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INTERNATIONAL SANCTIONS AND THEIR IMPACTS ON IRAN'S ECONOMY

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Abstract

Iran's nuclear program and the west's response have attracted a considerable attention from the international community since 2003. The United States, the United Nations (UN) and the European Union (EU) have imposed severe sanctions on Iran because of high distrust of the country's pursuance of a nuclear program due to suspicion about nuclear weapon development.This paper has been accomplished in order to fulfill a gap in implementing a comprehensive study of the western sanctions on Iran and their impacts on Iran's economy in detail. The current study intends to answer one of the most important questions in recent years, which is "what are the impacts of western multilateral sanctions on Iran's economy?" The results provide a support for deriving to the conclusion that sanctions, along with Iranian government economic mismanagement, seriously affected Iran's economy. Moreover, the details of the country's economic problems will be given through analyzing Iran's macroeconomic indicators changes after the multilateral sanction years as such as the impacts of the sanctions on Iran's GDP, unemployment rate, inflation rate, foreign direct investment export and import, Iran's oil industry and oil market, banking and financial system. The analysis should help shed some light on this current interesting controversial issue, and should be especially useful to political economists, or anyone else who may be considering the impacts of international multilateral sanctions on an economic situation of a country.

Key Words: International Sanctions, Iran's Economy, Impacts of Sanctions, Nuclear Program, Western-Iranian Relations.
JEL Classification: F51

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1. INTRODUCTION

When the Iranian nuclear program has been revealed in 2002, The anti-western policy orientation of Iran and its regional power-seeking nature after the Iranian 1979 revolution fed the idea that Iran is following the target of having nuclear weapons. The concealment of history of Iran's nuclear program also created a lack of confidence for Western countries. Indeed, Iran couldn't convince the west that its nuclear program has only peaceful objectives and thereupon since 2006 the United Nations, European Union and United States applied Economic sanctions on Iran. the multilateral sanctions were strengthen with time and this generated many economical problems for the Iranian government and people. This paper accomplished to study the International sanctions against Iran and their impacts on different parts of Iran's economy in a comprehensive view. In order to fulfill this goal, Numerical data has gathered from the official resources and the graphs generated from these data has been analysed. The results of analysing both quntitative and qualitative data provide the conclusion that if the Iranian government would better manage the economy of the country on the earlier years, the sanction results would not be that much severe. Iran's economy weak point which is the rentier nature of the government has increased the negative impacts of the economic international sanctions.

2. IRAN'S ECONOMY AND THE ANALYSIS OF MACROECONOMIC INDICATORS AFTER THE MULTILATERAL SANCTIONS

In order to understand Iran's economy mechanism, it is important to underline a main issue in the country's economic structure which is the rentier nature of the Iranian state. as a rentier state, Iranian governmnet is obtaining its income mostly from the national resources revenues. In this case the share of domestic production sector is not considerable; hence in a time of expansion of oil revenues the economy almost has a good situation and vice versa. International Monetary Fund (IMF) reported on July 2011 that about %63.5 of government budget is consisting of oil and gas export revenues. Significantly, oil and gas revenues are both sources of power and Achilles' heel for Iran's government: on the time of oil export sanctions on Iran, the country can hardly sell its oil and this makes serious economis problems.In the next pages of this paper, the overview of changes of the

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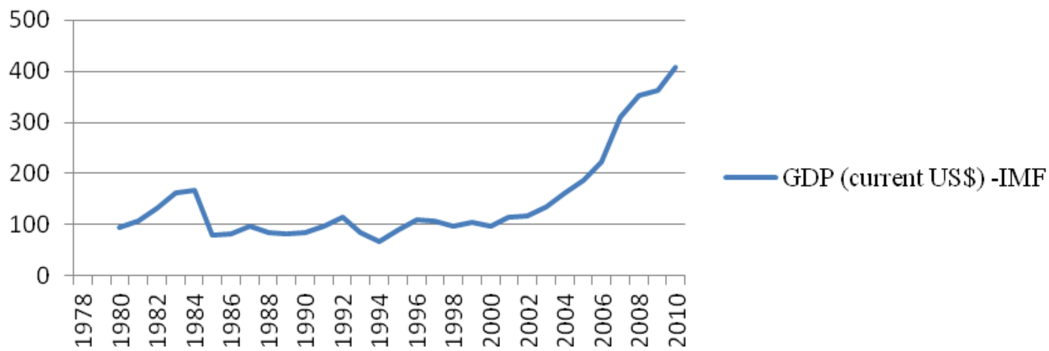
Main macroeconomic indicators during the time period before and after the sanctions will be discussed.

