants," *Iran Times*, May 16, 2014, p. 1, http://iran-times.com/government-decides-to-pay-welfare-to-all-applicants/.

25. "Film Stars Urge Public NOT to Apply for Welfare," *Iran Times*, April 18, 2014, p. 3, available at http://www.thefreelibrary.com/Film+stars+urge+public+not+to+apply+for+welfare.-a0367641666.

26. Warren L. Nelson, "94% Apply for Welfare Checks," *Iran Times*, May 2, 2014, p. 1. Also found in: Mohammad Davari, "Iran's Rouhani Tastes First Political Defeat," Agence France-Presse, April 26, 2014.

27. "Rouhani Food Baskets Backfire on Gov't," *Iran Times*, February 7, 2014, p. 1.
28. Nazila Fathi and Jad Mouawad, "Unrest Grows Amid Gas Rationing in Iran," *New York Times*, June 29, 2007, http://www.nytimes.com/2007/06/29/world/middleeast/29iran.html.
29. "Iran Testing Fuel Smart Cards In Tehran," Reuters, February 25, 2007, http://uk.reuters.com/article/2007/02/25/iran-gasoline-idUKBLA55159620070225.
30. *BP Statistical Review of World Energy 2013* shows Iran's primary energy consumption in 2012 as 234 million tons of oil equivalent, while the UK's was 204 million and Turkey's was 119 million.
31. Per dollar of 2011 GDP at 2005 prices converted using purchasing power parity exchange rates, Iran used 11,655 BTUs; the United States, 5,807; and the world average was 7, 302. See http://www.eia.gov/cfapps/ipdbproject/iedindex3.cfm?tid=92&pid=46&aid=2.
32. "Islamic Republic of Iran, Selected Issues Paper," *IMF Country Report No. 14/94*, International Monetary Fund, April, 2014, p. 8. The data are presented as barrels of oil equivalent "per unit of value added"; what unit is not specified, so comparison to other countries is not possible. The data are only in chart form, but the 1991 figure appears to be 2.2 and the 2012 figure, 3.2.
33. Akbar Torkan, as cited by Tasnim News Agency, http://www.tasnimnews.com/print/Index/294354, February 25, 2014 (author's translation). Torkan, identified as "advisor to the president," cites 700 million barrels of oil consumed at a value of $100 per barrel and 160 billion cubic meters of gas, which he says should be valued from 44 to 48 cents a cubic meter, although the $124 billion figure he cites implicitly values the gas at 34 cents. The IMF shows the 2013/14 GDP as 9,069 trillion rials and the average exchange rate for the dollar as 24,770. On U.S. consumption, see table 1.5 in the U.S. Energy Administration's *Annual Energy Review 2011*, p 13.
34. For instance, if prices were raised 20,000 rials/liter (to the equivalent of $3.22 per gallon for unrationed gasoline), then even if higher prices cut demand to 60 million litres/day, government revenue would go up 438 trillion rials, equivalent to $13 billion at the free market rate. That 438 trillion rials would be sufficient to raise 2014/15 government expenditures by 25 percent over the level the IMF forecasts.
35. Najmeh Bozorgmehr and Monavar Khalaj, "Iranians Defy High Fuel Costs as Rouhani Raises Prices Again," *Financial Times*, April 26, 2014, p. 3.
36. "Islamic Republic of Iran, Selected Issues Paper," *IMF Country Report No. 14/94*, International Monetary Fund, April, 2014, p. 12.
37. Najmeh Bozorgmehr and Monavar Khalaj, "Iranians Defy High Fuel Costs as Rouhani Raises Prices Again," *Financial Times*, April 26, 2014, p. 3.
38. "Targeted Subsidy Reform in Iran," Islamic Republic of Iran: Selected Issues Paper, *IMF Country Report No. 14/94*, International Monetary Fund, April 2014, p. 8.
39. Farideh Farhi, "The Iranian Evolution: A Shift in Tehran and the National Mood," *Muftah*, April 22, 2014, http://muftah.org/iranian-evolution/#.U5nJ1vldWCn.
40. The April 2014 IMF report, p. 13, states that CBI loans for Mehr housing are 40%

of base money. The percentages cited in the text are calculated from the data on base money and 2013/14 GDP on p. 41.

41. Djavad Salehi-Isfahani, Bryce Wilson Stucki, and Joshua Deutschmann, "The Impact of Iran's Subsidy Reform on Households: Evidence from Survey Data," 2013, Virginia Tech. Available at: http://filebox.vt.edu/users/salehi/Iransubsidy_v3.pdf. Cited in the IMF Selected Issues paper, "Targeted Subsidy Reform in Iran," which is the source for the other data on the subsidy reform, unless otherwise cited.

42. Jahangir Amuzegar, "Iran: The Subsidy Dilemma," *Middle East Economic Survey (MEES)*, December 20, 2013.

43. Najmeh Bozorgmehr, "Iran's Bloated State Grapples with Excessive Overstaffing," *Financial Times*, February 28, 2014, p. 5.

44. Cited by Farideh Farhi, "The Iranian Evolution: A Shift in Tehran and the National Mood," *Muftah*, April 22, 2014, http://muftah.org/iranian-evolution/#.U1fkMPldVkn.

45. Andrew Torchia, "Politics, Markets Complicate Rouhani's Rescue of Iran Economy," Reuters, May 1, 2014.

46. To be sure, foreign exchange reserves rose under Ahmadinejad from $33 billion to $107 billion, but that $74 billion increase is not impressive compared to $435 billion in additional income.

47. "Sanctions Would Stay for a Decade," *Iran Times*, May 30, 2014, p. 10 [look for Tansim news agency source].

48. See the account of the U.S-Vietnam normalization in Ernest Preeg, *Feeling Good or Doing Good with Sanctions* (Washington, D.C.: The CSIS Press, 1999), pp. 88–110. This is the source for the comments below about Vietnam.

49. Even Magnus Ranstorp, *Hizb'allah in Lebanon: The Politics of the Western Hostage Crisis* (New York: St. Martin's Press, 1997), who emphasizes the internal dynamics shaping Hezbollah's decisions, acknowledges, "It may be the case that Hizb'allah abducted these American citizens in an effort to both replace previously released hostages and discredit Rafsanjani's position in Iran" (p. 98).

50. Jennifer Rubin, "Senate Passes Iran Sanctions 100-0; Obama Objects (Really)," *Washington Post,* http://www.washingtonpost.com/blogs/right-turn/post/senate-passes-iran-sanctions-100-0-obama-objects-really/2011/12/02/gIQA7yELKO_blog.html.

