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# Sanctioning Iran: Implications and Consequences



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## Executive Summary

This briefing seeks to address the impact of unprecedented sanctions passed against the Islamic Republic of Iran in 2012.

Firstly, the briefing examines the logic behind Western sanctions, as well as their objectives and how extra-territorial sanctions might be constrained by Great Power rivalry. The paper then goes on to catalogue the impact of sanctions in the energy and financial sectors. It also attempts to distinguish where government policy and Western-led sanctions might be held “responsible” for Iran’s present economic condition.

An outline of how sanctions on oil and P&I (Protection and Indemnity) coverage has impacted Iranian oil sales, with each one of its primary buyers e.g. Japan, Turkey, South Korea, China etc. is provided. With the overall trend being one of declining oil purchases, the crucial questions are whether Iran is able to prevent a further marked decrease, and whether the various *ad hoc* measures it has adopted will prevent another precipitous decline. What is clear is that Iran’s fate will in large part hinge on the actions of China going into the future.

The briefing then goes on to look into the growing authoritarian consolidation in the Islamic Republic, and how sanctions have helped catalyse an already pre-existing tendency, in which the Islamic Revolutionary Guard Corps (IRGC) has sought to play a decisive role in the development of Iran’s energy sector.

The next section then briefly addresses Tehran’s on-going currency crisis, and the implications of the devaluation of the rial, and the re-emergence of multiple exchange rates.

The briefing also analyses the Islamic Republic’s strategies for mitigating the impact of sanctions are examined, and it is concluded that the Iranian government has yet to forge a comprehensive strategy, and that the current measures in place are largely reactive and *ad hoc* in nature.

Next, the briefing looks at the impact of high levels of inflation on the standard of living of ordinary Iranians and the political establishment’s reactions to the rising cost of living. These reactions show that the regime, even its most conservative elements are aware of the problem, and realise that if the price of bread is not brought under control, the prospect of a restive population is all too real.

The paper then goes on to analyse how the sanctions and current economic turbulence have impacted domestic factional infighting, and how such infighting has been exacerbated by tensions sparked by a number of President Ahmadinejad’s economic policies, and his troubled relationship with the Majles.

The final section assesses the efficacy of sanctions as part of a more comprehensive diplomatic strategy and how the West should best leverage the current policy to the end of constructive engagement in order to end the impasse and proliferation risks which continue to surround Iran’s nuclear programme.

## The Logic behind Western Sanctions

There are three readings of the logic behind Western sanctions, in particular, U.S. unilateral sanctions:

- 1) To cause Iran to change policy, compromise on the scale and ambitions of its nuclear programme, and ensure that all proliferation risks i.e. possible military dimensions (PMDs) and highly enriched fissile material, which the P5+1 states fear provide Iran with a “nuclear weapons

capability” i.e. the ability to build a nuclear weapon in a short space of time, if it were to leave the Non-Proliferation Treaty and eject the IAEA’s inspectors are eliminated.<sup>1</sup>

- 2) To cause Iran to scale back its nuclear programme to the research level, and forgo all uranium enrichment. Republican presidential nominee Mitt Romney has unambiguously stated this as his position, and it has been the West’s objective in the past.<sup>2</sup>
- 3) To target the lifeblood of the Iranian regime, provoke civil unrest, and ultimately aid the regime’s overthrow. Advocates of this reading of U.S. sanctions policy cite the Johnson-Shelby Iran Sanctions, Accountability and Human Rights Act of 2012, which was passed by the Senate in May 2012, as an appropriate example.<sup>3</sup> The removal of the People’s Mojahedin of Iran from the State Department’s list of terrorist organisations, has also been claimed by Iranian MPs as proof of Washington’s desire to push for “regime change”.<sup>4</sup>

### Great Power Rivalry and Sanctions

While there have been meetings between the P5+1 and Iran in Istanbul, Baghdad, Moscow, significant differences continue to divide the two sides, and the immediate response by the western members of the P5+1, has been to ramp up the pressure further through sanctions. Even prior to the Baghdad talks, which proved inconclusive, Congress had passed a new round of sanctions against Iran.<sup>5</sup>

An important question, which sanctions advocates need to ponder, is how effective can the current sanctions strategy be in the medium to longer term, in the face of the recalcitrance of other major powers, namely Russia, India and China, to taking additional multilateral measures against Iran.

As alluded to above, Western sanctions are themselves constrained by divergent Great Power competition, interests and rivalry.<sup>6</sup> Both Russia and China have proven themselves reluctant in the past to back further sanctions against Iran. The main reason in the case of China is because its growing economy relies heavily upon Iranian oil. This is despite the slowdown in Chinese economic growth rates as a result of the global economic slump. China has benefited greatly from U.S. unilateral sanctions, which have been in place and piling up since the Iran-Libya sanctions Act (1995) passed by the Clinton administration.<sup>7</sup> China had signed potentially lucrative agreements to develop Iran’s Azadegan and South Pars oil and gas fields, though it was reported in July that the China National Petroleum Corporation (CNPC) had decided to pull out of the eleventh phase of South Pars. The \$4.7 billion deal had been signed in 2009, with CNPC replacing Total.<sup>8</sup>

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<sup>1</sup> Of course barring the highly unlikely eventuality that Iran might have a secret enrichment facility at which it is enriching weapons grade uranium.

<sup>2</sup> Did Romney Offer an Alternative on Iran?, *Commentary*, 24/07/2012 <http://www.commentarymagazine.com/2012/07/24/did-romney-offer-an-alternative-on-iran-obama-vfw-foreign-policy-speech/>; Also see, *Nuclear Iran: The Birth of an Atomic State*, David Patrikarakos, I.B. Tauris; London, 2012, p214

<sup>3</sup> Though the House of Representatives and the Senate are yet to come to a final agreement over the bill, and there are doubts whether the two houses will reach an agreement before the next Congressional session. For details, please see Josh Rogin’s account of the bill upon which both the Senate and House of Representatives are yet to reach an agreement: Will Congress pass new Iran sanctions this year?, Josh Rogin, *Foreign Policy*, 11 July 2012, [http://thecable.foreignpolicy.com/posts/2012/07/11/will\\_congress\\_pass\\_new\\_iran\\_sanctions\\_this\\_year](http://thecable.foreignpolicy.com/posts/2012/07/11/will_congress_pass_new_iran_sanctions_this_year)

<sup>4</sup> Rais komisiun-e amiyat-e melli-ye majles dar goftogu ba Fars: Amrika hami-ye monafeghin ast, Fars News, 08/07/1391 <http://www.farsnews.com/printable.php?nn=13910708001221>

<sup>5</sup> U.S. approves new sanctions against Iran ahead of Baghdad talks, *Al Arabiya*, 22 May 2012, <http://english.alarabiya.net/articles/2012/05/22/215678.html>

<sup>6</sup> *Sanctions as Grand Strategy*, Brendan Taylor, The International Institute for Strategic Studies, Routledge, p15

<sup>7</sup> *Iran: The Nuclear Challenge*, ed. Robert D. Blackwill, Council on Foreign Relations, 2012, p13

<sup>8</sup> China pulls out of Iranian giant South Pars gas field, *Trend*, July 29 2012, <http://en.trend.az/regions/iran/2051377.html>

Notwithstanding, various not insignificant “bumps in the road”, and the concerns of some Iranian politicians over China’s precipitous increase in importance in determining Iran’s economic vitality,<sup>9</sup> over 100 Chinese companies are said to be operating in Iran, and China as of yet has shown little sign of a desire to considerably wind down its economic ties with the Islamic Republic.<sup>10</sup> China also views the American position not as being essentially driven by concern for the non-proliferation regime, but rather guaranteeing U.S. hegemony in the region. That being said, it can be stated with confidence China would not welcome the prospect of a nuclear armed Iran.

Russia has a comparable view, but has proven more willing to bargain its support for Iran into tangible concessions from the United States. For this reason there have been repeated statements emanating from Tehran, that its faith in Russian support is far from assured, even if for the moment the latter remains unwilling to join the U.S. directly in dialling up economic pressure against Tehran. Russia, while not possessing substantial trade ties with Iran (it doesn’t even feature in Iran’s top ten trading partners<sup>11</sup>), has been reluctant to advocate sanctions since it believes them destabilising for the region, and could possibly result in armed conflict. Moreover, the possible fall of the Assad regime, has arguably made buttressing Tehran all the necessary.

Tehran’s increasing dependence upon China and Russia, has not been wholly welcomed. In fact Asadollah Asgarowladi, who heads the Iran-China Chamber of Commerce, and whose brother, Habibollah, is the former Secretary-General of the influential traditional rightist (*rast-e sonnati*) Islamic Coalition Party, which represents Conservative clerical and bazaari interests, has described the increase in trade between the two countries as deriving more out of necessity than design.<sup>12</sup>

### Loss of Iranian Oil Export Revenues

Advocates of crippling sanctions understood early on that Iran’s energy sector is the state’s lifeblood and key source of revenue, constituting an estimated 70-80% of the country’s oil export earnings and an estimated 50% of total income.

The EU oil embargo came officially into effect on July 1, itself a response to U.S. legislation which penalizes any entity which deals with Iran’s Central Bank, through which Iran’s oil revenues have traditionally been channelled.<sup>13</sup> Europe had accounted for approximately 20% of Iranian oil revenues. The embargo did not enact an immediate shock to the Iranian economy, or the oil market since traders had already factored in the approximately 1 million bpd of Iranian oil which would exit the market. Saudi Arabian, Iraqi, Libyan and U.S. increases in production have also thus far forestalled any major spikes in oil prices, which are Tehran’s best chance to cushion the considerable loss in export earnings.

In the face of the July 1 European oil embargo, Iran’s rhetoric directed at the outside world has remained defiant, but there have been an increasing number of admissions by senior leadership figures that sanctions are having serious negative effects on the Iranian economy. While President Ahmadinejad had initially acknowledged that the latest round of sanctions are the toughest yet, his retort was that Western policy would only compel Iran to wean itself off oil revenues, and thus decrease the nation’s dependency on them.<sup>14</sup> This, however, seems wishful thinking, since oil revenues would ideally be necessary in order to stimulate the growth of domestic industries, which can only be a long-term strategic objective and not

<sup>9</sup> An Insider’s View: Iran Ready to Do Business with the West, *Tehran Bureau*, 24 June 2012, <http://www.pbs.org/wgbh/pages/frontline/tehranbureau/2012/06/media-watch-an-insiders-view-iran-ready-to-do-business-with-the-west.html>

<sup>10</sup> *Sanctions as Grand Strategy*, Brendan Taylor, The International Institute for Strategic Studies, Routledge, p88

<sup>11</sup> Iran: Main Economic Indicators, European Union, [http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc\\_113392.pdf](http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_113392.pdf)

<sup>12</sup> Asgarowladi: chareh joz emtiyaz dadan nadarim, *Khodnevis*, Soroush Jafari, 12 Mordad 1391www.khodnevis.org

<sup>13</sup> Iran tries to dodge oil sanctions, Amir Paivar, *BBC News*, 29 June 2012 <http://www.bbc.co.uk/news/world-middle-east-18640746>

<sup>14</sup> Ahmadinejad: bayad tahrir ra forsati baraye kahesh-e vabastegi be naft bebinim, *BBC Persian*, 3 June 2012 [http://www.bbc.co.uk/persian/iran/2012/07/120703\\_103\\_iran\\_oil\\_nuclear.shtml](http://www.bbc.co.uk/persian/iran/2012/07/120703_103_iran_oil_nuclear.shtml)



a short-term solution to Western pressure. It also wouldn't solve the difficulties Iran faces as a result of U.S. extra-territorial financial sanctions. While Ahmadinejad's statements concur with the Islamic Republic's ideological emphasis on "autarky" and "independence", they do little to help Tehran confront the immediate and considerable drop in revenues, to which the Iranian state has now to become accustomed.

