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Iran Adapts to Economic Sanctions: Room to Ensure Real Economic Growth by 2014

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Reports flowing to Israel and the West about the Iranian economy and the challenge of the sanctions indicate not just ongoing deterioration, but suggest impending catastrophe. Is this indeed the case from an economic-strategic point of view? Does this information reflect a realistic, balanced view of the situation?

Western sanctions against Iran intensified significantly in 2012, and include a boycott of Iranian banks, a freeze on Iran's central bank assets, disconnection of Iran from SWIFT, the global electronic banking system, a boycott on the import of Iranian oil and petrochemical products, and a boycott on naval insurance for oil and petrochemical tankers. These sanctions comprise a set of severe, painful steps capable of causing serious economic and political shocks to most nations that would be accompanied by damage to the economy and social unrest, and would seem to have serious potential to encourage significant change in the regime policy.

In fact, in 2012, the rate of inflation in Iran doubled to 40 percent; oil revenues dropped by 30 percent; the automotive industry (dependent mainly on imports from the West) was hurt severely; and there was at least an 80 percent drop in the Iranian exchange rate on the local currency market. At least half a million people lost their jobs (three times the number claimed by official data) and unemployment skyrocketed to 17 percent of the workforce (versus 12.5 percent, according to official data). How then does the Iranian regime manage to overcome these immense difficulties that present it with complex economic and social challenges without any deterioration or unrest liable to impair or even risk its continued hold on the reins of government?

An analysis of the data reveals a more complex picture. Despite the many negative economic indicators and despite the gloomy forecasts given the devaluation of the Iranian

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currency, the steep rise of the Tehran stock exchanged continued in 2012 at a real rate of more than 15 percent, and at more than 22 percent in January-June 2013. Moreover, despite the real drop of the Iranian rial, since early 2012 the construction and real estate sector has boomed, with not only increased activity but also a significant rise in real prices. In addition, as a result of the limits imposed on imports, various industrial plants have experienced significant recovery, contributing both to increased production for the domestic market and economic activity in times of crisis.

Economic-Strategic Background to the Regime's Policy

Those who formulated Iran's nuclear policy over the last six years were supported by three cardinal facts:

a. The enormous income from oil exports over the period 2007-2012 netted $500 billion, compared to the $185 billion in the previous six year period (an average annual increase of more than $50 billion) is power that allows the regime to adopt an unconventional, wasteful, unfocused economic and social policy generating skewed trends in virtually every sector.
b. Despite the fact that the oil sector is critical to Iran's economy and generates more than 60 percent of the annual revenue from exports, in practice it contributes only 10 percent to the GDP.
c. The vast majority of Iranian annual foreign trade (imports and exports) is conducted with Asia and the Far East, with only 20 percent conducted with the West and the former Soviet bloc.

Furthermore, in its report published on May 20, 2013, the International Monetary Fund estimated that while Iran's real gross domestic product (GDP) dropped by an average of 1.6 percent in both 2012 and 2013, Iran will nonetheless amass a $25 billion surplus in its current account in the balance of payment that can certainly be used during 2014. In addition, after two years of especially harsh Western sanctions, Iran will, in late 2013 or early 2014, still have some $79 billion of foreign currency and gold reserves.

Regime Tactics to Prevent Erosion in the Standard of Living

In early 2013, the Iranian regime began taking a range of steps to prevent any significant erosion in the standard of living of the working classes, including raising the minimum wage and state employee salaries by 20-25 percent, handing out food stamps to some 17 million impoverished people (about one-quarter of the total population) for purchase of basic goods (such as rice, beans, and oil) at reduced cost, and a significant increase in per capita financial grants. As a result, the average monthly income per family in which one person earns minimum wage reached $660 in 2013, compared to $466 in 2012 – an increase of more than 40 percent, keeping pace with the rate of inflation.

Moreover, although there has been a marked increase in unemployment, which now affects more than 4 million people, there has still not been any significant rise in social unrest, because the regime's social policy provides unemployment benefits for a period of 50 months, the longest period in the world (compared to 38 months in the Netherlands, and 5-15 months in other Western nations). To date, there has been no change to this wasteful policy despite IMF recommendations.

2014: A Year of Economic Reversal

In late 2013, two years after the tightening of the Western sanctions, Iran will still have foreign currency and gold reserves in the amount of $79 billion, along with cumulative surpluses in the 2012 and 2013 balance of payment account in the amount of $25 billion in various countries that can, in practice, be used to finance more Iranian imports from these nations as needed. So, for example, in order to use some of the tremendous surpluses, Iran recently signed agreements to import train locomotives from China, textiles from India, and wheat from Pakistan.

Accordingly, even if the sanctions are tightened and Iran loses 70 percent of oil export revenues (not just 30 percent as has been the case to date), it will still be able not only to finance annual imports at a rate of $50-60 billion but also continue to enjoy a striking surplus in the trade balance and current account in the balance of payments.

What, then, is Iran's economic forecast for July 2014, a year in which many expect Iran to cross the red line of nuclear arms production? According to the IMF assessment, 2014 will already see a turnaround, and Iran will experience renewed real growth at least at a 1.1 percent rate, thanks to significant strengthening of economic activity of the various branches of the economy and despite the expected continuing drop in oil exports.

In economic-strategic terms and considering the economic room for maneuver provided by Iran's vast foreign currency and gold reserves, it is doubtful that a worsening of Western economic sanctions – even the imposition of a full Western embargo on Iran – can prevent the regime of the ayatollahs from continuing to pursue its nuclear policy. Even if the sanctions cause significant damage to the Iranian economy, both in the short term and certainly in the long term, whether because of stifled development of the oil sector or because of tremendous resources wasted to support the nuclear policy, in practice the vast reserves of foreign currency and gold and the tremendous cumulative surpluses in Iran's balance of payments of 2012-2013 will allow Iran from early 2014 to maintain its nuclear policy without causing economic and social shockwaves that could possibly endanger the regime's stability.