51. Tyler Cullis, "Will 'Sanctions Hawks' Kill an Iran Nuclear Deal?" *National Interest*, June 6, 2014, http://nationalinterest.org/feature/will-sanctions-hawks-kill-iran-nuclear-deal-10608.

52. U.N. Security Council 5500th Meeting, "Resolution 1696 (2006) [Iran Says Peaceful Programme No Threat, Council's Consideration Unwarranted]," July 31, 2006, Qatar.

53. U.N. Security Council 6335th Meeting, "Resolution 1929 (2010) [Brazil, Turkey, Lebanon Say Tehran Declaration Could Boost Diplomatic Efforts, While Sanctions Represent Failure of Diplomacy]," Reuters, June 9, 2010.

54. This discussion of EU sanctions is largely based on Cornelius Adebahr, "Easing EU

Sanctions on Iran," Atlantic Council, June 2014. He states that the legal basis for "restrictive measures" (the EU legal term for sanctions) is Article 29 of the Treaty on the European Union and Article 215 of the Treaty on the Functioning of the European Union, which means that the Article 31 provision of the former treaty about qualified majority voting applies to such decisions.

55. Dianne Rennack, "Iran: U.S. Economic Sanctions and the Authority to Lift Restrictions," Congressional Research Service, February 4, 2014. Items that cannot be waived include requiring export licenses for sales to governments designated as state sponsors of international terrorism (Trade Sanctions Reform and Export Enhancement Act of 2000, Section 906). A number of the waivers must be renewed every 180 days. Rennack lists a considerable number of actions taken by the State and Treasury departments in the period January 20–22, 2014, in conjunction with the coming into effect of the JPOA, which either waive certain sanctions or state "the USG will not impose sanctions" under other provisions.

56. CISADA, Section 104. See the analysis in Kenneth Katzman, "Easing US Sanctions on Iran," Atlantic Council South Asia Center, June, 2014, p. 8.

57. National Defense Authorization Act, Public Law 112–81, 112th Congress, December 31, 2011, Section 1245 ("Imposition of Sanctions with Respect to the Financial Sector of Iran"), subsection (d) ("Imposition of Sanctions with Report to the Central Bank of Iran and Other Iranian Financial Institutions"), http://www.treasury.gov/resource-center/sanctions/Programs/Documents/ndaa_publaw.pdf.

58. The exception lasts 180 days for financial institutions whose primary jurisdiction is in any country the president determines "has significantly reduced its volume of crude oil purchases from Iran during the period beginning on the date on which the President submitted the last report with respect to the country." As set out in paragraph 4(C), the sanction provisions apply only if the president determines that "there is a sufficient supply of petroleum and petroleum products from countries other than Iran to permit a significant reduction in the volume of petroleum and petroleum products purchased from Iran."

59. "Provision of Certain Temporary and Limited Sanctions Relief in Order to Implement the Joint Plan of Action of November 24, 2013 Between the P5+1 and the Islamic Republic of Iran," State Department, *Federal Register*, January, 29, 2014, June 3, 2014, http://www.state.gov/p/nea/rls/220049.htm.

60. Presumably of the JPOA provision that the United States and its P5+1 partners would "pause efforts to further reduce Iran's crude oil sales, enabling Iran's current customer to purchase their current average amounts of crude oil."

61. "Guidance Relating to the Provision of Certain Temporary Sanctions Relief in Order to Implement the Joint Plan of Action Reached on November 24, 2013, Between the P5+1 and the Islamic Republic of Iran," U.S. Department of State, January 20, 2014, June 3, 2014, http://www.state.gov/p/nea/rls/220049.htm.

62. Gary Samore, "Nuclear Deal by July?," *Politico*, June 2, 2014, http://www.politico.com/magazine/story/2014/06/will-iran-strike-a-nuclear-deal-by-july-107250_Page2.html#.U9ZoL_ldWCk.

63. On June 17, 2014, House Foreign Affairs Committee chair Ed Royce and ranking Democratic member Eliot Engel, along with 342 other representatives including a majority of the delegations of each party, sent President Obama a letter which stated, "Your Administration has committed to comprehensively lifting 'nuclear-related' sanctions as part of a final P5+1 agreement with Tehran. Yet the concept of an exclusively defined 'nuclear-related' sanction does not exist in U.S. law. Almost all sanctions related to Iran's nuclear program are also related to Tehran's advancing ballistic missile program, intensifying support for international terrorism, and other unconventional weapons programs…. Iran's permanent and verifiable termination of all these activities—not just some—is a prerequisite for permanently lifting most congressionally mandated sanctions." See http://foreignaffairs.house.gov/sites/republicans.foreignaffairs.house.gov/files/Iran%20sanctions%20letter.pdf.

64. Sherman at CNN's Amanpour, http://edition.cnn.com/TRANSCRIPTS/1407/25/ampr.01.html. At the same time, a "senior administration official" told the *New York Times*, "We wouldn't seek congressional legislation in any comprehensive agreement for years….The early suspensions would be executive action" (David Sanger, "Lawmakers Voice Skepticism on Iran Nuclear Deal," *New York Times*, July 30, 2014, p A3).

65. Ben Protess and Jessica Silver-Greenberg, "BNP Admits Guilt and Agrees to Pay $8.9 Billion Fine to U.S.," *New York Times*, July 1, 2014, pp. B1 and B4. BNP's violations overwhelmingly involved Sudan; Iran was a distant second. That does not lessen banks' concerns about violating U.S.-imposed financial regulations. Devlin Barrett et al., "U.S. Seeks $10 Billion Penalty from BNP," *Wall Street Journal*, May 30, 2014, pp. 1–2, lists fines and forfeitures to date as HSBC, $1,921 million; Standard Chartered, $667 million; ING, $619 billion; Credit Suisse, $536 billion; ABN Amro, $500 million; Lloyds, $350 million; Barclays, $298 million; Bank of Tokyo–Mitsubishi, $259 million; Clearstream Banking, $152 million; and Royal Bank of Scotland, $100 million. Most of the fines have been levied by federal authorities, some by New York State or New York City authorities in conjunction with the federal fines. This list of fines and forfeitures may well not be complete; for instance, it appears the Bank of Moscow paid $9.5 million on January 27, 2014.

66. "Poor Correspondents," *The Economist*, June 14, 2014, pp. 65–66.