2.1. The Impacts of the International Sanctions on Iran's GDP

Since the International Sanctions, Iran's GDP has increased: This relates directly to increase in global oil prices. Iran's GDP could be defined as a reflection of oil revenues; Abolhassan Banisadr (2010) - Iran's first President -claimed that share of oil revenues in Iran's GDP is about 60%. Many researchers has studied the correlation coefficient between oil revenues and Irans GDP, Tavassoli and Fooladi (2006) has estimated this as 24%. Accordingly, the oil prices could have direct impact on Iran's GDP. Indeed, a comparison between figure 2.1.1 and 2.1.2. shows that The Iranian government has been compensated the sanction effects by benefiting from high oil prices. According to IMF report in August 2011, "the rebounding in international oil prices benefits Iran." In other words, the rising global oil prices have covered the impacts of the sanctions on Iran's economy for some years. however this wouldn't be the same case after 2012, when the oil sanctions were imposed.

Figure 2.1.1: Iran's GDP (current US$)



Data extracted from the International Monetary Fund (IMF) data bank.

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Figure 2.1.2: Global Crude Oil Price - U.S. Dollar per Barrel

Data extracted from the World Bank data Source.

2.2. The Impacts of the International Sanctions on Iran's Inflation Rate

The high inflation rate was the most important source of people's economic dissatisfaction from the government during the last 40 years. Figure 2.1.2 indicates Iran's inflation rate since 1978: The average inflation rate of Iran from 1978 to 2011 is about 18.86 percent. However, the recent inflation pressure started with psychological concerns which were effects of the sanctions. The worry of increasing the prices because of the sanctions let the people bought more and saved the products, resulting in an increased demand for goods and more inflation. The lack of people's trust to the government plans is in turn a reason for inflation itself.

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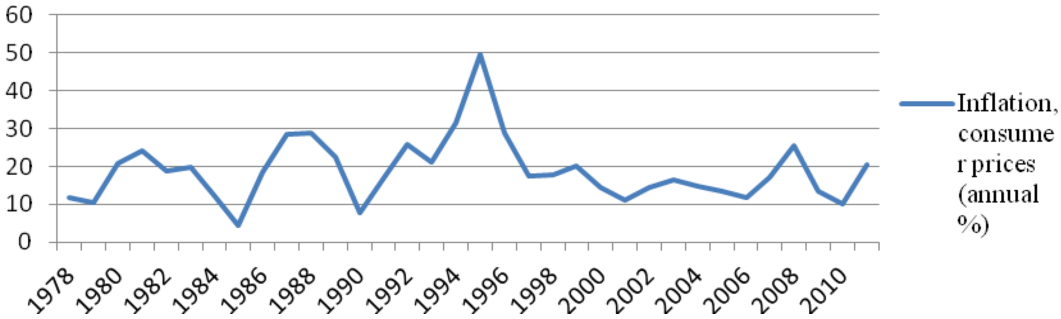
Figure 2.2.1: Iran's Inflation Rate, Consumer Prices (Annual %)



Data extracted from the World Bank data Source.

The latest statistics released by Iran's Central Bank included the inflation percentage on consumer goods. The percentage increase in consumer goods from 20th of March 2012 until 20th of April 2012 is 23.9% which put high pressure on Iranian people's life. Some argue that the real inflation growth is more than the Central Bank's report, however even the official report is considerably high. Indeed, according to the IMF 2011 report, Iran is one of the first 10 countries in the world which had the most inflation rate. While Iran's inflation rate is double digit, The 88 countries had inflation rate lower than 5% in 2011 and it has been anticipated by IMF that this number would raise to 103 countries on 2012.