In 2011, Saudi Arabia, the world's largest oil exporter, had oil export revenues valued at \$318.5 billion, compared with \$215.4 billion in 2010. A considerable increase in oil export earnings, and also part of the reason for the aversion of the spike in oil prices some analysts had feared.<sup>15</sup> Iran's oil revenues also increased in 2011 compared with 2010 from \$72.2 billion to \$114.8 billion, despite a decrease in shipments of 8.5%.<sup>16</sup> The influx of high revenues, especially when compared with historical precedent, might be thought of as both a blessing and a curse, since as will be shown below, poor economic management and spending policies, have caused as many problems as they have solved.

Since August 2012, Iran has been losing an estimated \$133 million per day as a result of U.S.-led sanctions.<sup>17</sup> According to figures compiled by Bloomberg, Iran has been confronted with a decrease in oil exports of 1.2 million bpd, tantamount to \$48 billion in revenues annually, and estimated at approximately 10% of the Iranian economy.<sup>18</sup> Iranian oil revenues have and most likely will continue to decline. The rate at which they decline is contingent on how quickly Tehran can find buyers for its oil, and find creative means of circumventing the European embargo. There are few reasons to be sanguine, especially if Majles Deputy Speaker, Mohammadreza Bahonar's slip on 23 September that Iranian oil exports in July fell to approximately 800,000 bpd, or two thirds of what they were last year, is accurate.<sup>19</sup> The International Energy Agency (IEA) reported an increase in August to 1.1m bpd, but this small gain is likely to fall again in the event of further sanctions.<sup>20</sup>

In June 2012, Turkish purchases of Iranian oil decreased from 180,000 bpd to 110,000 bpd compared with June of the previous year;<sup>21</sup> a net decrease of some 39%.<sup>22</sup> As a result, Turkey was granted a waiver by the United States and for the time being seems like it will initiate further cuts in the future. Increases in crude imports from Saudi Arabia, Russia, Libya and Iraq also seem to imply the prospect of additional cuts in the coming months.<sup>23</sup> The fact that the two nations have locked horns indirectly over the turmoil in Syria has not helped matters either. A planned delegation to Turkey to ensure sales would continue headed by the Iranian Oil Minister, Rostam Qassemi, was cancelled.<sup>24</sup> The precise reason for the cancellation remains unclear, but given Turkey's heavy reliance on Iranian gas, and non-oil trade and tourism, it is unlikely that the two nations will publicly clash.

<sup>15</sup> OPEC Reports Saudi, Iran's Oil Revenues in 2011, *BEDigest*, 18/07/2012

<http://www.bedigest.com/NEWS/75777.aspx>

<sup>16</sup> Ibid <http://www.bedigest.com/NEWS/75777.aspx>

<sup>17</sup> Iran Loses \$133 Million a Day on Embargo as Oil Buys Obama, Anthony DiPaola and Isaac Arnsdorf, *SFGate / Bloomberg News*, 2 August 2012 <http://www.sfgate.com/business/bloomberg/article/Iran-Loses-133-Million-a-Day-on-Embargo-as-Oil-3757459.php>

<sup>18</sup> Ibid, <http://www.sfgate.com/business/bloomberg/article/Iran-Loses-133-Million-a-Day-on-Embargo-as-Oil-3757459.php>

<sup>19</sup> Deputy Majlis Speaker Confirms Sharp Drop in Iran's Oil Exports, *BEDigest*, 24/09/2012

<http://www.bedigest.com/NEWS/78021.aspx>

<sup>20</sup> Iran's crude exports back over 1m barrels, Guy Chazan, *Financial Times*, 12 September 2012

<http://www.ft.com/cms/s/0/345dd39e-fcad-11e1-ba37-00144feabdc0.html>

<sup>21</sup> Varedat-e naft-e torkieh az Iran dar mah-e zhuan, *Radio Farda*, 16/04/1391

<http://www.radiofarda.com/archive/news/20120706/143/143.html?id=24637536>

<sup>22</sup> Ibid, <http://www.radiofarda.com/archive/news/20120706/143/143.html?id=24637536>

<sup>23</sup> Turkey: weaning off Iranian oil, David O'Byrne, *Financial Times*, 31 July 2012 <http://blogs.ft.com/beyond-brics/2012/07/31/turkey-weaning-off-iranian-oil/#ixzz260mz4y05>

<sup>24</sup> Laqv-e didar-e nafti-ye maqamat-e Iran ba torkieh, *Alef*, 14 Mordad 1391,

<http://alef.ir/vdcb9fb8arhb08p.uiur.html?163194>

While Iranian-Turkish relations have undeniably reached one of their lowest points in recent years, this rift should not be exaggerated however, since the two continue to have considerable bi-lateral trade relations, reaching \$16 billion in 2011.<sup>25</sup> Iran and Turkey have been able to maintain a relatively stable relationship post-1979, largely because they have been successful in compartmentalising their disagreements, and have not allowed them to jeopardise longstanding cooperation on the so-called “Kurdish question”, and above all energy. Given these factors, as well as numerous other shared interests and historic ties, it is unlikely Turkey will take a more overtly aggressive posture vis-à-vis Iran than it has during the first half of 2012.<sup>26</sup>

On 20 June 2012, Japan’s parliament provided sovereign guarantees of \$7.6 billion for Japanese shipping companies transporting Iranian oil in response to the EU oil and insurance embargo, as a result of concerns over the embargo’s negative impact upon Japan’s own economy.<sup>27</sup> In 2011, Iran supplied 9% of Japanese oil demands. Nonetheless, Japanese purchases of Iranian oil were down this summer by over half the volume they stood at in July last year,<sup>28</sup> and they are set to decrease for the remainder of 2012.<sup>29</sup> It remains to be seen how sustainable Japan’s policy is into the longer term, especially if U.S. extra-territorial sanctions continue to expand their reach and eventually force Japan to end all Iranian oil purchases under threat of being heavily penalised. Other questions which are yet to be answered are whether Japan can insure up to pre-embargo volumes, which seems very unlikely, or whether as far as Japan is concerned this is merely an intermediary solution until it can replace Iranian oil with an appropriate substitute.

Switzerland has passed limited sanctions which affect supplies for the petrochemical industry, telecommunications equipment, as well as the purchase and sale of precious metals and diamonds. Switzerland did not however adopt the European oil embargo, but does not import Iranian oil in any case, so the most recent Swiss sanctions won’t affect Iranian oil income.<sup>30</sup>

Despite the recent return of Chinese oil purchases to their pre-March 2012 levels in June 2012, it is unclear whether China will replace lost Iranian revenues by increasing their demand for Iranian oil, even at sizable discount. China continues to be Iran’s most important purchaser of oil, buying around 20% of Iran’s total oil exports. In 2011, these amounted to approximately \$16 billion.<sup>31</sup>

Many analysts have argued that the U.S. had little choice but to grant Beijing a waiver and Washington’s move was primarily a face-saving gesture. It is not politically expedient or perhaps even desirable for the U.S. to sanction China or push it to the point whereby it will have to cease all business with the Islamic Republic. Iranian oil tankers are able to carry some 20 million barrels of oil and Beijing has been using Iranian vessels to sidestep sanctions since July.<sup>32</sup> If China were prepared to use its own ships to cargo

<sup>25</sup> Turkey and Iran: A Fraying Relationship or Business as Usual?, Daphne MCurdy and Nick Danforth, *Foreign Policy*, 28 February 2012

<sup>26</sup> Ibid

<sup>27</sup> Iran Loads Oil for Japan on Tokyo-Insured Tankers, BEDigest, 22/07/2012

<http://www.bedigest.com/NEWS/75898.aspx>

<sup>28</sup> How Iran’s Main Oil Buyers Deal with Insurance Sanctions, Insurance Journal / Reuters, 30 August 2012

<http://www.insurancejournal.com/news/international/2012/08/30/261204.htm>

<sup>29</sup> Japan’s Iran Oil Imports to Drop Further for Rest of 2012, BEDigest, 30/09/2012

<http://www.bedigest.com/NEWS/78180.aspx>

<sup>30</sup> Swiss opt against Iran oil ban despite U.S., EU moves, Reuters, 5 July 2012

<http://www.reuters.com/assets/print?aid=USL6E8I58CQ20120705>

<sup>31</sup> *Iran: The Nuclear Challenge*, ed. Robert D. Blackwill, Council of Foreign Relations, p17

<sup>32</sup> How Iran’s Main Oil Buyers Deal with Insurance Sanctions, Insurance Journal / Reuters, 30 August 2012

<http://www.insurancejournal.com/news/international/2012/08/30/261204.htm>

Iranian oil, then that could be of significant help to Tehran in increasing export levels.<sup>33</sup> Thus far, Beijing hasn't been forthcoming in making any such offer.

Iran-Chinese relations are far from invulnerable to pressure from Western sanctions, however. In a meeting with Parliamentary Speaker, Ali Larijani in September 2012, the Chairman of the Congress of the People's Republic of China, had complained of how sanctions have hampered Chinese investment opportunities in the Islamic Republic.<sup>34</sup> Not only has Chinese CNPC pulled out of the \$4.7 billion deal to develop the eleventh phase of South Pars, Iran also suspended a contract with a Chinese company to build a liquefied natural gas plant in the Persian Gulf port of Assaluyeh, valued at \$3.3 billion, because the Chinese group was unable to finance the project.<sup>35</sup> The question is thus not whether Western sanctions will impinge upon Chinese-Iranian economic ties, they very clearly do, but rather a question of the extent and depth of their impact, and whether Beijing and Tehran, over time, will fashion innovative means of circumventing U.S.-led sanctions.

India, which is the third largest purchaser of Iranian oil, has also agreed to provide insurance for Iranian oil shipments. However, as a result of sanctions and subsequent asset freezes, the Shipping Corp of India will end its joint venture of 37 years with the Islamic Republic of Iran Shipping Lines.<sup>36</sup> Due to the intervention of the Indian government, in response to the redundancy of some 95% of Protection & Indemnity (P&I) clubs due to the European oil embargo, Indian insurers have agreed to provide \$100 million of cover per voyage to allow shipments to continue.<sup>37</sup> Nevertheless, Indian oil purchases will decrease in the coming year by a projected 11%.<sup>38</sup> This is most likely the result of the lower cover offered by Indian insurers, because their access to reinsurance has been blocked, which will in turn hamper the amount which can be realistically shipped. India is offering a mere \$50 million in indemnity insurance compared to the usual \$1 billion, and thus another vital question arises as to who will cover the costs of an oil clean up if an accident should occur in third party waters?<sup>39</sup> This might be part of the reason why India's top oil buyer Mangalore Refinery and Petrochemicals Ltd, despite receiving embargo waivers, has been purchasing significant volumes of Omani oil to compensate for the shortfall in Iranian supplies.<sup>40</sup>

South Korea, another key purchaser of Iranian oil had said it would suspend all oil imports from the Islamic Republic as of July, so as to comply with U.S. sanctions. But two of its refineries, SK Energy and Hyundai Oil bank have continued to import Iranian crude. According to the state-run Korea National Oil Corp, Seoul imported 137,400 bpd in July, 42 percent lower than a year earlier.<sup>41</sup> Seoul has previously refused Iran's offers of sovereign insurance for oil shipments,<sup>42</sup> even though the Economy Ministry had