67. Matthias Rieker, Joseph Palazzolo, and Victoria McGrane, "Banks Exit from Embassy Business," *Wall Street Journal*, November 20, 2010, http://online.wsj.com/news/articles/SB10001424052748703531504575625060985983720.

68. "Bank of America Is Third US Bank to Probe Iranians," *Iran Times*, May 23, 2014, p. 2.

69. Ryan Costello and Jamal Abdi, "Why Is Bank of America Closing Iranian Students' Accounts?," *Huffington Post*, May 15, 2014, http://www.huffingtonpost.com/ryan-costello/why-is-bank-of-america-cl_b_5330851.html.

70. Jonathan Saul and Parisa Hafezi, "Payment Problems Disrupting Iran Food Deals," Reuters, May 10, 2014, http://www.reuters.com/article/2014/05/11/iran-nuclear-food-idUSL6N0NO3OK20140511. This article is the source for the next quote as well.

71. Jonathan Saul and Parisa Hafezi, "Western Banks Cold-Shoulder Iran Trade Finance Scheme," Reuters, March 13, 2014.
72. Rick Gladstone, "Sanctions Are Eased; Iran Sees Little Relief," *New York Times*, April 14, 2014, pp. A4–A6. See also Jonathan Saul and Parisa Hafezi, "Western Banks Cold-Shoulder Iran Trade Finance Scheme," Reuters, March 13, 2014.
73. Jonathan Saul and Parisa Hafezi, "Exclusive: Iran Seeks to Resolve HSBC Freeze on Some Trade Financing," Reuters, June 24, 2014, http://uk.reuters.com/assets/print?aid=UKKBNOEZOKE20140624.
74. "Just a Hint of Iran Sanctions Risk Stalls Bank Transactions," *Wall Street Journal*, July 31, 2014. In one case, a Barclays client trying to wire money to the Jordanian government had approval held up for months because of the similarity in name between the Iranian Central Bank and the Jordanian Central Bank.
75. Laurence Norman and Benoît Fauçon, "European Companies Walk on Eggshells in Iran," *Wall Street Journal*, March 13, 2014.
76. Aniseh Bassiri Tabrizi, "The EU's Sanctions Regime Against Iran in the Aftermath of the JPA," European Council on Foreign Relations Policy Memo, June 2014.
77. Benoit Faucon, "Iran Still Unable to Sell Petrochemicals to EU, Top Official Says," *Wall Street Journal*, May 9, 2014.
78. Jonathan Saul and Parisa Hafezi, "Payment Problems Disrupting Iran Food Deals," Reuters, May 10, 2014.
79. Quoted in Patricia Zengerle, "Treasury Official: Firms Not In New Deals with Iran after Pact," Reuters, April 2, 2014, http://www.reuters.com/article/2014/04/02/us-iran-nuclear-usa-sanctions-idUSBREA311TV20140402.
80. Adam Goldman, "Fokker Fined for Evading Sanctions," *Washington Post*, June 5, 2014, p. A5.
81. "Treasury Department Issues New General License to Boost Internet-Based Communication, Free Flow of Information in Iran, Sudan and Cuba," Department of Treasury Press Center, March 8, 2010, http://www.treasury.gov/press-center/press-releases/Pages/tg577.aspx.
82. Jamal Abdi, "Why Is Yahoo Blocking Email for Iranians?" National Iranian American Council, April 30, 2014, http://www.niacouncil.org/why-is-yahoo-blocking-email-for-iranians/.
83. Lorenzo Franceschi-Bicchierai, "Yahoo Account Policy Hurts Iranians' Free Speech, Activists Say," Mashable, May 1, 2014, http://mashable.com/2014/05/01/yahoo-iran-email/.
84. Hillary Rodham Clinton, January 21, 2010, http://www.state.gov/secretary/20092013clinton/rm/2010/01/135519.htm.
85. Jonathan Saul and Parisa Hafezi, "Exclusive: Iran Seeks to Resolve HSBC Freeze on Some Trade Financing," Reuters, June 24, 2014, http://uk.reuters.com/assets/print?aid=UKKBNOEZOKE20140624
86. Ibid.
87. Louis Charbonneau, "U.S. Experts' Report Shows Iran's Deceptive Procurement

Tactics," Reuters, May 12, 2014, http://www.reuters.com/article/2014/05/12/us-iran-nuclear-sanctions-idUSBREA4B0BG20140512.

88. Steve Stecklow, "Iran Shipper Evades U.S. Blacklist," *Wall Street Journal*, April 10, 2010, highlights the risk firms incur because of Iran's practices. In 2011 and 2012, the U.S. Treasury issued advisory warnings about the risks posed by Iranian disguising shipping operations, including operating ships despite their flags having been revoked. In February 2012, Reuters did a lengthy special, "Iran's Global Cat-and-Mouse Game on Sanctions," http://graphics.thomsonreuters.com/12/02/IranSmuggling.pdf, about the illicit techniques Iran was using to disguise shipping operations. On continuing problems shipping to Iran despite the JPOA, see Jonathan Saul and Parisa Hafezi, "Shipping Firms Shy Away from Iran Despite Deal to Ease Sanctions," *Reuters*, May 28, 2014, http://www.reuters.com/article/2014/05/28/iran-shipping-trade-idUSL6N0OD31H20140528.

89. Andrew Torchia, "Iran Hopes for End of Sanctions Boom but Investors Still Wary," Reuters, June 25, 2014, http://reuters.com/assets/print?aid=USKBNOFO18820140625.

90. Anne Gearan, "Anticipating Looser Sanctions, Foreign Firms Flock to Iran," *Washington Post*, February 5, 2014, p. A10. Daniel Bernbeck, head of the German-Iranian chamber in Tehran, reported in August 2014 that inquiries from German companies had more than doubled from recent years (Andrea Thomas, "German Business Looks to Renew Iran Contacts," *Wall Street Journal,* August 3, 2014).

91. Jay Solomon, "Global Companies Circle Iran, Awaiting Break in Sanctions," *Wall Street Journal*, July 2, 2014, pp A1 and A9. This is also the source for information about Ali Amiri.

92. The opposite argument is made in Paul Domjanz et al., *Sanctions Relief: What Did Iran Get?,* Roubani Global Economics and the Foundation for the Defense of Democracies, July 2014. They write, "The de-escalation of sanctions since mid-2014 and the suspension of some sanctions through the first half of 2014 as result of the JPOA generated positive economic effects….The value to the Iranian economy sanctions [includes] domestic benefits [which] can be summarized as a stronger currency, more moderate inflation, and an economy that we forecast to grow 2% in FY 2014/15 rather than contract as it has in previous years when sanctions were escalating."