2.3. The Impacts of the International Sanctions on Iran's Unemployment Rate

As shown on figure 2.3.1, In the years after the revolution and war there was a high unemployment rate in iran. the 70's and 80's were the time of the population boom; hence the highest unemployment level belongs to the 70's and 80's generations who formed the labor supply in the 90's and the 2000's decades. Clearly, the population was not the only reason for the increasing of the unemployment rate. According to Figure 2.3.1, when the sanctions get tougher the growth rate is falling and the unemployment rate is increasing. After the multilateral sanctions –especially the central bank and the SWIFT sanctions– the firms in Iran faced with problems and many of them went into bankruptcy. Many of the foreign firms and their representatives in Iran left their businesses such as General Motors, Mitsubishi, Peugeot, Nokia, Edison, Vestel and Selpak.

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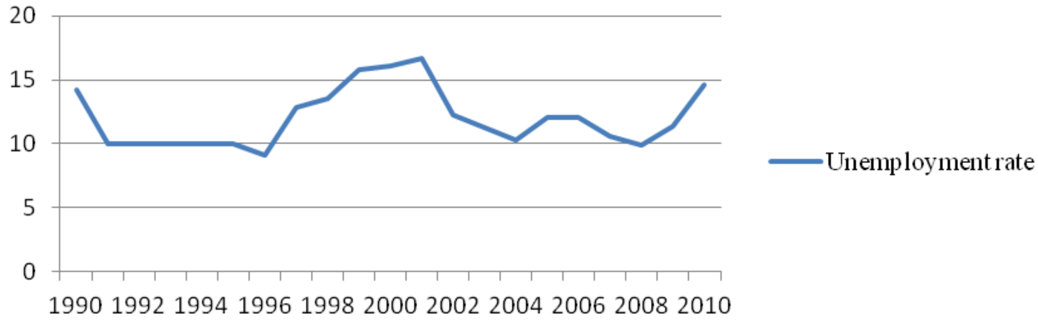
Consequently, the exit of the foreign firms from Iran because of the sanctions situation and difficulties for domestic companies increased the unemployment rate in Iran.

Figure 2.3.1: Iran's Unemployment Rate



Data extracted from the International Monetary Fund (IMF) data bank.

2.4. The Impacts of the International Sanctions on Foreign Direct Investment Rate in Iran

The foreign direct investment (FDI) in Iran has been decreased significantly because of the unfavorable business environment in the country after the sanctions. The index of 'economic freedom' gave Iran a score of 42.1, making its economy the 171st freest in the 2011 index.While Iran has a great investment potential because of its special geographic and strategic regional situation as well as inexpensive raw material and labor force, the economic and bureaucratic problems plus sanctions generated inappropriate economic conditions in Iran which increases the risk of investment in Iran. As shown in figire 2.4.1, It is obvious that how FDI in Iran decreased after the multilateral western sanctions. without international economic cooperation it is almost impossible for Iran to have economic development; Therefore, losing the foreign investors have irreparable effects on Iran's economy.

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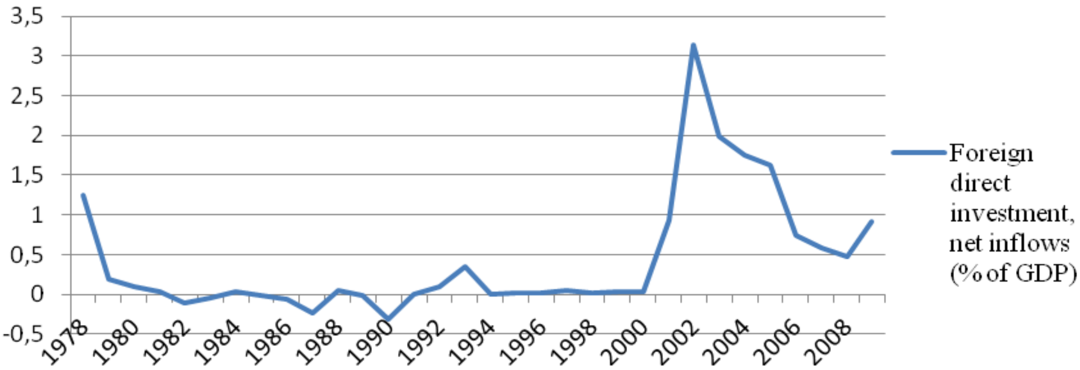
Figure 2.4.1: Foreign Direct Investment in Iran, Net Inflows (% of GDP)



Data extracted from the World Bank data Source.