<sup>33</sup> Iran Loses \$133 Million a Day on Embargo as Oil Buys Obama, Anthony DiPaola and Isaac Arnsdorf, *SFGate / Bloomberg News*, 2 August 2012 <http://www.sfgate.com/business/bloomberg/article/Iran-Loses-133-Million-a-Day-on-Embargo-as-Oil-3757459.php>

<sup>34</sup> Rais-e majles-e chin dar didar ba Larijani matrah kard: enteqad az amrika be dalil-e ijad-e mahdudiyat baraye sherkat-ha-ye chini jahat-e sarmayehgozari dar Iran, *Khabar Online*, 21/06/1391 <http://www.khabaronline.ir/print/242408/politics/parliamen>

<sup>35</sup> Iran Suspends Major LNG Contract with China, *BEDigest*, 03/09/2012 <http://www.bedigest.com/NEWS/77346.aspx>

<sup>36</sup> India-Iran Shipping JV Folds Under Sanctions Pressure, Anirban Chowdhury, *Wall Street Journal*, 26 July, 2012 [http://online.wsj.com/article/SB10000872396390443343704577550362034321848.html?mod=googlenews\\_wsj](http://online.wsj.com/article/SB10000872396390443343704577550362034321848.html?mod=googlenews_wsj)

<sup>37</sup> Iran Oil Shipping To Resume As Insurers Step In: Corporate India, Pratish Narayanan and Karthikeyan Sundaram, *Bloomberg*, 2 August 2012, <http://www.bloomberg.com/news/2012-08-01/iran-oil-shipping-to-resume-as-insurers-step-in-corporate-india.html>

<sup>38</sup> *Ibid*, <http://www.bloomberg.com/news/2012-08-01/iran-oil-shipping-to-resume-as-insurers-step-in-corporate-india.html>

<sup>39</sup> Conversation with Robin Mills, Head of Consulting at Manaar Energy Consulting, 30/08/2012

<sup>40</sup> How Iran's Main Oil Buyers Deal with Insurance Sanctions, *Insurance Journal / Reuters*, 30 August 2012 <http://www.insurancejournal.com/news/international/2012/08/30/261204.htm>

<sup>41</sup> *Ibid* <http://www.insurancejournal.com/news/international/2012/08/30/261204.htm>

<sup>42</sup> South Korean Oil Imports From Iran: Not Quite Zero, Min-Jeong Lee, *Wall Street Journal*, 23 August 2012 <http://blogs.wsj.com/corruption-currents/2012/08/23/south-korean-oil-imports-from-iran-not-quite-zero/>



announced that as of September 2012, Iranian oil shipments would increase up to 200,000 bpd.<sup>43</sup> Nevertheless, Seoul should not have much trouble obtaining a further sanctions waiver from the U.S. in December, because their purchase of Iranian oil would have decreased by 20% since last year.<sup>44</sup>

Iran's best hope for damage control under Western pressure is high oil prices, which will also have the added effect of encouraging the evasion of sanctions. The national budget was calculated on the premise of \$85 per barrel,<sup>45</sup> while the IMF has estimated Iran needs prices to stand at \$117 per barrel for it to meet its budgetary requirements.<sup>46</sup> This estimate was projected before the initiation of the European oil embargo, and thus Iran will need an even higher spike in oil prices if it is going to avoid the destabilising effects of massive losses of oil revenue.

At the beginning of September 2012, the price of Brent crude was \$114 per barrel, and this is not even factoring in the sizable discount Iran has started to offer,<sup>47</sup> the bartering agreements by means of which goods are swapped for oil, and private sales on which it will be forced to pay commissions.<sup>48</sup> All of these issues reduce the amount of hard currency that will flow into Iran's coffers. It therefore appears that Iran's only real recourse for the time being is serious austerity measures, which will increase with time, and add to the difficulties of ordinary Iranians, including the regime's key base of support.

### Revolutionary Guards' Economic Consolidation

Before the most recent sanctions, Iran's energy sector had long been in a state of limbo. Southern Pars Gas field has remained undeveloped, despite the pledge of Iran's oil minister, Rostam Qassemi to undertake a major overhaul of its extracting capacity, which is embarrassingly outstripped by the rate at which Qatar is extracting gas, from the shared gas field.<sup>49</sup> Not a single phase of this huge gas field has been developed to completion during Ahmadinejad's presidency. Iran's ability to extract gas has been a longstanding problem, but in the immediate present, with U.S. sanctions on the energy sector, Tehran will struggle on figuring out how and to whom to sell its gas, given its loss of the European market and the constraints on its primary oil purchasers.

A \$25bn contract for the development of South Pars is presently in the hands of Khatam al-Anbia, the Revolutionary Guards' engineering arm, and is reported to have made little progress. Shell and Total were forced to withdraw under U.S. pressure several years ago.<sup>50</sup> The Ministry of Oil has stated that it requires approximately \$200 billion for the development of the gas and oil industry. This level of

<sup>43</sup> South Korean Refiner Resumes Importing Iran's Oil, *Reuters / BEDigest*, 23/09/2012  
<http://www.bedigest.com/NEWS/77971.aspx>

<sup>44</sup> Ibid

<sup>45</sup> Iran's budget revised higher at \$453 bn, *AFP*, 20 May 2012  
<http://www.google.com/hostednews/afp/article/ALeqM5hVkpV9vGyWMSTmlpkUY9ryBaszYg?docId=CNG.a8f5da375be2d2302fea54446d2bf8d9.361>

<sup>46</sup> Iran feels sanctions pain as oil income slumps, *Reuters*, 11 June 2012  
<http://in.reuters.com/article/2012/06/11/iran-oil-revenues-idINL5E8H78K120120611>

<sup>47</sup> Last year, the Turkish crude importer, Tupras, renewed a long-term deal with Iran which has been reported as allowing it to buy crude at approximately \$6 pb below the Brent crude price and make payment in Turkish Lira. Deals like this however are largely hostage to U.S. sanctions, because Tupras are in the predicament of anticipating whether Washington will grant additional waivers in the future, or decide to tighten the screws even further, Turkey: weaning off Iranian oil, David O'Byrne, *Financial Times*, 31 July 2012 <http://blogs.ft.com/beyond-brics/2012/07/31/turkey-weaning-off-iranian-oil/#ixzz26Qmz4y05>

<sup>48</sup> Iranian oil selling at \$115 on European markets, *Tehran Times*, 06/09/2012  
<http://www.payvand.com/news/12/sep/1045.html>

<sup>49</sup> Pars-e jonubi asir-e tahrir, Kaveh Omidvar, *BBC Persian*, 2 June 2012  
[http://www.bbc.co.uk/persian/business/2012/07/120701\\_ka\\_sanctions\\_iran\\_oil\\_gas.shtml](http://www.bbc.co.uk/persian/business/2012/07/120701_ka_sanctions_iran_oil_gas.shtml)

<sup>50</sup> Total withdraws from Iran amid political tensions, David Jolly, *New York Times*, 10 July 2010  
<http://www.nytimes.com/2008/07/10/business/worldbusiness/10iht-total.1.14387760.html> ; 2 Multinationals Pull Back From Iran, Ron Nixon, *New York Times*, 10 March 2010  
<http://www.nytimes.com/2010/03/11/world/middleeast/11iran.html>

investment is unlikely to be forthcoming in light of sanctions and the IRGC's dislike of foreign competitors.

Contracts continue to be signed with companies affiliated to the IRGC, or to the Ministry of Defence,<sup>51</sup> which suggests that rather than pressuring the Islamic Republic to open up, sanctions are consolidating the "praetorian regime", which has overtly taken root since the late 1990s.<sup>52</sup> This increasing penetration of the Iranian economy, in particular the energy sector is only reinforced by the fact that the incumbent Oil Minister is a former head of Khatam al-Anbia and a Major General in the IRGC.<sup>53</sup> In this way, the IRGC widens its net over the Iranian economy, and is emboldened to use its military muscle to strong arm both political and economic rivals. Also, given the fact that statements issued by members of the IRGC are the most severe and condemnatory of the Reformists and the Green Movement leadership,<sup>54</sup> its further economic consolidation, will no doubt further weaken prospects of a revival of the Reform movement and/or *glasnost* of any description.

Due to the dive in Iranian oil exports, Iraq has now overtaken Iran in August 2012, reaching its highest level of crude exports for thirty years.<sup>55</sup> This goes to further undermine Iran's reputation as a regional hegemon and Iran's bargaining power in OPEC. Iran dropped to third among OPEC's biggest exporters, having held the No. 2 spot since May 2000.<sup>56</sup> It is highly doubtful Iraq will place Iran's national interest over its own, and cut back on oil production, when it is in need of crucial revenue itself.<sup>57</sup>

Meanwhile, Iran is reluctant to cut production because of its symbolic significance for its status as a regional power and the difficulty of increasing it once again further down the line. Consequently, *The New York Times* in July 2012 reported that some 65 tankers were docked in the Persian Gulf containing Iranian oil yet to find buyers.<sup>58</sup> In order to solve the storage issue Iran has bought 12 super tankers from China.<sup>59</sup> However, Chinese super tankers only solve part of the equation if Iran continues to face difficulties over P&I insurance.

In sum, Iran has seen a dramatic loss in revenue, and in the short and medium term is attempting to find temporary solutions to prevent oil revenues from sliding even further, and despite its rhetoric to the contrary. At the Non-Aligned Movement (NAM) summit, Iran's oil minister Rostam Qassemi, was busy on the side lines trying to wrangle buyers for its oil. This conveys well the dichotomy between Tehran's public rhetoric in the face of Western pressure, and its private endeavours for damage control.<sup>60</sup> The National Iranian Oil Company also has now started to offer to transport oil to buyers using its own fully-insured vessels, but only time will tell how the market will react to the Iranian initiative. There would

<sup>51</sup> Sevvomin qarardad-e qarargah-e khatam ol-osiya ba nafti-ha emza shod: vagozari dow meydan-e nafti beh vezarat-e defa, 2 August 2012, <http://www.etemaad.ir/Released/91-05-12/150.htm>

<sup>52</sup> The Militarization of Post-Khomeini Iran: Praetorianism 2.0, Elliot Hen-Tov and Nathan Gonzalez, *Washington Quarterly*, Winter 2011, p45-59

<sup>53</sup> Iran's Revolutionary Guards Strike Oil, Ali Alfoneh, *Middle East Quarterly*, Winter 2012, <http://www.meforum.org/3153/iran-revolutionary-guards-strike-oil>

<sup>54</sup> Farmande-ye sepah-e vali-ye amr: nofuzi-ha-ye dooshman dar har lebasei qasd-e zarbe zadan be enqelab ra darand: tohin be aemeh az dowran-e eslahat aqaz shod, Fars News, 05/03/1391 <http://www.farsnews.com/printable.php?nn=13910305000032>

<sup>55</sup> Iraq's Crude Exports at 30-Year High, BEDigest, 2 September 2012 <http://www.bedigest.com/NEWS/77310.aspx>

<sup>56</sup> Iran Loses \$133 Million a Day on Embargo as Oil Buys Obama, Anthony DiPaola and Isaac Arnsdorf, SFGate / Bloomberg News, 2 August 2012 <http://www.sfgate.com/business/bloomberg/article/Iran-Loses-133-Million-a-Day-on-Embargo-as-Oil-3757459.php>

<sup>57</sup> An Iran-Iraq clash over oil?, Gary's Choices, 3 July 2012 <http://garysick.tumblr.com/post/26441011786/an-iran-iraq-clash-over-oil>

<sup>58</sup> Oil Backed Up, Iranians Put It on Idled Ships, Thomas Erdbrink and Clifford Krauss, *New York Times*, 4 July 2012 <http://www.nytimes.com/2012/07/05/world/middleeast/oil-embargo-leads-iran-to-disguise-tankers.html>