93. Based on the increase in the consumer price index of 30.5 percent on average for the year in 2012/13 and 35.2 percent in 2013/14 plus the IMF's projection of a 23.0 percent increase in 2014/15. Iran also calculates a GDP deflator (17.6 percent, 35.8 percent, and 20.1 percent for those three years), but that suffers from some problems. Government spending was 1,192 trillion rials in 2011/12 and is projected by the IMF to be 1,648 trillion in 2014/15. The TSO deficit was 98 trillion rials in 2011/12 and is projected by the IMF staff at zero for 201/15.

94. As explained below, that almost certainly understates the adjustment, since considerable arrears were incurred during the high-spending Ahmadinejad years.

95. Charts on the exchange rate, such as http://www.cato.org/research/troubled-currencies-project or published weekly in *Iran Times* (Washington, D.C.), understate the change because 2012 saw a considerable shift in transactions from the official

exchange rate to either an intermediate semi-official rate or to the free market rate. That shift had the effect of reducing the average exchange rate even faster than the 50 percent fall in the official rate from about 12,000 rials per dollar to 25,000 rials per dollar.

96. Table 2, p. 37.
97. IMF, p. 45. To be sure, the IMF staff conclude on p. 48 that "The projected current account deficit in the medium term (the underlying current account) is close to its sustainable level." That is based on a conservative assumption about oil exports: "staff assumes that export volumes of crude oil remain constant...at a level that is three quarters below the average export volumes in 2007–12."
98. The condensate issue was flagged by Nathaniel Kern, "Iranian Exports and Sanctions: A Case for More Transparency from the Obama Administration," May 1, 2014 (report prepared for Foreign Reports Inc.). The issue is explored further in Clifford Kraus, "With Gas Byproduct, Iran Sidesteps Sanctions," *New York Times*, August 13, 2014, pp B1–B2. Because Iran is planning a substantial increase in natural gas production that produces condensates as a byproduct, it plans to increase its condensate production from the current 500,000 barrels per day to 1,150,000 barrels per day, with most of the increase slated for export ("Iran Lays Giant Condensate Export 'Refinery' Bait for Foreign Investors," *MEED*, August 8, 2014, p. 8.).
99. The April 2014 IMF report delicately states, "In response to [IMF] staff concerns, [NDFI senior officials] explained that their financial statements and balance sheets were in the process of being finalized....Staff noted that other QFAs [quasi-fiscal activities] (such as the Mehr Housing Program) and their respective interest rate subsidies should be made more transparent and gradually incorporated into the central government budget." Perhaps the largest such QFA is the operation of the Targeted Subsidy Organization, whose 122-trillion-rial loss was included by the IMF in its estimate of government net lending/borrowing.
100. Table 3, p. 39; for the TSO, IMF, "Targeted Subsidies," p. 11. These amounts appear to exclude the operations of the National Development Funds of Iran (NDFI), which receives part of the oil income and which makes "loans" that are unlikely to be repaid.
101. "Third of Iran Debt is Owed to Ripped-Off Pension Fund," *Iran Times* (citing Fars News), August 8, 2014, p. 5. He described the debt as being one sixth to contractors (presumably arrears), one quarter to banks, and one quarter to the National Pension Fund, which would leave one third held by the general public and others.
102. The IMF report presents on pp. 51–52 a detailed "debt sustainability analysis," but footnote 1 explains that this only covers central government debt, which is but a small fraction of the problem, given the broad extent of QFAs.
103. Another way of looking at the situation is that the Iranian authorities have prioritized creating capacity for response to additional sanctions. Consistent with their view that the main factor explaining the modest improvements in the Iranian economy has been sanctions relief, Domjan et al. write in *Sanctions Relief: What Did Iran Get?*, "Sanctions relief has helped the Iranian authorities build up

resilience against future shocks. Although the government began its interest rate and fiscal adjustment before sanctions relief kicked in, the improving external environment created more space for the government to do fiscal consolidation without exacerbating the recession. Iranian authorities so far have preferred to use the breathing room created by sanctions relief to build economic resilience than to maximize economic growth....These policies make Iran more able to cope with any future sanctions."

104. Jessica Silver-Greenberg and Ben Protess, "BNP Paribas Pinned Hopes on Legal Memo, in Vain," *New York Times*, Deal Book, June 3, 2014, http://dealbook.nytimes.com/2014/06/03/bnp-paribas-pinned-hopes-on-legal-memo-in-vain/. Also found in: Devlin Barrett, David Enrich, and Christopher Matthews, "U.S. Seeks $10 Billion Penalty from BNP," *Wall Street Journal*, May 30, 2016, p. 1.

105. Laurence Norman, Nour Malas, and Benoit Faucon, "Iran Assets Unfrozen but Still on Ice," *Wall Street Journal*, April 7, 2014, p. A8.

106. Benoit Faucon and Joel Schechtman, U.S. Pushes to Expedite Some Humanitarian Shipments to Iran," *Wall Street Journal*, July 28, 2014. This is also the source for the Ferrari quote and the reference to Aghili.

107. Jonathan Saul and Parisa Hafezi, "Exclusive: Iran seeks to resolve HSBC freeze on some trade financing," Reuters, June 24, 2014, http://uk.reuters.com/assets/print?aid=UKKBNOEZOKE20140624.

108. The JPOA language is that the P5+1 will "pause efforts to further reduce Iran's crude oil sales, enabling Iran's current customers to purchase their current average amounts of crude oil. Enable the repatriation of an agreed amount of revenue held abroad. For such oil sales, suspend the EU and U.S. sanctions on associated insurance and transportation services." That wording does not include any explicit statement that the P5+1 will facilitate Iranian access to the revenue from the oil sold; the only commitment is to allow Iran to sell oil.

109. U.S. Public Notice 8610, "Provision of Certain Temporary and Limited Sanctions Relief in Order to Implement the Joint Plan of Action of November 24, 2013, between the P5+1 and the Islamic Republic of Iran," U.S. Department of State, January 22, 2014.