2.5. The Impacts of Western Sanctions on Iran's Export and Import

The major impact of the sanctions on Iran's export and import links toward changing the countries which trade with Iran. During the last years, Iran's trade with Turkey and Gulf Cooperation Council (GCC) has increased. This is because of Iran's economic and diplomatic efforts to compensate the cost of the unwillingness of many countries to make business with Iran regarding the sanctions. Iran is forced to use re-export strategy to import and export the desired products into and out of the country. Previously, the relation between Iran and most of the GCC countries were rather sensitive than based on trust. Nader Habibi (2010) explains this issue clearly in his article, He states that Iran chosen a diplomacy to increase the volume of the trade and investment with GCC countries for two reasons: on the one hand, to overcome the difficulties resulting Iran's sanctions to do business with European countries by re-exporting through GCC countries; and on the other hand, Iran's effort to improve its relations with GCC countries because of their developing cooperation with U.S. in order to isolate Iran.

Moreover, according to Habibi, the volume of both exports and imports between Iran and GCC countries has increased in which the most share of trade between GCC countries and Iran is related to the United Arab Emirates. The investment opportunities, ease of travel and Dubai's free trade zone have allowed Iranian's to establish their own companies in this country and develop their

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business there. Furthermore, as Karim Sadjadpour (2011) stated, Iran was the second major re-export partner for UAE on 2010, also Dubai had re-exported about $5.8 billion worth of goods to Iran in 2009. The western sanctions had discouraged many countries to do business directly with Iran, Dubai let these companies to do so indirectly and let Iranians to flow their exports and imports through this country. Table 2.5.1 shows the import value of Iran from UAE during last six years in which the amount of the trade with UAE from the total Iran imports have increased. Thus, UAE has been Iran's first main Import partner over the recent years.

Table 2.5.1: Iran Imports from UAE

	Dollar value of Iran Imports From UAE	percentage from the total import value of each year
21 March 2006 to 20 March 2007	$9,349,421,645	22.50
21 March 2007 to 20 March 2008	$11,508,447,384	23.78
21 March 2008 to 20 March 2009	$13,489,983,062	24.16
21 March 2009 to 20 March 2010	$16,163,397,062	29.45
21 March 2010 to 20 March 2011	$16,669,232,736	29.91
21 March 2011 to 20 March 2012	$17,473,056,135	30.41

Data extracted from the Iran's Chamber of Commerce Trade Statistics.

However, since 2008, the U.S. has started to put pressures on UAE by threatening this country and warning the loss of access to the U.S. market. Consequently, Central Bank of UAE ordered to freeze 41 accounts of the Iranian people and entities (Reuters, 2010). Intensifying the Iran's sanctions resulted more pressure for the Iranian businessmen.They could no more easily trade with Dubai, the access to the bank currency exchanges for many of them has been restricted, and the transportation of their goods has hardened (Sajadpour, 2011: 28). All these persuade many Iranians to increase their tendency toward shifting their business through another country: Turkey. Using Turkey as the third country, Iranians can carefully perform re-exporting from Iran to European countries and vice-versa. According to Iran's chamber of commerce statistics, trade volume with Turkey has raised over the last years. The Table 2.5.2 and 2.5.3 show that from 21 March 2009 to 20 June 2012 Iran's percentage of the export to Turkey from the total

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exports, and the percentage of the imports from Turkey of the total imports have doubled.

Table 2.5.2: Iran's Export to Turkey		
Time Period	Export Dollar Value	Export To Turkey, rate within total exports
from 21 march 2009 to 20 march 2010	$592,988,451	2.71
from 21 march 2010 to 20 march 2011	$1,055,816,939	3.98
from 21 march 2011 to 20 march 2012	$1,432,574,233	4.24
from 21 march 2012 to 20 June 2012	$365,834,482	5.41

Table 2.5.3: Iran's Import from Turkey		
Time Period	Import Dollar Value	Imports from Turkey, rate within total imports
from 21 march 2009 to 20 march 2010	$2,016,871,830	3.67
from 21 march 2010 to 20 march 2011	$2,464,203,967	4.42
from 21 march 2011 to 20 march 2012	$3,079,950,785	5.36
from 21 march 2012 to 20 June 2012	$763,849,852	6.68

Both Table 2.5.2 and 2.5.3 data had been extracted from Iran’s Chamber of Commerce Trade Statistics.