<sup>59</sup> China delivers first of new Iranian oil tankers, *Business Recorder*, 29 September 2012 <http://www.brecorder.com/fuel-a-energy/193/1243212/>

<sup>60</sup> Vazir-e naft: dar hal mozakere ba kharidaran-e naft-e Iran dar majmueh-ye adam-e taahod hastim, Hamidreza Tahmasebi Pur, Etemaad, 09/06/1391 <http://www.etemaad.ir/Released/91-06-09/150.htm>

appear to be no real way through which Iran might restore lost oil sales. The main question is whether it can arrest a further slide.<sup>61</sup>

Tehran will also continue to search for means to circumvent sanctions. In the short-term, Iranian tankers have sought to fly other nations' flags and change the names of its vessels. This ultimately solved little because tankers bear a serial number which doesn't change, and so vessels can be easily identified. The Majles has also passed a law allowing a fifth of Iranian oil to be sold privately. This way, payments will be deposited in private accounts, which have not yet been blacklisted unlike Iran's Central Bank and several other smaller Iranian banks.<sup>62</sup>

The blows to Iran's regional prowess, one which it sought to reassert by means of the NAM Summit in Tehran, do not mean the Islamic Republic will be prepared to forgo nuclear enrichment or meet Western demands as they stand. Virtually every Iranian leader who spoke at THE NAM Summit including Ayatollah Khamenei, Ali Akbar Salehi, Ali Asghar Soltanieh, and Mahmoud Ahmadinejad, strenuously reaffirmed Iran's right to enrich uranium for peaceful purposes, and insisted Iran would not be pressured into forgoing such a right under pressure of sanctions.<sup>63</sup>

### Sanctions Targeting Iranian Financial and Banking Sector

Sanctions have already dealt a major blow to one of the most important achievements of the Rafsanjani and Khatami administrations, which was to unify the multiple exchange rates, which had emerged in the course of the eight year conflict with Iraq. As of July 2012, the government stated it will supply dollars at the official rate to import "basic goods" and a rate of 15,000 rials to the dollar for "capital and intermediate goods".<sup>64</sup> With the rial's on-going plummet in value throughout September and early October, the currency crisis has entered uncharted territory and at present the government is at a loss on how to respond.

The pool of individuals eligible for the official currency rate is rapidly shrinking, and this is exacerbating the dearth of confidence which already exists amongst people, who regard the Central Bank of Iran's (CBI) assurances of its possession of plentiful foreign currency reserves, with a great deal of scepticism. Because of this scepticism, Iranians have continued to buy foreign currency and gold, in order to preempt the further erosion of their savings. This in turn has perpetuated a vicious cycle, which acts as an obstacle to the rial's stabilisation.

Moreover, despite claims by Oil Minister, Rostam Qassemi that Iran has \$150 billion in foreign currency reserves, so-called 'travel currency' which Iranians could previously purchase at the official government rate has been scrapped. Foreign currency for travel has been limited exclusively to religious pilgrimage to Saudi Arabia, and the shrine cities of Iraq.<sup>65</sup> Parents wishing to send their children studying abroad money are forced to send cash through friends, or via wire transfer, and in the process are forced to pay

<sup>61</sup> Iran offers its own fully-insured ships for crude shipments, *The Economic Times*, 28 August 2012 <http://economictimes.indiatimes.com/news/economy/foreign-trade/iran-offers-its-own-fully-insured-ships-for-crude-shipments/articleshow/15884212.cms>

<sup>62</sup> Iran tries to dodge oil sanctions, Amir Paivar, *BBC News*, 29 June 2012 <http://www.bbc.co.uk/news/world-middle-east-18640746>

<sup>63</sup> Bayanat dar shanzdahomin ejlas-e saran-e jonbesh-e adam-e taahod dar Tehran, Ayatollah Khamenei, 09/06/1391 <http://farsi.khamenei.ir/speech-content?id=20840> ; Soltanieh dar neshast-e khabari: az haqq-e ghani sazi kutah nakhahim amad va mosaleheh nemikonim, *Fars News*, 07/09/1391 <http://www.farsnews.com/printable.php?nn=13910607000358>

<sup>64</sup> Iran introduces tiered exchange rates for imports, *Reuters*, 21 July 2012 <http://www.reuters.com/article/2012/07/21/us-iran-currency-imports-idUSBRE86K08J20120721>

<sup>65</sup> Natijeh-ye diruz-e majles va vaziran-e eqtesadi-ye dowlat: arz-e mosaferati baraye keshvar-ha-ye donya safar-e hajj-e vajeb hazf shod, *Etemaad*, 26 July 2012, <http://etemaad.ir/Released/91-05-05/150.htm>

hefty commissions.<sup>66</sup> Students studying abroad on scholarships have also been requested by the Ministry of Education to return to the country.<sup>67</sup>

Such restrictions, it has been argued, save Iran some \$5 billion annually, even if they are not exactly an action which bespeaks of brimming confidence. Whether such policies have been enacted because Iran is planning ahead, or because its claims regarding its foreign currency reserves are more bravado than reality is not clear, since the IMF has testified to Iran's possession of substantial foreign currency reserves. The most recent IMF report stated Iran had \$80 billion in foreign reserves and some \$20 billion in gold, which are said to have accumulated over the years and as a result of the windfall in oil revenues.<sup>68</sup>

Iran has also been purchasing large amounts of gold from Turkey, suggesting that the Islamic Republic has possibly been exchanging gold for energy, so as to build up reserves in the advent of a future conflict. Also, due to the devaluation and fluctuations in the rial, some parties with privileged access to official currency have been making a killing, buying Turkish gold on the cheap, and then importing it back to Iran to sell at a healthy profit. The marked increase in gold purchases since the effective emergence of Iran's multiple exchange rates has seen Turkey's gold and precious stones exports to Iran reach \$8 billion in the first seven months of this year, in comparison to \$2 billion during the same period in 2011.<sup>69</sup> As a result of a 395% increase in the purchase of gold and precious stones in July, Iran became Turkey's biggest trading partner.<sup>70</sup> Thus, apart from the state's need to ensure it has sufficient gold reserves going into the future, the multiple exchange rates have seriously exacerbated corruption. Until the government is able to quell unease over the rial, Iranians will continue to exchange their savings for a safer and more assured option.

### The Weak Rial

The Iranian currency had lost half of its value in early 2011, and before the impact of sanctions had been on shaky ground, in part because it has been overvalued for many years.<sup>71</sup> On 14 March the Central Bank of Iran (CBI) permitted private money changers to handle imports for 'non-essentials', and by the end of March Iran's currency had lost 55% of its 2002-2011 value.<sup>72</sup> The downward spiral has continued unabated and on 1 October the rial was trading on the black market at 36,000 rial to the dollar. Veteran Iranian economist Jahangir Amuzegar has outlined four key reasons why the Iranian rial has gone into free fall.

- 1) The misconception that a high currency is economically desirable.
- 2) Wrong-headed policies of the Ahmadinejad administration in tackling inflation and unemployment.
- 3) Western economic sanctions as a result of the on-going nuclear deadlock.

<sup>66</sup> Interviews with several Iranian university students who preferred to remain anonymous.

<sup>67</sup> Tasmim-e vezarat-e olum baraye davat az daneshjuyan-e bursieh-ye khareji be dakhel-e keshvar, *Mehr News*, 08/07/1391 <http://www.mehrnews.com/fa/newsdetail.aspx?NewsID=1705614>

<sup>68</sup> How Sanctions Affect Iran's Economy, Hassan Hakimian & Toni Johnson, Council on Foreign Relations, 23 May 2012 <http://www.cfr.org/iran/sanctions-affect-irans-economy/p28329>

<sup>69</sup> Iranian Purchases of Turkish Gold May Help It to Foil Sanctions, *Milliyet*, 6 September 2012 <http://www.al-monitor.com/pulse/business/2012/09/gold-laundering-behind-mind-boggling-iran-turkey-trade-increase.html>

<sup>70</sup> Ibid

<sup>71</sup> Iran: The Rial Saga, Jahangir Amuzegar, *Middle East Economic Survey*, 6 August 2012 <http://www.mees.com/en/articles/5584-iran-the-rial-saga> : <http://djavard.wordpress.com/2012/05/21/irans-subsidy-reform-survives-crucial-hurdle/#more-1623>

<sup>72</sup> Ibid

- 4) Loss of public confidence in the Iranian government's ability to support the official currency rate.<sup>73</sup>

While the rial's overvaluation is the product of deeper and systemic issues in Iran's economy, the latest sanctions enveloping the Central Bank beginning in December 2011-January 2012 have acted as a catalyst.<sup>74</sup> Amuzegar deems it highly unlikely that Iran's on-going economic crisis will be abated until the nuclear crisis is also solved, since the current sanctions against Iran's energy sector, which directly impacts the value of the Iranian rial, will not be lifted without a conclusion to the decade long impasse.

### Mounting Difficulties

#### a) Health Sector

An independent report has yet to be written on the impact of financial sanctions on the availability and prices of pharmaceuticals in Iran, but some analyses have been ringing alarm bells regarding the negative impact of sanctions on civilians in this regard.<sup>75</sup> Rahbar Mozhddehi Azar, the Head of the Society for Pharmacists of Iran, in an interview with Mehr News, has stated that the "majority of pharmacies are up for sale" due to a four-fold increase in taxation on pharmacies and serious delays in insurance payments. As a result, around 100 pharmacies have been put up for sale in recent months.

The government has been criticised due to the poor allocation of official rate currency for vital medicines and drugs. This suggests that if the Iranian government is able to bring some competent management to bear, more effective policies could help avert some of the disaster scenarios currently being aired.<sup>76</sup> Here the Iranian government is not doing itself any favours, and is thus far losing the PR campaign for ordinary people's hearts and minds. One incident, which sparked the ire of Iranian MPs and has been criticised by the Chief of the Majles' Economic Commission, Arsalan Fathipour, was the import of \$70 million worth of Chinese dolls. He argued that the government should allocate foreign currency more appositely and efficiently.

#### b) Private Sector

Beyond pharmacies, it seems that the private sector as a whole is being seriously squeezed and making foreign investment by even non-western companies, or the pursuit of joint ventures, a risky and unattractive proposition.<sup>77</sup> Many Iranian and even Iraqi banks have proven incapable of offering the most rudimentary of financial services such as letters of credit or cash transfers.