3

Khamenei and Nuclear Negotiations

> *In recent decades, Western governments and, on top of them, America... have gotten used to bullying, taking the global economy in their hands, and dominating the culture of other peoples. In sum, they have gotten used to taking the affairs of other countries in their hands. When a people and a country stand up against this hideous habit, the Americans become extremely angry...The enmity of our enemies is rooted in the resistance of the Islamic Republic against global arrogance and against the hideous habit of dividing the world into the oppressor and the oppressed. Other issues are excuses. Today, their excuse is the nuclear issue. One day their excuse is human rights, and another day their excuse is something else. They want to discourage the Islamic Republic from showing resistance against bullies, thugs, blackmailers, and global oppressors. Of course, this will not happen.*[1]
>
> *—Ayatollah Ali Khamenei*

AFTER HASSAN ROUHANI was elected president of the Islamic Republic in 2013, a new round of nuclear negotiations officially began between Iran and the P5+1 (Britain, China, France, Russia, and the United States, plus Germany). According to a *New York Times* report, U.S. deputy secretary of state William Burns had contacted Iranian officials in the last months of Mahmoud Ahmadinejad's presidency with the aim of reopening talks when the new president assumed office.[2] This meant that bo matter who won the election, high-ranking officials of the Islamic Republic *did* want to seriously engage in negotiations, in particular with Americans, to ease the pressure of and prevent further imposition of sanctions.

When Hassan Rouhani was elected, hopes for a diplomatic opening infused the West. And indeed, Rouhani has prioritized the nuclear negotiations and worked to expedite the process as much as possible. Success in these talks, in his view, is the only way to rescue the Iranian economy and normalize Iran's political and financial relations with the world. In June 2014, Iranian minister of intelligence Mahmoud Alavi addressed his ministry's deputies as follows:

> The president said I have made up my mind and the "Master" [Ayatollah Ali Khamenei] has allowed us to negotiate. Now we negotiate. Negotiations may or may not lead to the desired result. If we succeed, I [meaning Rouhani] give the credit to the Master and declare that it was the Supreme Leader's guidance that brought us the success because it is in everyone's interest to strengthen the Supreme Leader's position as much as possible. But if we do not succeed, I undertake the responsibility; I believe that the Master has shown us the path very well but we failed; because if I get discredited, the regime would be damaged less, but if, God forbid, the hard core of the regime and the principle of the guardianship of the jurist get harmed, everyone would lose.[3]

Alavi claimed that Rouhani desires so strongly for the talks to succeed that, if they fail, Rouhani would run them himself.[4]

Ayatollah Khamenei meanwhile is taking a very sophisticated approach toward the negotiations. He is well aware that the West acknowledges his authority and would not attempt negotiations if its leaders doubted the Supreme Leader's support for the Iranian negotiating team. Yet Khamenei also expresses pessimism about the effectiveness and fruitfulness of the negotiations, even as he says he approves of Rouhani's initiative for the talks:

> Even now that it has been clear for religious, rational, and political reasons that the Islamic Republic of Iran is not pursuing nuclear weapons, when American officials talk about the nuclear issue, they implicitly or explicitly mention nuclear weapons, while they know themselves that it is a definite policy of the Islamic Republic of Iran not to have nuclear weapons...[this is part of] their goal to maintain the anti-Iran international environment. This is why [the Rouhani government's] new initiative for negotiations was approved [by me]—in order to destroy this global mood and hold the initiative [so that the] truth would be revealed for world public opinion...meanwhile, negotiation does not mean that the Islamic Republic of Iran would make a concession over its nuclear scientific movement...the nuclear scientific movement should not be stopped or even slowed down.[5]

Therefore, for Ayatollah Khamenei, negotiations do not mean a resolution to the nuclear dispute. Supporting such a notion, the Supreme Leader tellingly blames the United States for the failure of the 2010 Tehran Research Reactor deal brokered by Brazil and Turkey:

> At that time, there was a formula for acquiring fuel, but the Americans—contrary to what they have said to their friends in the region and one of the South American countries which made some of our officials believe them—sabotaged [the deal] and thought that [they had] put Iran in dire straits...Even then, I have said from the very beginning that America is not seeking to resolve this issue. Then everyone saw that when the agreement was about to be implemented, the Americans stopped it...While our scientists declared that they can produce the nuclear fuels for the Tehran reactor, Westerners mocked [us]; but our young [scientists] have done this sooner than what was expected, and our enemies were surprised.[6]

With respect to the present situation, Ayatollah Khamenei said explicitly, "I am not optimistic about the negotiations. It will not lead anywhere, but I am not opposed either."[7] As time has passed, Khamenei's pessimism has only grown stronger. On August 13, addressing the foreign minister, other ministry officials, and Iranian ambassadors and diplomats, the Supreme Leader emphasized:

> Relations with America and negotiations with this country, except in specific cases, not [only have no] benefit for [the] Islamic Republic but also [are] harmful. And how can a wise person do a futile job?...[S]ome people have suggested that if we sit with [the Americans at] the negotiation table, many problems can be solved. Certainly we knew that this is not true but what happened in [the last year has] just proven this fact more than one time...in the past there was no contact between our officials and American officials. But in [the] last year this contact has been established due to sensitive nuclear issues and [some people's suggestion that we need to] try [negotiation]. It was decided that contacts, meetings, and negotiation [should] take place at the level of foreign ministers, but [not only was this] futile but also the rhetoric of Americans became more aggressive and offensive; they have increased their [unreasonable] expectations in the negotiation meetings and public announcements...this is valuable experience for all of us to learn that sitting and talking to Americans would not have any influence in diminishing their animosity and is futile.[8]

Further, Khamenei believes one consequence of negotiations is that they allow Washington to set new expectations: "As long as the status quo, meaning America's animosity and the hostile statements of the U.S. administration and Congress against Iran, continues, there is no reason to engage with them."[9]

Conservatives, for their part, have overtly criticized Rouhani's initiative for negotiations.[10] Unlike conservatives in democratic countries, Iranian conservatives do not constitute an independent political force. They are financially and politically dependent on Khamenei and the entities under him, such as the Islamic Revolutionary Guard Corps (IRGC). Khamenei has enough leverage and effective mechanisms to control Iranian conservatives and push them in whatever direction he desires. One leading conservative figure recently claimed that Khamenei had controlled conservatives' moves against former president Mohammad Khatami in the late 1990s and early 2000s. State radio and television, then headed by Ali Larijani—who is now speaker of the Majlis—broadcast two series targeting intellectuals and writers and accusing them of being agents of the West: "Lamp" (*cheragh*) and "Identity" (*hoviyyat*). These series, with production help from the Ministry of Intelligence and Khamenei confidant Hossein Shariatmadari,[11] also sought to discredit reformists supported by many intellectuals.