Beside Turkey, one of the countries which have good economic relation with Iran is China. The trade opportunities between two countries had increased after the sanctions. Table 2.5.5 and Table 2.5.6 show that Iran’s imports from China have increased about twice since 2007 and also Iran exports to China have increased about fourfold since 2006. In addition, China was among the countries which were in advocate of negotiations with Iran rather than sanctions and economic pressure. Chinese Premier, Wen Jiabao, has announced that China has decided to boost trade with Iran by 2015 (Press TV, 2012). Iran has not much more choice other than increasing import from China in order to giving privileges for asking support from this country.

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Table 2.5.5: Iran Imports from China		
	Dollar value of Iran Imports From China	percentage from the total import value of each year
21 March 2007 to 20 March 2008	$4,247,023,290	8.78
21 March 2008 to 20 March 2009	$4,944,726,520	8.86
21 March 2009 to 20 March 2010	$4,802,030,935	8.75
21 March 2010 to 20 March 2011	$5,788,316,158	10.39
21 March 2011 to 20 March 2012	$7,387,518,612	12.86

Table 2.5.6: Iran Exports to China		
	Dollar value of Iran exports to China	percentage from the total export value of each year
21 March 2006 to 20 March 2007	$1,052,996,801	8.19
21 March 2007 to 20 March 2008	$1,243,523,764	8.13
21 March 2008 to 20 March 2009	$2,051,320,534	11.20
21 March 2009 to 20 March 2010	$3,125,762,675	14.28
21 March 2010 to 20 March 2011	$4,570,965,673	17.22
21 March 2011 to 20 March 2012	$5,652,242,564	16.74

Both Table 2.5.5 and 2.5.6 data had been extracted from Iran's Chamber of Commerce Trade Statistics.

Indeed, beside the normal official trade, an uprising issue is a volume of sanctioned goods which are smuggling through Iran and its neighbor countries. most of the smuggled goods imported into Iran are regular consumer goods, but there are also some strategic goods, which can be carried on small boats among the smuggling goods as well. The Iranian smugglers transport goods from UAE, Oman, Iraq and Turkey (Habibi, 2010: 09). Iran's official news declares that the value of smuggling goods to Iran each year is more than $20 Billion (Khabar Online, 2012). Also Mostafa Motavarzade, member of Iran's parliament economy commission, states that the value of the smuggling goods is about one third of Iran's official trade (Pars Daily News, 2012).

2.6. The Impacts of the Western Sanctions on Iran's Oil Industry and Oil Market

The oil productions and export play a significant role in Iran's economy. Iran has been ranked by the Central Intelligence Agency (CIA) in January 2011, as the fourth world largest oil producer country after Saudi Arabia, Venezuela and

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Canada. Also, Iran is the world's third largest crude oil exporter after Saudi Arabia and Russia (EIA, 2012: 01). Written in the oil and gas journal in January 26, 2012, Iran's second huge oil importer after China is the EU. As an example, in the first nine months of 2011, Iran provided 34.2% of Greece's total oil imports, 14.9% of Spain's, and 12.4% of Italy's (Watkins, 2012); however, after the sanctions Iran had to cut its oil export to the EU. Losing the EU as Iran's oil customer has a considerable impact on Iran's economy, regarding the loss of one of the important sources for receiving international exchanges.

Moreover, energy sector has a tightened link to Iran's economy, crude oil and its derivatives export are about 80% of Iran's total exports. Hence, Iran's economy is very sensitive and vulnerable to the oil prices. Paul Rivlin (2006) has studied the Iran's energy vulnerabilities and concluded that Iran is highly reliant on oil export revenues, and it is massively vulnerable to international energy sanctions.Whereas the EU stands for 18% of Iran's oil exports from January to June of 2011 (EIA, 2012: 04), the dilemma if Iran could bypass the EU energy embargo by selling its oil to other countries might arise. But the multilateral sanctions have made hard conditions for Iranian government in order to receive the oil payment due to the SWIFT sanction and also problems for exporting its oil to other countries because of the oil tankers insurance embargo.