Another consequence of U.S. financial sanctions has been that many companies now refuse to sell auto-parts to Iranian automobile companies. As a result there has been a 36% decrease in car manufacturing, which will lead to widespread layoffs and could lead to serious labour unrest.<sup>78</sup> 10,000 workers have already signed and addressed a petition to the Minister of Labour complaining of their declining purchasing power and the general state of the economy.<sup>79</sup>

<sup>73</sup> Ibid

<sup>74</sup> Ibid

<sup>75</sup> Sanctions will kill tens of thousands of Iranians, Muhammad Sahimi, *Antiwar.com*, 9 August 2012, <http://original.antiwar.com/sahimi/2012/08/08/sanctions-will-kill-tens-of-thousands-of-iranians/>

<sup>76</sup> Rais-e anjom-e darusazan-e Iran: aksar darukhaneh-ha dar ma'raz forush gharar gerefteand, *Radio Farda*, 14/05/1391

[http://www.radiofarda.com/content/f12\\_most\\_of\\_iranian\\_pharmacists\\_are\\_getting\\_bankrupt/24666606.html](http://www.radiofarda.com/content/f12_most_of_iranian_pharmacists_are_getting_bankrupt/24666606.html)

<sup>77</sup> In Iran, Private Sector Feels Squeeze of Sanctions, Benoit Faucon, *The Wall Street Journal*, 2 August 2012, <http://online.wsj.com/article/SB10000872396390443687504577564991148939740.html>

<sup>78</sup> Report from Tehran: How Sanctions Hurt the Lives of Ordinary Iranians, *Inside Iran*, Ehsan Mehrabi, 26 July 2012 <http://www.insideiran.org/featured/report-from-iran-how-sanctions-hurt-the-lives-of-the-ordinary-iranians/>

<sup>79</sup> A New Sign of Distress as Iran's Currency Falls, Rick Gladston, *New York Times*, 1 October 2012 <http://www.nytimes.com/2012/10/02/world/middleeast/irans-rial-plummets-against-the-dollar.html>



The automobile industry, moreover, is by no means an exception here,<sup>80</sup> as many other industries are finding it extremely difficult to pay foreign suppliers. The weak rial is also hurting importers, who are lobbying against a devaluation, arguing that a strong rial will keep down producers' costs.<sup>81</sup>

### Mitigating the Effects of Sanctions

The head of the CBI, Mahmood Bahmani, has stated that the bank has formed a committee for combatting "economic warfare".<sup>82</sup> As has been mentioned, few if any comprehensive measures have materialised, and it seems for the moment the government is preoccupied with stopgap and makeshift efforts to alleviate the crisis. The Chief of the Judiciary and Chief Prosecutor have promised severe punitive measures for those found culpable of "disrupting the market", but to little avail.<sup>83</sup> The one exception is the CBI's establishment of a "foreign exchange centre", in order to give preferential exchange rates to importers of priority goods,<sup>84</sup> but it has already been widely criticised as inefficient, and as evidenced by the rial's startling fall, has failed to solve the crux of Iran's economic tribulations.

The CBI chief has had tense relations with President Ahmadinejad in the past, and according to one source, rather than work together the president is more set on casting Bahmani aside to score points domestically, and position an appointee in his stead.<sup>85</sup> Bahmani has been vociferous in commenting on the dire state of Iran's economy stating at different points that it is in a worse state than during the eight year conflict with Iraq, and that the country is now in the time of Ali ibn abi Taleb, the first Shi'i Imam, seen as a dark and uncertain time for the Shi'is, when they were crushed and marginalised by the Umayyad caliphate.<sup>86</sup>

These comments provoked a rebuke by Ayatollah Khamenei in January 2012, but in late August in a meeting with Ahmadinejad and the cabinet he seems to have realised that levels of discontent amongst the population are rapidly growing and that the damage to people's real disposable income and spending power must be countered as soon as possible if a full-blown crisis is to be averted.<sup>87</sup> Khamenei had previously reiterated the imperative of resistance and the pursuit of a "resistance economy" in the face of Western pressure.<sup>88</sup> Beyond the slogans, which chime with the Shi'i Islamist ideology upon which the Islamic Republic was founded, a well-thought out and comprehensive programme to counter Iran's economic woes is yet to materialise.

On the 27 August, the Minister of Economy, Shamseddin Hosseini, presented a report to Khamenei on the current state of the economy, which while admitting the sanctions were having an unprecedented negative effect on Iran's economy, offered few ideas beyond austerity on how to neutralise them.<sup>89</sup> His prognosis was far from all doom and gloom, however, and the Minister sought, despite the undeniable reality, to reassure the Leader that positive developments over the last year had also occurred. For

<sup>80</sup> Karkhane-ha-ye tatil shode va afzayesh "artesh-e bikaran" dar Iran, *Radio Farda*, 26/02/1391

<http://www.radiofarda.com/articleprintview/24581558.html>

<sup>81</sup> <http://www.mees.com/en/articles/5584-iran-the-rial-saga>

<sup>82</sup> Mahmud Bahmani dar jam'-e khabarnegaran khabar dad: bank-e markazi gharargah-e jang-ha-ye na-monazam-e eghtesadi tashkil dad, *Digarban*, 10 Mordad 1391 <http://www.digarban.com/node/8164>

<sup>83</sup> Tosieh-ye dadsetan-e kol be Ayatollah Hashemi / shenasa'i furi-ye ekhlalgaran-e arzi, *Mehr News*, 10/07/1391 <http://www.mehrnews.com/fa/newsdetail.aspx?NewsID=1709640>

<sup>84</sup> A New Sign of Distress as Iran's Currency Falls, Rick Gladston, *New York Times*, 1 October 2012

<http://www.nytimes.com/2012/10/02/world/middleeast/irans-rial-plummets-against-the-dollar.html>

<sup>85</sup> Aya scenario-ye penhan-e Ahmadinejad bastarsazi baraye barkenari-e Bahmani? *Baztab, -e Emruz* 22 Shahrivar 1391

<sup>86</sup> Ali Khamenei ezharat-e rais-e bank-e markazi-ye Iran ra rad kard: nezam-e eslami dar sharayet-e sho'ab-e abi taleb nist, *Digarban*, 19 Dey 1390 <http://www.digarban.com/node/4253>

<sup>87</sup> Rahbar-e enqelab dar didar-e rais-ye jomhur va aza-ye heyat-e dowlat, *Tabnak*, 2 Shahrivar 1391

<sup>88</sup> Eqtesad-e moqavemati ya tiri dar tariki, Feridun Khavand, *Radio Farda*, 11/06/1391

<http://www.radiofarda.com/articleprintview/24663084.html>

<sup>89</sup> Matn-e kamel-e gozarah dar mahzar-e rahbar-e moazam-e enqelab: talash-e tahrirkonandegan baraye tashkik dar amar-ha-ye rasmi va tazif ruhieh-ye mardom, *Fars News*, 06/06/1391

<http://www.farsnews.com/printable.php?nn=13910606000904>

instance, he claimed foreign investment and non-oil exports had increased sizably.<sup>90</sup> Such claims, however, need independent verification and should not be taken at face-value.

Because Washington's sanctions are extra-territorial in nature, it has also taken the step of sanctioning a Chinese and an Iraqi bank, both accused of facilitating Iranian transactions, amongst numerous other companies found to be doing business with Iran. In the case of the Chinese bank, Beijing protested firmly and refused to take the measure lying down.<sup>91</sup> If this were to become a repeated occurrence, Washington might well begin to feel the strain and limited efficacy of its extra-territorial banking sanctions, especially when applied against a power of the size of China.

Iran is bound to find various ways and methods of circumventing sanctions, even if sanctions continue to increase in breadth and scope. It has already been reported that Iran is working with various smaller banks in China, Pakistan, Malaysia and elsewhere, which do not have business relations with the United States and in many respects benefit from the vacuum left by American,<sup>92</sup> European and larger competitors at home. This practice will likely continue for the foreseeable future.

### Price Increases and Inflation

Subsidy reforms in concert with sanctions, particularly those which have targeted Iran's banking sector, have been the cause of dramatic increases in the prices of many basic goods. In order to cushion the impact of the price increases, cash payments of roughly equivalent to \$45 per month have been deposited in people's bank accounts.<sup>93</sup> Since last year however, due to inflation this figure has rapidly diminished as the rial's value continues to decline against the dollar. The cash payments have been of little consequence for the much of the middle class, many even deeming the payments not worth the time of registering for their receipt. That being said, Djavad Salehi-Isfahani, professor of economics at Virginia Tech, has argued that payments have had a positive impact upon the poorest sectors of Iranian society, helping them to escape the international poverty line of \$2 per day.<sup>94</sup> Salehi-Isfahani has also estimated that the Iranian government spends approximately \$70 billion annually on subsidies, a significant proportion of which will be saved as a result of the reforms.<sup>95</sup> Even so, many Iranians' purchasing power has severely deteriorated, and they are as a result trying their utmost to make ends meet by cutting back on "luxuries" and economising.<sup>96</sup>

Iran has, for many years, suffered from chronically high levels of inflation, though under Presidents Rafsanjani and Mohammad Khatami the economy was managed with a fraction of the oil revenue windfall the Ahmadinejad administration has enjoyed, and with considerably lower levels of inflation. In the first six years of his presidency alone, Ahmadinejad received \$560bn in oil revenues, exceeding by

<sup>90</sup> Matn-e kamel-e gozash dar mahzar-e rahbar-e moazam-e enqelab: talash-e tahrirkonandegan baraye tashkik dar amar-ha-ye rasmi va tazif ruhieh-ye mardom, *Fars News*, 06/06/1391

<http://www.farsnews.com/printable.php?nn=13910606000904>

<sup>91</sup> Beijing firmly protests US sanctions on bank, Zhou Wa, *China Daily*, 01/08/2012

[http://www.chinadaily.com.cn/china/2012-08/01/content\\_15638994.htm](http://www.chinadaily.com.cn/china/2012-08/01/content_15638994.htm)

<sup>92</sup> Most recently, Iran has been using a port off the coast of East Malaysia in order to hide millions of barrels of oil, Insight: Iran parks oil off Malaysia to dodge Western sanctions, Luke Pachymuthu and Randy Fabi, *Reuters*, September 13, 2012, <http://in.reuters.com/article/2012/09/12/us-iran-oil-sanctions-idINBRE88B1I020120912>

<sup>93</sup> Iran: Subsidy Reform amid Regional Turmoil, Djavad Salehi-Isfahani, *Brookings*, 3 March 2011

<http://www.brookings.edu/research/opinions/2011/03/03-iran-salehi-isfahani>

<sup>94</sup> West, Iran Have Different Ideas About Iran's Economic Health, Djavad Salehi-Isfahani, *Al-Monitor*, 30 July 2012, <http://www.al-monitor.com/pulse/originals/2012/al-monitor/irans-economic-health-reading-fr.html>

<sup>95</sup> Iran: Subsidy Reform amid Regional Turmoil, Djavad Salehi-Isfahani,

<http://www.brookings.edu/research/opinions/2011/03/03-iran-salehi-isfahani>

<sup>96</sup> Majles Speaker, Ali Larijani has argued on numerous occasions that the cash payments of the first phase of subsidies reform and essentially been negated by inflation brought about as a result of government mismanagement. Larijani restates claim that 80% of Iran's economic problems derive from mismanagement, Eskandar Sadeghi-Boroujerdi, *Iran Pulse: Al-Monitor*, 02/10/2012 <http://iranpulse.al-monitor.com/index.php/2012/10/427/larijani-restates-claim-that-80-of-irans-economic-problems-derive-from-mismanagement/>

some margin the \$433bn received by the previous eight governments of the Islamic Republic combined.<sup>97</sup> The high levels of currency which have been injected into the Iranian economy in conjunction with low interest rates and, thus, a disincentive to save, are partially responsible for the rial's rapid decline. As confidence in the official exchange rate began to dissipate and fears intensified over the CBI's access to foreign currency, Iranians quickly turned to buying dollars and gold to protect their savings. Another upshot of the currency crisis has been a property boom, as Iranians look for a "safe" investment for their money.

In June of this year, inflation reached an annualised rate of 34%.<sup>98</sup> In July, Gholamreza Kateb, spokesman for the Majles's planning committee, also revealed that real inflation rate is 33.5%.<sup>99</sup> Some officials have claimed, including Asadollah Asgarowladi, the Head of the Iran-China Chamber of Commerce, and one of the wealthiest businessmen in Iran, the rate of inflation is as high as 40%.<sup>100</sup> The recent decision to stop reporting the inflation rate altogether has only exacerbated the suspicion that the government is hiding something and that its economic pronouncements are to be taken with a heavy dose of scepticism.