Ruhollah Hosseinian, former prosecutor for Iran's Special Court for Clerics and a well-known intelligence official under former president Akbar Hashemi Rafsanjani, said that through the "Lamp" series the Supreme Leader "was managing both sides and preventing them from entering into uncontrollable tensions." He mentioned several occasions on which Khamenei sent messages indicating he should not criticize or attack Khatami's government.[12]

But the Supreme Leader can also use his levers of power to weaken the president. Since Rouhani's victory, Khamenei has allowed Hossein Shariatmadari to criticize the president's moves in talks with the West. It is clear Khamenei has full control over the newspaper *Kayhan* and is perfectly capable of silencing it.[13] Likewise, the commander of the IRGC has criticized the negotiations and the Joint Plan of Action, as the interim agreement between Iran and the P5+1 is known.[14]

Ayatollah Khamenei's ambivalent approach to the negotiations raises several important questions. Namely, to what extent can negotiations over Iran's nuclear program be successful? If Khamenei is not completely satisfied with an agreement, will he allow the negotiation team to sign off on the terms? If he feels he has no choice but to sign off on an agreement with which he does not agree, what will his next move be? Will he comply with such an agreement or find a way to escape its terms? To what extent can the West be certain about the sustainability of any deal with Iran under Khamenei? In other words, would an agreement now mean the end of the nuclear dispute entirely, or merely an end to negotiations for the time being?

In answering such questions, one must first recognize the great extent to which Khamenei can control and constrain the president or any other elected official. The Supreme Leader also has exclusive authority over several key institutions—such as the armed forces, state television and radio, the judiciary, and foundations—which are run by hardliners. Much of Iran's regional policy is shaped and commanded by the IRGC, including its Qods Force. The Supreme National Security Council (SNSC), currently run by Ali Shamkhani as secretary—even as Rouhani nominally heads the council—plays an important role in policy planning and setting the boundaries for Iran's foreign policy. Shamkhani, who formerly headed the IRGC navy and served as defense minister under Mohammad Khatami,[15] represents the Supreme Leader on the SNSC.

The other current SNSC members include

- Saeed Jalili, Khamenei's representative alongside Shamkhani;
- Ali Larijani, Majlis speaker;
- Sadeq Larijani, judiciary chief;
- Maj. Gen. Ataollah Salehi, commander of Iran's regular armed forces (Artesh);
- Maj. Gen. Mohammad Ali Jafari, IRGC commander-in-chief;
- Maj. Gen. Hassan Firouzabadi, armed forces chief of staff;
- Mahmoud Alavi, intelligence minister;
- Abdolreza Rahmani Fazli, interior minister;
- Mohammad Javad Zarif, foreign minister; and
- Muhammad Baqer Nobakht, head of the Management and Planning Organization of Iran.

As regards the SNSC and its members, Khamenei can easily exert his will and implement his preferred strategy, overruling the president as necessary.

Beyond his particular influence over the SNSC, Khamenei insists on having the final say on two issues: relations with the United States and Iran's nuclear policy. Khamenei carries out this program in both overt and subtle ways—by sabotaging Majlis legislation he opposes and, when he wishes for his efforts to be concealed, enlisting his various representatives around government to ensure his desires are realized.

According to Ayatollah Muhammad Taqi Mesbah-Yazdi, a hardline member of the Assembly of Experts, "Understanding the views of the leader of the revolution [Khamenei] is not easy. One must understand what he really means through evidence."[16] Corroborating such an interpretation, Khamenei himself said, "My official view is what I say in my speeches to people and meetings with officials. I may not say some of my views—partly in order to prevent the enemy from knowing them—but this does not mean that I lie."[17]

Hossein Shariatmadari, in a 2007 editorial, warned the Foreign Ministry of public statements by the Supreme Leader about

> direct negotiation with America—because what he says publicly in this regard is different from what is really going on "at the bottom of his heart." We expect from the ninth cabinet [under President Mahmoud Ahmadinejad] to understand the real intentions of the Master (Aqa) and to not walk in a direction which is suspected to be exploited by the Americans. It is possible that Aqa has permitted [the government to directly negotiate with the United States], but he should be willing about this in his blessed heart too. Is he willing?[18]

The Supreme Leader's ability to influence discourse, as well as legislative initiatives, was demonstrated notably three years ago. On June 26, 2011, a hundred members of parliament signed a letter seeking clearance to "question and possibly impeach the president [Ahmadinejad]" over fraud allegations and economic mismanagement.[19] But some parliament members claimed Khamenei might not be satisfied with this initiative, and the Majlis leadership subsequently removed the effort from its agenda. That October, Ali Motahhari, Tehran's Majlis representative, wrote to the Supreme Leader asking him to let the Majlis question the president.[20] The Supreme Leader did not respond, and Majlis deputy speaker Muhammad Reza Bahonar explained, "Elders of the regime [meaning Khamenei] do not believe this issue is expedient."[21] A few days later, the Majlis members withdrew their demand to question the president.

Hardliners close to Khamenei believe that sometimes he is forced to support elected officials for political reasons, but that this does not mean he is content with them or wants them shielded from pressure or attacks from his own followers. When Khatami was elected president, Khamenei once publicly expressed "one hundred percent" support for him. In a private meeting with the Supreme Leader, Abul Qassim Khazali, a former member of the Guardian Council and a prominent hardline figure, asked how he and others could criticize Khatami after such a statement of support. Khamenei replied that the sensitive conditions of the country required him to publicly back Khatami. "This does not mean that you should not criticize him," he continued. "If you have something to say, criticize him."[22]

The doctrine of "expediency of the regime," or *maslahat-e nezam*, has governed Iranian decisionmaking in previous generations as well. When Ruhollah Khomeini was Supreme Leader, he wrote to then interior minister Ali Akbar Mohtashamipur explaining that he did not want Mehdi Bazargan to be interim prime minister, Abolhassan Bani Sadr to be president, or Hossein Ali Montazeri to be his own deputy, but that expediency would allow for these figures to assume the positions. This historical context was noted by Mesbah-Yazdi when his followers asked him why Khamenei supported some figures known not to be "good." Said Mesbah-Yazdi, "Khamenei's support exists under particular circumstances. For him, safeguarding the interest [of the regime] is the ultimate religious duty."[23]

Hence, hardliners do not doubt that Khamenei identifies with their mindset, even if in practice he may let other policies be implemented or individuals be promoted to protect the regime's interests. Therefore, as soon as he feels the regime's interests can be protected without those other policies or individuals, he can act in the direction of what he "really" believes—rooted in the hardliners' camp.