After the western sanctions, the transaction of money for the oil payments was difficult. This was the reason for which Iran started to export oil with bartering system to countries such as India and Turkey (BBC Persia, 2012). India was the first country which started to buy oil from Iran by paying Gold instead of Dollar. However, not only the payment system but also the insurance of the oil tankers was problematic for Iran. The main previous insurance companies, Europeans are banned to insure Iran's oil tankers and sea regulations don't let oil tankers deliver oil without having insurance. Financial Times stated that the main Asian oil consumers of Iran -South Korea, China and Japan- suspended buying Iran's oil in 2012 because of the EU insurance ban on tankers transporting Iran's crude oil (The Washington Free Beacon: 2012). Nevertheless, Iran declared on July 28, 2012 that the country will insurance the oil tankers itself (Radio Farda News, 2012).

Another problem raised because of sanctions in regard to Iran's oil industry and oil export is related to the decline of Iran's oil production. Iran's oil fields need huge investment that Iranian government could not afford it. In addition, due

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to the international isolation, the government cannot borrow its necessary money from foreign countries (Yavari and Mohseni, 2010: 38). The oil and gas directory of the Middle East has recently published a report which analyses the future outlook of Iran's oil and gas industry. Accordingly, Iran needs to make economic reforms and develop foreign investment together with technological advancement in order to increase its energy resources. But following the sanctions many of projects are sentenced to slow down due to the lack of investment and financial sources. Furthermore, oil has the prominent position on Iran's economy growth rate; according to Crane, Lal and Martini (2008) who studied statistical analysis, the results show that if the oil production changes by 10 percent, the GDP of Iran will change by 2.7 percent. As shown on Figure 2.6.1, Iran's crude oil production has decreased considerably from 2009. Iran reached to production level of 3.16 Million Barrel per day (bpd) on June 2012 which has been the lowest level since 1992. The U.S. Energy information Administration (EIA) predicted that Iran's crude oil production will fall to 2.7 Million bpd at the end of 2012.

Figure 2.6.1: Iran's Crude Oil Production and Capacity

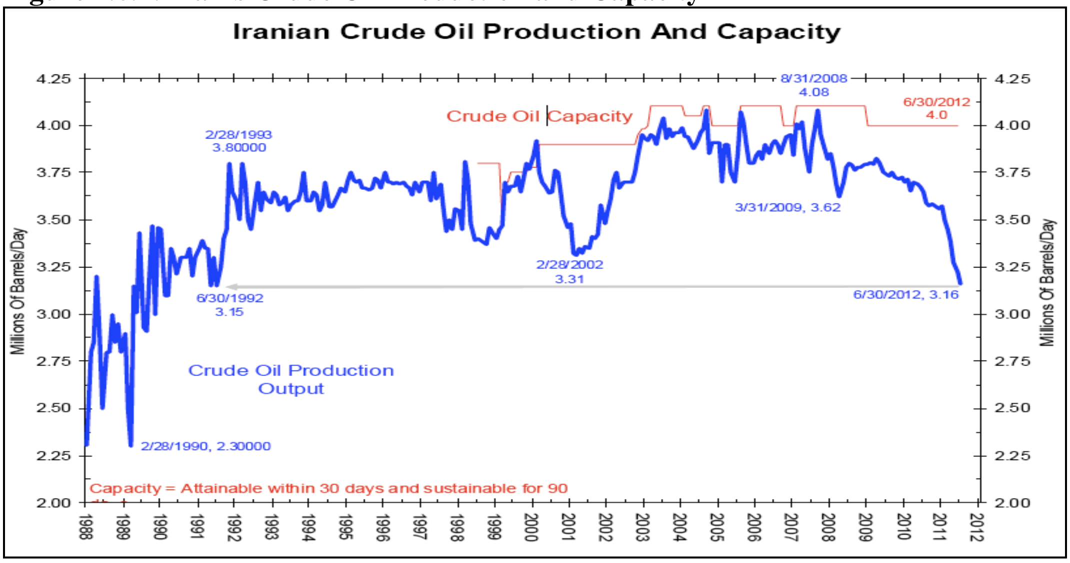

Figure extracted from Bianco Research, Charts of the Week, 11 July 2012.