Despite the promise by Mehdi Qazanfari, Minister of Industry, Mines and Trade, to control rapidly increasing prices, they have continued to spiral.<sup>101</sup> A motion for his impeachment had been circulating the Majles, and it seems that much of the Conservative ruling establishment is restive and quick to cite the government's economic policies as the chief cause.<sup>102</sup> In October 2011, even before the severest Western sanctions had come into effect, a motion to impeach the Minister of Economy, Shamseddin Hosseini, was defeated on the Majles floor. The main criticism at that time, however, was the Minister's failure to prevent the biggest banking corruption scandal in the Islamic Republic's history.<sup>103</sup> Ali Larijani at that time defended the Hosseini, but since January 2012 fractures in the visage of Principalist unity have turned into fully fledged breaks. The Minister of Economy has been repeatedly summoned to the Majles to explain his chosen policy course. The MPs exclaimed their "dissatisfaction" with the Minister's answers, gave him a "yellow card", with Elias Naderan, an MP critical of the government, threatening to pursue his impeachment.<sup>104</sup>

More recently, the current Speaker of Parliament, Ali Larijani, has gone as far as to state publicly, and on more than one occasion, that only 20% of Iran's economic problems are the corollary of sanctions, while the remaining 80% finds their provenance in government mismanagement.<sup>105</sup> On a similar note, Deputy Speaker of the Majles, Mohammadreza Bahonar in an interview with the Reformist daily *Etemaad* bluntly stated that the government's Principalist critics "would not tolerate another year of the

<sup>97</sup> Iran: The Rial Saga, Jahangir Amuzegar, <http://www.mees.com/en/articles/5584-iran-the-rial-saga>

<sup>98</sup> West, Iran Have Different Ideas About Iran's Economic Health, Djavad Salehi-Isfahani, <http://www.al-monitor.com/pulse/originals/2012/al-monitor/irans-economic-health-reading-fr.html>

<sup>99</sup> Iran Lawmaker Says Inflation Is 33.5 Percent, Donya Reports, Ladane Nasser, *Bloomberg*, 8 July 2012 <http://www.bloomberg.com/news/2012-07-08/iran-lawmaker-says-inflation-is-33-5-percent-donya-reports.html>

<sup>100</sup> Asgarowladi: tavarom-e vaqei 40 dar sad ast, *Radio Farda*, 21/10/1390 [http://www.radiofarda.com/content/f3\\_iran\\_inflation\\_forty\\_percent/24448590.html](http://www.radiofarda.com/content/f3_iran_inflation_forty_percent/24448590.html)

<sup>101</sup> Amel-e gerani-ha dar Iran; tahrir ya siyat-ha-ye eqtesadi-ye dowlat, Arash Hassan Nia, *Radio Farda*, 06/05/1391 <http://www.radiofarda.com/content/f5-iran-tough-economy-is-not-for-just-sanctions/24657984.html>

<sup>102</sup> Namayande-ye ghasr-e shirin: ehtemal-e estizah-e vazir-e sanat, *Fars News*, 01/05/1391 <http://www.farsnews.com/newstext.php?nn=13910501000808>

<sup>103</sup> Estizah-e vazir-e eqtesad dar majles ray nayavord, *Radio Farda*, 10/08/1390 <http://www.radiofarda.com/articleprintview/24378113.html>

<sup>104</sup> Namayandegan-e Majles az pasokh-e vazir dar bare-ye "bomb-e arzi" qane' nashodand; kart-e zard-e Majles beh vazir-e eqtesad, *Etemaad*, 30 Shahrivar 1391 <http://www.etemaad.ir/Released/91-06-30/150.htm>

<sup>105</sup> Ali Larijani: sahm-e tahrir-ha dar moshkelat-e eqtesadi 20 dar sad ast, *Radio Farda*, 28/04/1391 <http://www.radiofarda.com/content/f5-iran-larijani-admits-on-some-sanctions-pressures/24648366.html>; Larijani restates claim that 80% of Iran's economic problems derive from mismanagement, Eskandar Sadeghi-Boroujerdi, *Iran Pulse: Al-Monitor*, 02/10/2012 <http://iranpulse.al-monitor.com/index.php/2012/10/427/larijani-restates-claim-that-80-of-irans-economic-problems-derive-from-mismanagement/>

Ahmadinejad government”.<sup>106</sup> It should be borne in mind that both Larijani and Bahonar have long been vehement critics of Ahmadinejad; the former openly so since his resignation as Head of the Supreme National Security Council in October 2007. Larijani’s key point was that domestic production must increase, and that the Iranian economy must wean itself off its dependence on foreign imports,<sup>107</sup> which undercut domestic production, and were effectively a government splurge funded by the oil windfall enjoyed by the Ahmadinejad government as an easy shortcut to assuage inflationary pressures.

Like the Principalist critics of the Ahmadinejad government, Ali Mazrui, former Deputy Chief of the Sixth Majles’ Commission for Budget and Planning, has claimed that the lion’s share of responsibility for the inflation of the price of basic foodstuffs resides with the government.<sup>108</sup> Ahmadinejad’s critics have in particular pointed to his dissolution of the Economic Planning Organisation which used to oversee the manner and method of government spending. Since its dissolution, oversight of government spending has been minimal to non-existent, and many economists allege that this has resulted in much of the economic turbulence witnessed in recent years.<sup>109</sup> Critics have pointed to the government’s inadequate management of the huge Maskan-e Mehr housing project, as merely one example of several.<sup>110</sup>

Of course an important question, which cannot be properly answered here, is to what extent Ahmadinejad has pursued his agenda with the approval of the Supreme Leader. Since the President’s too bold step of challenging Khamenei for the Intelligence Ministry in April 2011,<sup>111</sup> Ahmadinejad, but particularly his entourage, and his elusive Chief of Staff, Esfandiar Rahim Mashaei, have been something of a soft target on which to lay the blame for the consequences of arguably larger strategic decisions, in which the Supreme Leader, and the ruling cabal of the IRGC are implicated.

In the first half of 2012, the response of the government and broader regime to the sanctions and their impact on the economy had often been confused and varied. One party’s respective interpretation of the sorry state of the economy and the chief reasons for its occurrence seems to accord with the particular speaker’s political agenda and priorities. For example, the First Vice President, Mohammadreza Rahimi has blamed price hikes not on sanctions, which he went as far to name “a gift from God”,<sup>112</sup> but rather on hoarding. Speculation was also blamed as a key reason for the plummeting value of the rial. Due to fears over sanctions it does appear that hoarding has been taking place, and that the government fears over potential shortages in the future have themselves contributed to this development.<sup>113</sup> Ahmadinejad himself ordered the stockpile of 3 months’ worth of basic goods in response to sanctions pressure, which has in turn catalysed hoarding by both businesses and households.<sup>114</sup> Fears remain that shortages of wheat still might occur.<sup>115</sup>

<sup>106</sup> Goftogu-ye “Etemaad” ba Mohammadreza Bahonar, naeb-e majles, *Etemaad*, 1 Shahrivar 1391 <http://etemaad.ir/Released/91-06-01/150.htm>

<sup>107</sup> Larijani: nabud-e modiriyat-e sahih mojab-e gerani dar Iran shod east, *BBC Persian*, 29 Tir 1391 [http://www.bbc.co.uk/persian/iran/2012/07/120719\\_I21\\_majlis\\_price\\_larijani.shtml](http://www.bbc.co.uk/persian/iran/2012/07/120719_I21_majlis_price_larijani.shtml)

<sup>108</sup> Amel-e garani-ha dar Iran; tahrir ya siyat-ha-ye eqtesadi-ye dowlad, Arash Hassan Nia, *Radio Farda*, 06/05/1391 <http://www.radiofarda.com/content/f5-iran-tough-economy-is-not-for-just-sanctions/24657984.html>

<sup>109</sup> It is not merely Reformists, but Principalists and also IRGC members have been vociferous in their criticisms of the Ahmadinejad’s economic mismanagement. See, Aqa-ye Ahmadinejad mardom bahaneh-ye taqirat-e bujeh ra az shoma nemipazirand, *Shafaf*, 6 Mordad 1391

<sup>110</sup> Iran: The Rial Saga, Jahangir Amuzegar, <http://www.mees.com/en/articles/5584-iran-the-rial-saga>

<sup>111</sup> Analysis: Row between Iranian leaders comes to a head, James Reynolds, *BBC News*, 7 May 2011 <http://www.bbc.co.uk/news/world-middle-east-13312907>

<sup>112</sup> Rahimi: tahrir-ha lotf-e khodast, *Fars News*, 31/04/1391 <http://www.farsnews.com/newstext.php?nn=13910431001367>

<sup>113</sup> Iran boosts strategic grain stocks with wheat buy, Sarah McFarlane and Michael Hogan, *Reuters*, 3 August 2012 <http://www.reuters.com/article/2012/08/03/iran-wheat-idUSL6E8J3M6220120803>

<sup>114</sup> Dastur-e vizheh-ye Ahmadinejad baraye zakhireh sazi / tamin 3 mah niaz-e kala-ha-ye asasi, *Mehr News*, 06/05/1391 <http://www.mehrnews.com/fa/newsdetail.aspx?NewsID=1659073>

<sup>115</sup> Yek namayandeh-ye Majles dar bareh-ye ehtemal-e kambud-e gandom dar Iran hoshdar dad, *Radio Farda*, 07/05/1391 <http://www.radiofarda.com/archive/news/20120729/143/143.html?id=24660453>

The Iranian government had in response pledged to send out inspectors into the bazaar and shops across to monitor prices and hoarding, with threats of fines to be meted out to those traders and shopkeepers found responsible for overcharging customers and contributing to the price crisis.<sup>116</sup> While, unlike 1979, there is as of yet no serious revolutionary movement waiting in the wings to seize power, such measures are reminiscent of steps taken during the latter years of the Shah's era in which inspectors of the sole legal party of the time, the *Rastakhiz*, were sent out to investigate rising prices and alleged hoarding in the bazaar. Despite the public pledge, prices have not stabilised. Rather state media and unions have been warned against reporting on the price hikes affecting the standard of living of Iranians across the country.<sup>117</sup>

Basic food stuffs, and particularly meat have dramatically increased in price since even before June and prices have continued to rise through to the present. As damage control, the government has once again been forced to offer quotas of subsidised foods, in particular chicken. The Majles also held a closed session with the various ministers whose portfolios are economically related to try and come up with ways to get a handle on the situation, thus far with little success.<sup>118</sup> The situation has become so dire that even high level clerics such as Grand Ayatollah Makarem Shirazi have been forced to come out publicly and proffer a religious veneer for the state of imposed frugality, claiming meat consumption is not desirable or beneficial to one's health.<sup>119</sup> One report from the Green Movement affiliated website, *Kalameh*, has reported that chicken store in the provincial town of Minab was even raided by armed gunmen.<sup>120</sup>

Because of the inability of the CBI and government to tackle inflationary pressures the second phase of subsidy reform has been halted by the Majles, and Ahmadinejad even felt himself compelled to disassociate himself from this year's budget, contending the Majles had altered it beyond recognition.<sup>121</sup> The main critics of the second phase were individuals such as Ali Larijani, who was re-elected as Majles speaker in May 2012 and Ahmad Tavakkoli, former head of the Majles Research Centre, because they insisted the second phase's implementation would only go to further compound inflation, and add to the pressure under which ordinary people were already struggling to make ends meet.

Moreover, it was alleged Ahmadinejad ultimately sought to use the second phase as a populist stunt and publicity boon, by handing out cash payments with little thought to the resultant negative effects on the economy. There are also probably fears that Ahmadinejad would attempt to use the cash payments to re-energise his own base of support, which has been fading over the last three years, ahead of the 2013 presidential election, and give a boost to his own favoured candidate, by which he would attempt to perpetuate his influence in the political system. And aside from such political power rivalries, there were numerous technical problems and delays in the first phase's implementation, which critics place at the government's doorstep.