Over the last twenty-five years, the *Kayhan* newspaper has mirrored Khamenei's detailed positions on various issues ranging from culture to foreign policy. *Kayhan* has been not only an effective tool in the psychological war against the Supreme Leader's critics but also a medium through which one could understand Khamenei's worldview. The paper is headed by Shariatmadari, a former intelligence interrogator and a representative of Khamenei whose hardline credentials have never been questioned. Typically, Shariatmadari's writings and speeches indicate what Khamenei "really" believes but does not want to spell out himself owing to obvious reservations.

Since Ayatollah Khamenei is not an omnipotent or even a charismatic leader like his predecessor, he cannot easily speak his mind or ask officials to follow him unquestioningly. This explains his tactic of temporarily accepting certain policies, leadership appointments, or election outcomes only to criticize or subvert them later. Thus, he ultimately undermined Khatami, just as Barzagan, Bani Sadr, and Montazeri were undermined by Khomeini.

In the negotiating team, Deputy Foreign Minister Abbas Araqchi is now known to be much closer than Zarif to Khamenei. Araqchi does not hesitate to echo the Supreme Leader's pessimism about the prospect of negotiations, as do many others in Rouhani's administration. Furthermore, according to Araqchi, even without a final agreement, Iran has gained a victory by altering the anti–Islamic Republic mood internationally:

> If we do not reach the result, this would not be a catastrophe...[In such a case] we go back to our program and they resume their sanctions, but the negative environment against the Islamic Republic would not be back...the other party [P5+1] is making efforts to prepare itself so in case of not reaching an agreement they would launch a psychological war and put the blame on us. We should prepare ourselves for the same thing.[24]

Quite relevant to today's nuclear talks is Khamenei's avowed support for Rouhani's efforts when he was chief nuclear negotiator from 2003 to 2005. The Supreme Leader publicly backed Rouhani's deal with the EU-3 (Britain, France, and Germany) to temporarily suspend uranium enrichment in exchange for European cooperation on various matters. Khatami's interior minister, Abdolvahed Mousavi Lari, has stated publicly that all decisions regarding nuclear policy were preapproved by Khamenei. Also, Rouhani, in his book on the nuclear talks, *National Security and Nuclear Diplomacy*, argues that the suspension would not have been possible without Khamenei's backing. While the world noted Rouhani's seemingly exceptional relationship with Iran's key decision-maker, the Supreme Leader would later deny he was satisfied with the move as Ahmadinejad came to power. This shows Khamenei's ability to support a decision at a particular time despite his opposition simply because he feels the alternative might be costly or infeasible.

Iran and the P5+1 might reach a final agreement over Iran's nuclear program, although one can argue that the final agreement is neither the end of the negotiations nor the end of the nuclear crisis. Even if the final agreement is signed off on by the Iranian negotiation team with Khamenei's explicit permission, this does not mean he is satisfied with the agreement. Past experience shows he might deny his role in the current negotiations or potential agreement if he ceases to feel forced to comply with its terms.

Notes

1. Speech at Imam Hossein University, May 21, 2014 . See YouTube video, posted by Manuchehr Lenziran, 24:49, May 22, 2014, http://www.youtube.com/watch?v=p_VjeJWy9hM.
2. Burns's outreach to Iran is referenced in Michael R. Gordon, "Diplomat Who Led Secret Talks with Iran Plans to Retire," *New York Times*, April 11, 2014, http://www.nytimes.com/2014/04/12/world/official-who-led-secret-talks-with-iran-plans-to-retire.html?_r=0.
3. Mahmoud Alavi, speech addressing the deputies of the Ministry of Intelligence, June 2014, http://www.entekhab.ir/fa/news/165003.
4. Ibid.
5. For a version of this passage, see Center for Preserving and Publishing the Works of the Grand Ayatollah Sayyid Ali Khameini, "Supreme Leader Meets with Director, Managers, and Experts of Atomic Energy Organization of Iran," April 9, 2014, http://english.khamenei.ir/index.php?option=com_content&task=view&id=1894.
6. See ibid. for a version of this passage.
7. Reuters, "Iran's Khamenei Says Not Optimistic on Nuclear Talks: IRNA," February 17, 2014, http://www.reuters.com/article/2014/02/17/us-iran-nuclear-khamenei-idUSBREA1G0DD20140217.
8. See a report on his speech (in Persian) on his official website: at http://farsi.khamenei.ir/news-content?id=27180.
9. Ibid.
10. See, for example, Simon Tisdall, "Hassan Rouhani Faces Growing Criticism in Iran over Nuclear Talks," *Guardian*, May 4, 2014, http://www.theguardian.com/world/2014/may/04/hassan-rouhani-iran-nuclear-talks.
11. See (in Persian) http://www.irangreenvoice.com/article/2012/dec/28/31315.
12. Ibid.
13. See, for example, Neil MacFarquhar, "Elections in Iran Favor Ayatollah's Allies, Dealing Blow to President and His Office," *New York Times*, March 4, 2012, http://www.nytimes.com/2012/03/05/world/middleeast/iran-elections-deal-blow-to-ahmadinejad-and-the-presidency.html?pagewanted=all; Geneive Abdo, "The End of Rouhani's Honeymoon," Aljazeera, February 18, 2014, http://america.aljazeera.com/opinions/2014/2/hassan-rouhani-iranalikhameneinuclearnegotiations.html.
14. See, for example, Babak Dehghanpisheh, "Insight: Nuclear Deal Heightens Tensions between Iran President and Guards," Reuters, February 9, 2014, http://mobile.reuters.com/article/idUSBREA1804120140209?irpc=932.
15. Shamkhani's service as defense minister under Khatami, who officially selected him, does not suggest his closeness to Khatami but rather Khamenei's level of trust in Shamkhani. Shamkhani himself actually competed against Khatami during the latter's second presidential run—and lost.
16. Published by Mehr News Agency, August 7, 2007 (16 Mordad 1386).

17. Published by the Iranian Students News Agency, October 10, 2007 (18 Mehr 1386).
18. Delivered May 20, 2007 (30 Ordibehesht 1386).
19. Muhammad Sahimi, "Leading Legislator Resigns after Plan to Grill President Denied," *Frontline*, PBS, October 15, 2011, http://www.pbs.org/wgbh/pages/frontline/tehranbureau/2011/10/leading-legislator-resigns-after-plan-to-grill-president-denied.html.
20. Ibid.
21. See (in Persian) http://www.rahesabz.net/story/44552/.
22. See (in Persian) http://washin.st/WjnFNX.
23. See the transcript of the full speech on Mesbah-Yazdi's official website: http://mesbahyazdi.ir/node/358.
24. Abbas Araqchi, speech at "National Conference on Analysis of the Nuclear Policy under the Eleventh Government [Rouhani's cabinet]": see a BBC Persian report on Araqchi's remarks: http://www.bbc.co.uk/persian/iran/2014/08/140819_l12_iran_araghchi_nuclear_deal.shtml.