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2.7. The Impacts of the U.S Sanctions on Iran's Banks and Financial System

Following the sanctions, Iran's currency -Rial- has experienced depreciation against the U.S. Dollar and lost more than half of its value during the last year. In July 2011, the exchange rate of Rial against Dollar was about 11,600 Rial, but in the July of 2012 it was about 19,580 Rial on the free market, which means 60% Rail's devalueation (Aftab News, Exchange Rate Archieve). Figure 2.7.1 shows the Rial devaluating against Dollar from July 2011 to October 2012, in both Iran's free market and the rates of Iran's central bank. The figure also indicates how the gap is increasing between the market and state value of Dollar, which makes a good condition for rentier people to misuse this big gap through buying the state value dollar and selling it in market value, and gaining huge profits.

There are plenty reasons for devaluing Rial against the dollar, among which the most important ones are as below:

- The high volume of money liquidity, the recession in housing and land market made many people to invest their money in gold and exchange rate market (because of the low interest rates of the banks), so the high volume of currency has flooded into Iran's market.
- The high demand for exchange rates especially for the Dollar. People are worried about the consumer goods prices and inflation (psychological effects of the sanctions on market), and they find the way to buy currencies to protect their savings. People are converting their assets to gold or Dollar rather than make investments in housing or industry. The reason of this lies behind the fact that Iranian people have the experience of the Iran-Iraq war. So, they think that if war starts, they can prevent the loss of their assets by changing them to more liquid assets like Dollar and gold.
- Huge profits that rentier people earn due to multi-rate exchanges, causing them to gain great profits in a short time. The initial effect of the multi-rate exchange rates is just the getting richer of the rich people and getting poorer of the poor people.

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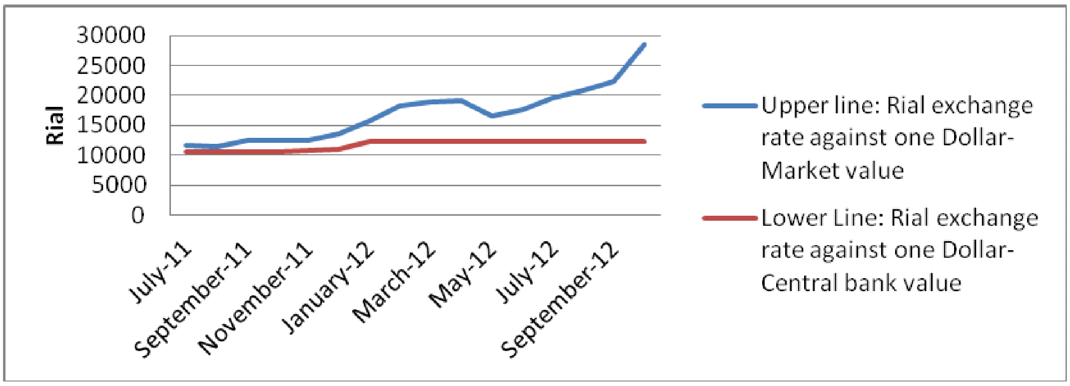
Figure 2.7.1: Rial Exchange Rate against Dollar, both in Free Market and the Iranian Central Bank Values



Market value data extracted from Aftab News exchange rate archive and central bank value data extracted from Iran's central bank exchange rate archive.

3. CONCLUSIONS

In response to the Iranian government's continuation of uranium enrichment, the U.S., UN and the EU ratified severe sanctions against Iran which had inevitable impacts on Iran's economy. Along with Iran's internal long-term economic problems, multilateral western sanctions have taken a toll on Iran's economy from many aspects. The previous economic problems make the favorable context for day-by-day sanctions to affect Iran's economy: Iran's dependency to the oil revenues were the best reason's for the West to impose sanctions on Iran's oil export which yielded more pressure on Iranian people and the government. Sanctions on Iran were wisely designed to generate a domino effect on all parts of Iran's economy. However, not only the sanctions but also The Iranian government mismanagement and inefficiency has enhanced the negative effects of the international sanctions. Hence, improving the political relations with the international community with serious and practical negations will be an inevitable step in Iran's economic development.

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