Representatives of the Green Movement opposition have attempted to capitalise on discontent, claiming there will be resurgent protests ahead of the 2013 presidential elections.<sup>122</sup> Despite such claims, protests on a large scale are yet to be seen, which is not to rule out their possibility, if there is an

<sup>116</sup> Iran Aims to Fight Hoarding, High Prices in Bazaars, Shargh Says, Yeganeh Salehi, *Bloomberg*, 13 June 2012 <http://www.bloomberg.com/news/2012-06-13/iran-aims-to-fight-hoarding-high-prices-in-bazaars-shargh-says.html>

<sup>117</sup> Iran Bans Unions from Commenting On Inflation, Golnaz Esfandiari, *RFERL*, 15 June 2012 <http://www.rferl.org/content/iran-inflation-ban-union-/24615769.html>

<sup>118</sup> Amel-e gerani-ha dar Iran; tahrir ya siyat-ha-ye eqtesadi-ye dowlat, Arash Hassan Nia, *Radio Farda*, 06/05/1391 <http://www.radiofarda.com/articleprintview/24657984.html>

<sup>119</sup> Ayatollah Makarem Shirazi: tasmim gereftam gusht-e morgh nakhoram, *Aftab News*, 31 Tir 1391 <http://www.aftabnews.ir/vdcfcidymw6dvva.igiw.html>

<sup>120</sup> Serqat-e mosalahaneh az yek morghdari dar Minab, *Kalameh*, 6 Mordad 1391 <http://www.kaleme.com/1391/05/06/klm-107680/>

<sup>121</sup> Rais-e jomhur qanun-e bujeh sal-e 91 kol-e keshvar ra eblaq kard, *President.ir*, 3 Khordad 1391, <http://www.president.ir/fa/38149>

<sup>122</sup> Dispatch: The Underground Fire, *Frontline: Tehran Bureau*, 26 July 2012 <http://www.pbs.org/wgbh/pages/frontline/tehranbureau/2012/07/dispatch-the-underground-fire.html>



appropriate spark. However, if protests eventually do break out, there is nothing to guarantee they will be politically organised or that the opposition will be able to capitalise on them.

As testament to the fact that economic discontent does not necessarily lend itself to progressive politics or democratisation, a wave of discrimination against Afghans has radically increased over the last several months and plans have even been drawn up to prevent them, including even Afghan-Iranian citizens from entering certain provinces.<sup>123</sup> This is in part a response due to the shortage of resources available for Iranians, and compounded by the institutionalised racism and discrimination, which already takes place on a regular basis against Afghans inside Iran.

According to the findings of Professor Salehi-Isfahani, the hardest hit by sanctions are Iran's youth, who from 1996-2006, accounted for 70% of unemployment,<sup>124</sup> and this looks set to be further exacerbated as the impact sanctions worsens. Likewise, the rate of young women's unemployment, the same young women so often framed as the champions of Iranian democracy, over the last decade has reached levels as high as 50%.<sup>125</sup> Besides poor levels of job creation for a steady supply of graduates emerging from the country's universities, Iranian labour markets are also rigid, with older workers being the recipients of tenured positions, to the detriment of their younger counterparts.<sup>126</sup> Obviously economic hardship will only go to exacerbate this trend. Again, thus far there appear to be few indications that high levels of youth unemployment will lead to a serious political challenge to the regime as a whole, while it is certainly feasible that people will lobby their local officials and government in order to air their deepening discontent.

### Domestic Political Repercussions

Statements from even the most Conservative quarters, such as that of Ayatollahs Jannati, Alamhoda, and numerous others, after much recalcitrance have gradually come to admit to dire state of the Iranian economy and its consequences for the lives of ordinary Iranians, and to a lesser extent the political elite itself.<sup>127</sup> The hardline Prayer leader of Mashhad, Ayatollah Alamhoda, went as far as to say that the "present conditions were warlike". He also advised his congregation to make preparation securing their food for the future.<sup>128</sup>

There have not as of yet been any open criticisms of Khamenei, but some rumblings and indications of discontent amongst the senior ranks of the ruling regime, and Conservative establishment have been heard.<sup>129</sup> In order to counter the prospect of a serious break in the ranks of the ruling elite, across the country and in coordinated fashion, Friday Prayer leaders appointed by the Supreme Leader's office, have been emphasising the imperative of tolerating the hardship inflicted by sanctions, maintaining unity and following the Leader unreservedly.<sup>130</sup> Mohsen Rezaei, former Commander of the IRGC and the incumbent Secretary of the Expediency Discernment Council, has also said publicly that the West has

<sup>123</sup> Yazdi va Kerman khastar-e mamnuiyat-e hozur-e afghan-ha dar in dow ostan shodand, *Radio Farda*, 24/04/1391

[http://www.radiofarda.com/content/f12\\_two\\_more\\_iranian\\_provinces\\_ask\\_for\\_afghan\\_ban/24645064.html](http://www.radiofarda.com/content/f12_two_more_iranian_provinces_ask_for_afghan_ban/24645064.html); Dar Iran tabiz alayeh-e shahrbandan-e afghani bidad mikonad, *rfi*, 9 June 2012

<sup>124</sup> Iranian Youth in Times of Economic Crisis, Djavad Salehi-Isfahani, *Iranian Studies*, 44:6, 2011, p795

<sup>125</sup> *Ibid*, p795

<sup>126</sup> *Ibid*, p795

<sup>127</sup> Jannati: Moshkelat-e eqtesadi jedi ast, *BBC Persian*, 3 August 2012

[http://www.bbc.co.uk/persian/iran/2012/08/120803\\_ka\\_janati\\_fridayprayer.shtml](http://www.bbc.co.uk/persian/iran/2012/08/120803_ka_janati_fridayprayer.shtml)

<sup>128</sup> Alamhoda: vaziyat-e ma vaziyat-e jangi ast, emkanat-e ghazaei-ye zendegietan ra tahiyeh konid, *Aftab News*, 6 Mordad 1391, <http://aftabnews.ir/vdcaymn6y49nie1.k5k4.html>

<sup>129</sup> Kazem Sediqi, emam-e jomeh-ye movaqat-e Tehran: barkhi be rahbari babat-e tahrir-ha taaneh mizanand, *Digarban*, 29 Tir 1391 <http://www.digarban.com/node/7938>

<sup>130</sup> Darkhast-e namayandegan-e Ali Khamenei az mardom: feshar-e tahrir-ha ra tahamol va az rahbar eta'at konid, *Digarban*, 5 Mordad 1391 <http://www.digarban.com/node/8074>

been conducting “economic warfare” against the Islamic Republic over the course of the last two years, and it has intensified over the last 6 months.<sup>131</sup>

Meanwhile, it appears as if the regime is relying more on Iranians blaming the West, and rallying around the flag, for their current economic travails. Such an outcome is by no means assured, and some reports have actually argued that Iranians are heaping just as much if not more blame on the incompetence of their own government.<sup>132</sup>

While domestic criticism of the nuclear policy has periodically flared up, there is as of yet, no major break of ranks on fundamentals. The most “controversial” statement made by a member of the political elite thus far was by Abdollah Nuri, a well-known state Reformist figure and onetime Interior Minister, who called for a referendum on the nuclear programme.<sup>133</sup> He argued that given the high cost which the regime and people have paid and severe pressure which Iran is under, a referendum will either strengthen the people’s resolve, or cause the policy to change. A lot was made of Nuri’s statement, but the fact is that he has not been a Minister since the late nineties, and even then, he found himself embattled, arrested and eventually condemned to five years in jail by the Special Court for Clerics. Despite Nuri’s provocative politicking, there is little to no chance that the current ruling regime will let Nuri participate in any future election, or that they will take all that much notice of his recommendation. Moreover, even if he were to put himself forward as a viable candidate, without a major shift in the status quo, he is certain to be disqualified by the Guardian Council. Finally, there is even disagreement within the Reformist camp itself, as chief Reformist political strategist and theoretician, Saeed Hajjarian has come out publicly against the idea of a referendum on Iran’s nuclear programme.<sup>134</sup>

Former President Rafsanjani has as usual played up to both sides, and tried to walk a tightrope between his Principalist rivals, some of which remain sympathetic to his politics, and the hardship and discontent of the general public as a result of the economy’s parlous state. While insisting that Iran show willingness to engage, after the Moscow talks, Rafsanjani explicitly criticised the Western powers and accused them of being disingenuous.<sup>135</sup> Rafsanjani remains head of the Expediency Discernment Council, which mediates disputes between the Majles and Guardian Council, but was ousted from the important position of Chairman of the Assembly of Experts, the institution which is supposed, at least in principle, to supervise the performance of the Leader and appoint his successor. In October 2012, two of his children, Faezeh and Mehdi Hashemi, languish in jail.

He has resisted confrontation with his erstwhile friend and ally Supreme Leader Khamenei, and for a number of years now, openly criticised Ahmadinejad’s style of diplomacy.<sup>136</sup> While there are members of the elite, who continue to be sympathetic to Rafsanjani’s more “technocratic” and “pragmatic”

<sup>131</sup> Dabir-e majma'-e tashkhis-e maslahat-e nezam-e Iran: dowlat baraye moqabeleh ba tahrir-ha barnameh-ye yeksaleh darad, *BBC Persian*, 18 Tir 1391

[http://www.bbc.co.uk/persian/business/2012/07/120708\\_i25\\_iran\\_sanctions\\_rezaee.shtml](http://www.bbc.co.uk/persian/business/2012/07/120708_i25_iran_sanctions_rezaee.shtml)

<sup>132</sup> Ahmadinejad Gets Blame And Sanctions As Economy Sputters, Ladane Nasser, 25 March 2012

<http://www.bloomberg.com/news/2012-03-25/ahmadinejad-gets-blame-and-sanctions-as-economy-sputters.html>

<sup>133</sup> Abdollah Nuri: monaqesheh-ye haste'i-ye Iran beh referendum gozashteh shavad, *Radio Farda*, 22/04/1391

[http://www.radiofarda.com/content/o2\\_nouri\\_iran\\_nuclear\\_reformists/24642379.html](http://www.radiofarda.com/content/o2_nouri_iran_nuclear_reformists/24642379.html) ; Iran’s former interior

minister calls for a nuclear referendum, Saeed Kamali Dehghan, *The Guardian*, 11 July 2012

<http://www.guardian.co.uk/world/iran-blog/2012/jul/11/iran-abdollah-nouri-calls-for-nuclear-referendum>

<sup>134</sup> Hajjarian rejects referendum on Iran’s nuclear programme, Eskandar Sadeghi-Boroujerdi, *Iran Pulse: Al-Monitor*,

12 September 2012, [http://iranpulse.al-monitor.com/index.php/2012/09/280/hajjarian-rejects-referendum-on-](http://iranpulse.al-monitor.com/index.php/2012/09/280/hajjarian-rejects-referendum-on-irans-nuclear-programme/)

[irans-nuclear-programme/](http://iranpulse.al-monitor.com/index.php/2012/09/280/hajjarian-rejects-referendum-on-irans-nuclear-programme/)

<sup>135</sup> Iran cleric attacks world powers’ ‘dishonesty’, Associated Press / Al-Arabiya, 21 June 2012

<http://english.alarabiya.net/articles/2012/06/21/221870.html>

<sup>136</sup> Ayatollah Hashemi Rafsanjani dar goftogu-ye ekhtesasi ba ruznameh-ye Jomhuri Islami: movafaghiyat-ha-ye

emam Khomeini marhun-e danesh-e ishan bud, *Jomhuri Islami*, 09/03/1391

[http://www.jomhourieslami.com/1391/13910309/13910309\\_03\\_jomhuri\\_islami\\_akhbar\\_dakheli\\_0003.html](http://www.jomhourieslami.com/1391/13910309/13910309_03_jomhuri_islami_akhbar_dakheli_0003.html)

approach,<sup>137</sup> few are willing to jeopardise their own political futures or publicly contradict the official line. This includes some members of the traditional right (*rast-e sonnati*) around the figure of Assembly of Experts Chairman, Ayatollah Mahdavi Kani, which comprises groups such as, e.g. the Islamic Coalition Party, the Society for Qom Seminary Teachers, and the Society for Combatant Clerics.