4

Conclusion

IMPLICATIONS FOR U.S. POLICY

PERHAPS A NUCLEAR DEAL will strengthen Rouhani and lead to an improvement in U.S.-Iran relations. Presumably, the deal would lead to higher growth and smoother interactions with the outside world, improvements that would convince Khamenei and some hardliners that Rouhani's strategy of compromise and coexistence with the West can pay off. Rouhani would then gain greater authority over other issues of concern to the United States such as Iran's role in the region from Lebanon/Syria to Afghanistan, particularly Iran's support for global terror activities by the Quds Force and Hezbollah. In this scenario, Iran and the United States would, over time, work out rules for acceptable competition and thereby normalize their relationship along the lines of what detente produced for U.S.-Soviet relations.

Such a positive outcome is possible, but it is by no means guaranteed. Some far less desirable results are also a strong possibility. At the very least, a nuclear deal might have little impact on other areas of Iranian policy. But much worse, if a nuclear deal led to Iranian disappointment, it could eventually collapse, with each side blaming the other for the breakdown. Two major reasons for the less optimistic scenarios have been discussed earlier in these pages.

Khamenei's institutional interest in greater power for the Office of the Leader inclines him toward undercutting other institutions, be it the Majlis or the presidency; indeed, Iran's last three presidents suffered this fate after their first two years in office. Moreover, Khamenei has expressed, clearly and repeatedly, his belief that the West is not to be trusted and that resistance works much better than compromise, a premise that is not consistent with Western approach.

Another issue is that in the aftermath of a nuclear deal, Iran's economy might not improve apace with public expectations. The barriers to improving the economy are many, and even a complete and immediate removal of sanctions might not lead to enough economic improvement to satisfy a demanding Iranian public, much less hardline skeptics. The reality is that nuclear sanctions will be lifted only over time and important other sanctions will remain in place so long as the Islamic Republic pursues its current policies.

In addition, it is by no means clear that a Rouhani empowered by a nuclear deal would press for change in other Iranian policies to which the United States has objected. Thus far, he has been a man of the system. He may see little reason to modify Iran's support of terrorism and its destabilization of neighbors, much less its human rights stance at home. In his public speeches, he has certainly provided no indication that he would change the nonnuclear policies to which the United States objects.

The United States can do little to influence which scenario comes to pass, optimistic or pessimistic: so much depends on Iran's internal political dynamics, in which the United States is at most only a minor player. For instance, the Rouhani administration's ability to implement serious economic reforms will have as much impact on the economy as the easing of sanctions. Moreover, Khamenei's relations with Rouhani depend on many issues beyond the nuclear program, yet the state of those relations will influence whether Khamenei undercuts the deal.

Since there are no guarantees that a nuclear deal will lead to a change in Iranian policies outside the nuclear realm, any such deal should be evaluated on the basis of its impact on the nuclear impasse, not on its putative benefits outside the nuclear realm. It would be inappropriate for Washington to enter into a nuclear deal because of its expected impact on overall U.S.-Iran ties.

Furthermore, there is a real risk that if enough Iranians become disaffected with the deal, arguing that their country is not benefitting sufficiently for what it has given up, they will blame the West for not living up to its side of the bargain or decide that the bargain was a bad one to begin with ,or both. Therefore, the structuring of the deal could have a major impact on how Iran's post-deal narrative unfolds. A deal will be more likely to be sustained if it accomplishes two not entirely consistent goals:

- to provide Iran with an immediate and noticeable benefit from agreeing to a deal; and

- to provision benefits for Iran at each point that outweigh the costs of walking away from—or chipping away at—the deal.

This tack argues for both a large upfront component and a continuing stream of additional benefits, as well as a clear and credible penalty if Iran fails to comply. Perhaps the best way to accomplish these objectives is to concentrate the initial sanctions relief on lifting the block on some $100 billion in foreign exchange reserves to which Iran has limited access. Unblocking part of those funds will have a more immediate economic impact than would reducing trade restrictions, and a schedule for release of further funds would provide a clear and credible incentive to stick with the deal. However, a serious barrier exists to unfreezing funds as a way to incentivize Iran: the "derisking" strategies used by commercial banks to avoid transactions that might later get them into trouble with regulatory authorities. It would be most unfortunate for Washington to take a laissez-faire approach toward Iran's relations with commercial banks, because few people anywhere—Iran, the United States, internationally—would believe that a commercial bank's refusal to conduct business with Iran was its own decision: Washington's hidden hand would be blamed. If the United States and its partners promise asset release to Iran, they should commit to taking whatever steps are necessary to ensure Iran actually has access to those funds.

In short, many delicate and difficult issues will remain after a nuclear deal. Negotiators should bear in mind that the deal is a means to an end, not the end of the story. Structured badly—in such a way as to inflame Khamenei's fears and without proper incentives—a deal could end up worsening the nuclear impasse and overall U.S.-Iran relations. In going forward, then, the challenge will be to make a deal as sustainable as possible.

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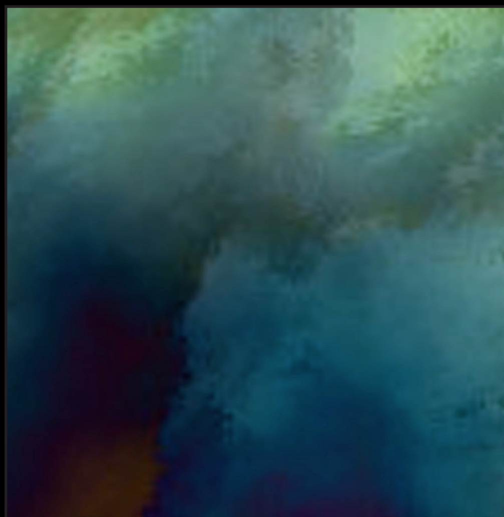

A POSITIVE OUTCOME IS POSSIBLE, but is by no means guaranteed: some far less desirable results are also a strong possibility. At the very least, a nuclear deal might have little impact on other areas of Iranian policy. But much worse, if a nuclear deal led to Iranian disappointment, it could eventually collapse, with each side blaming the other for the breakdown.

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