While the Endurance Front (*Jebhe-ye paidari*) affiliated with the radical cleric Ayatollah Mesbah Yazdi, did not perform particularly well in the Majles elections, and the traditional right, specifically individuals like Larijani, Bahonar, and Tavakkoli, continue to dominate the Majles, this vociferous group does constrain the traditional Right domestically in a number of important ways. The members of the Endurance Front, often regarded as Iran's "neoconservatives", constantly try to outflank the traditional right in their radicalism, and thereby undermine the latter's ability to take more moderate positions. This loose group of rightwing radicals are sympathetic to Ahmadinejad (apart from his controversial advisor Mashaei) and have shown more than willing to rebound ferociously on the president's critics. But, as was stated earlier, while neither of these two groups are prepared to publically or overtly criticise Khamenei's line on the nuclear programme, the poor standing of the economy will place the regime elite under significantly more pressure. It will also exacerbate intra-factional rivalries, which have always existed, but have been on the increase since 2009. Specifically, intra-factional Principalist infighting has worsened since the 2009 side-lining of Reformist forces, and it is set to continue into the coming year ahead of the 2013 presidential contest.

The most recent and controversial attack on Ahmadinejad has been the letter by a group of embittered ex-ministers to the Supreme Leader, calling on him to strip Ahmadinejad of his powers and hand over the reins of executive power to a council.<sup>138</sup> Khamenei has yet to publicly respond, and it is unlikely he, in fact, will do so, since he knows any attempt to remove Ahmadinejad could prove hazardous for the image of the regime as a whole. Excessive and destructive infighting might also provoke the politically active elements of the IRGC to enforce unity by fiat and to intimidate critics, even if they be long-standing members of the traditional right. The attacks on the Deputy of the Islamic Coalition Party, Asadollah Badamchian, after he alleged IRGC interference in the Majles elections is just one example of many.<sup>139</sup>

## Conclusion

Iran has lost approximately half of its oil revenue,<sup>140</sup> but still has substantial revenue flowing into its coffers. However, the economy is facing serious problems. The IMF has predicted a growth rate of 0.4%, which may well be overly optimistic, even the official rate of unemployment stands at well above 20%, with some estimates claiming that 500,000 to 800,000 Iranians have lost their jobs in the past year.<sup>141</sup> The Islamic Republic's leaders are well aware that Ahmadinejad's economic policies have added to the Iranian economy's decline, and will try their utmost to rein in the rising prices of basic foodstuffs, inflation and the currency crisis. Whether they will succeed in doing so is still not clear, but there is little doubt they are diligently struggling to circumvent Western financial and energy sanctions by the impromptu and ad hoc means available to them, and thus claw back some of their lost oil revenues. They are also enforcing austerity measures where they deem necessary, and where it is least politically costly. One of the few things Iran has going for it in terms in domestic economic policy is its low levels of debt.

<sup>137</sup> Mohsen Rafiqdust, ra'is-e mo'seseh-ye nur: Hashemi Rafsanjani bayad kenar rahbar bashad, *Digarban*, 22 Khordad 1391 <http://www.digarban.com/node/7070>

<sup>138</sup> Nameh parakani az jam-e zahr ta taqala-ye vaziran ma'zul: gozaresh az faz-e jadid-e salb-e masuliyat-ha-ye rais-e jomhur, *Iran*, 23/5/1391

<sup>139</sup> Ravabet-e omumi-ye hezb-e motalafeh: badamchian nagofteh ke sepah dar entekhabat dekhlat karde ast, *Khabar Online*, 09/05/1391 <http://khabaronline.ir/detail/231806/politics/parties>; Asadollah Badamchian, Qaem maqam-e hezb-e motalafe-ye eslami, dar goftogu ba "Sharq": Mardom baraye osulgarayan "salavat gharra" miferestand, Soroush Farhadian, *Sharq*, 4/5/1391

<sup>140</sup> The percentage has continued to fluctuate and has yet to stabilise.

<sup>141</sup> Unemployment mounts as Iran's economy falters, Marcus George and Zahra Hosseinian, *Reuters*, 19 September 2012 <http://www.reuters.com/article/2012/09/19/us-iran-unemployment-idUSBRE8810TA20120919>

Despite having experienced U.S. sanctions on the development of the energy sector for close to two decades, the current sanctions are unprecedented in the history of the Islamic Republic. While the Iranian authorities publicly recognise that a reorientation of the economy towards domestic production is of long-term strategic importance, for the present, it seems that Iran is willing to play a game of cat and mouse, and make do with makeshift solutions. They are also relying on great power rivalry as a factor constraining the scope and extent of U.S. extra-territorial sanctions. Iran, moreover, thinks it doubtful that the P5+1 will shift its position until after the U.S. presidential election, and the ruling elite of the Islamic Republic, at least for the present, believes it can carry on putting out one fire after another.

### **Efficacy of Sanctions**

As Meghan L. O’Sullivan, former U.S. Deputy National Security Adviser on Iraq and Afghanistan, and an expert on the construction and anatomy of sanction regimes, remarks: “It is first important to acknowledge that sanctions almost never “work” when they make up the entirety of a strategy.”<sup>142</sup> While sanctions have the ability to induce Tehran’s recalibration of its cost-benefit analysis in the pursuit of its nuclear programme, there is a general consensus among experts on Iran and sanctions that sanctions by themselves are most unlikely to yield a diplomatic solution to the current impasse. Saddam Hussein’s Iraq and Castro’s Cuba stand as stark reminders.

Previous American encounters with Tehran also reinforce the failure of sanctions in and of themselves to engender Iran’s agreement or acquiescence. The U.S. hostage crisis and the release of American hostages in Lebanon are poignant examples, in which an impasse or serious object of contention dividing Iran and the West, specifically the U.S., and its eventual resolution had little to nothing, to do with sanctions.<sup>143</sup>

Similarly, while the regime in Tehran is undeniably under considerable pressure - as are the general populace, suffering the brunt of pressure brought about by Iran’s flagging economy - Iran’s leaders do have the capacity to react to new circumstances and undertake necessary exercises in damage control, despite inefficiency, incompetence and corruption. Such a response of course is fraught with risks. If Iran’s leaders fail in this regard, then discontent and apathy could transform into unremitting anger, hostility and political instability, perhaps forcing the military to take a more visible lead in the running of the country.

Whether in the long-term the Iranian government will be able to meet its budgetary needs in the future is not entirely clear, especially since the precarious state of the world economy could well depress oil prices, and therefore make such a prospect fade fast.

Iran will also have serious difficulties recouping revenues through taxation, since the Islamic Republic’s system of tax collection is relatively undeveloped and tax evasion is widespread. According to the Head of the Organisation for Fiscal Affairs, some 60% of the population do not pay taxes, and 20% of the economy is essentially hidden.<sup>144</sup> Moreover, the state’s “legitimacy deficit” seriously constrains it from exerting further pressure on a population riddled with discontent, by increasing the tax burden even further.

The proposals, which have emerged in the negotiations between Iran and the P5+1 thus far, have failed in part because of their perceived lack of appropriate balance, but also domestic factors, which have led

<sup>142</sup> Iran: The Nuclear Challenge, ed. Robert D. Blackwill, Council of Foreign Relations, p15; also see *The effectiveness of UN and EU sanctions: lessons for the twenty-first century*, Alex Vines, *International Affairs*, 88 : 4, 2012, p872

<sup>143</sup> See, *October Surprise: America’s Hostages in Iran and the Election of Ronald Reagan*, Gary Sick, I.B.Tauris, 1992

<sup>144</sup> Rais-e kol-e sazman-e omur-e maliyati: 20 dar sad-e eqtesad penhan va 40 dar sad moaf az maliyat: 60 dar sad-e eqtesad-e Iran maliyat nemidahad, Jamal Rahmati, *Etemaad*, 28 Shahrivar 1391  
<http://www.etemaad.ir/Released/91-06-28/150.htm>

governments on both side of the diplomatic impasse to squander potentially fruitful opportunities at various junctures.

Tehran is keeping the door to diplomacy open, while at the same time, augmenting the size of the civilian nuclear programme,<sup>145</sup> in order to convey to the West that the sanctions are not impacting Iranian “progress”.

The key dilemma, which Western policy-makers should consider, is that rightly or wrongly, the Supreme Leader and much of the governing elite have staked their legitimacy on the nuclear programme. This is one reason why Oxford Research Group, in consultation with former policy-makers and diplomats with direct experience of the Iranian nuclear file, emphasised that in order to reach a diplomatic solution, Iran should be offered a package with integrated ‘face-saving’ measures.<sup>146</sup> This briefing has also sought to make the case that sanctions and defiance are no replacement for serious diplomacy, which ultimately means that both sides must show their readiness to depart from their opening positions.

If Iran’s total submission and relinquishment of all right to uranium enrichment is the endgame, then sanctions are highly unlikely to succeed as long as the present governing elite remains in power. A compromise solution, however, remains feasible and not beyond the realm of possibility.

Another factor which should be considered is that Iran does not believe the U.S. is prepared to offer a deal that would be palatable to it, prior to Obama’s re-election. Similarly, it is doubtful that Ayatollah Khamenei, and Ahmadinejad’s domestic critics, would favour conclusion of a comprehensive deal with the P5+1, if it meant Ahmadinejad could claim it as a victory and capitalise on it domestically. The Iranians thus want to keep negotiations going, so that diplomatic contact is maintained until the arrival of the most apposite time to strike a deal. Iran’s economic turbulence of course impacts its plans in this regard, but nonetheless the aforementioned should be borne in mind.

If the objective is to curb and limit Iranian uranium enrichment activities, and ensure they remain peaceful, then the sequencing of any deal needs to be carefully weighted to promote a “balance of advantage” for both sides of the dispute. As we had previously laid out in our May 2012 report, *Iran’s Nuclear Impasse: Breaking the Deadlock*,<sup>147</sup> it may be possible to exchange the demands made on Iran’s nuclear ambitions with the progressive lifting of nuclear related sanctions. It is still possible for the West to use the leverage provided by sanctions constructively. As yet, however, there are few signs that the U.S., France, Germany and Israel will agree to any such scheme.

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<sup>145</sup> Iran doubles underground nuclear capacity: U.N. agency, Fredrik Dahl, *Reuters*, 30 August 2012  
<http://www.reuters.com/article/2012/08/30/us-nuclear-iran-iaea-idUSBRE87T0Y220120830>

<sup>146</sup> See, *Iran’s Nuclear Impasse: Breaking the Deadlock*, Eskandar Sadeghi-Boroujerdi, Paul Ingram, Gabrielle Rifkind, Oxford Research Group, May 2012

[http://www.oxfordresearchgroup.org.uk/publications/briefing\\_papers\\_and\\_reports/iran%E2%80%99s\\_nuclear\\_impasse\\_breaking\\_deadlock](http://www.oxfordresearchgroup.org.uk/publications/briefing_papers_and_reports/iran%E2%80%99s_nuclear_impasse_breaking_deadlock)

<sup>147</sup> Ibid