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Introduction

On the eve of the Iranian presidential election in May, Iranian President Rouhani has much to feel good about. Thanks to his tireless efforts, Iran's economy has moved from a recession in 2015/2016 to 7.4% GDP growth in the first half of 2016/2017. But U.S. President Trump's opposition to the nuclear agreement could deter investment and trade with Iran and threaten to turn Iran's recovery into another painful recession for the embattled Iranian people.

UN Sanctions

One thing is certain. The UN economic sanctions in response to the Iranian nuclear program devastated the Iranian economy. The sanctions targeted everything from shipping and banking to foreign investment and exports. The sanctions also limited Iranian revenues and stymied industry. Over $100 billion in financial assets were blocked. The volume of oil exports fell over 50% (from 2.5 MBD to 1.4 MBD). Car production fell by 40%. One out of every five Iranians was jobless. The economy was 15 to 20% smaller than it would have been without the sanctions. That's the equivalent of the Great Depression in the U.S. in the 1930s.

Self-Imposed Sanctions

But lifting sanctions is not enough for Iran to be competitive in the global economy. Iran also needs to end the crippling sanctions it has imposed on itself. If Iran is to escape the trap of poor management and inefficiency, Iran must ensure that privatization creates a real private sector rather than a semi-governmental sector. It can take months to get a new company registered due to bureaucratic inefficiency and corruption. The Iranian economy suffers from price controls, import tariffs and other interventions. Efforts at corporate restructuring are frustrated by an archaic Napoleonic commercial code.

Nuclear Deal

That said, hope was on the way. After a decade of economic despair and three years of tortuous negotiations, Tehran at last was coming in from the cold. On 14 July 2015 Iran made a deal with the UN Security Council's five permanent members plus Germany (P5 plus 1) to unwind its nuclear program in return for lifting UN international economic sanctions.

But it would take six months before the nuclear deal would go into effect. Finally, on 14 January 2016 the UN nuclear watchdog announced that Iran had fulfilled all of its commitments under the July nuclear agreement to scale back its nuclear program. The UN inspectors verified that Iran carried out all measures required under the agreement. As a result, UN sanctions on Iran were lifted, as were most European restrictions, including an embargo on oil imports.

Lifting sanctions allows crucial Iranian sectors such as oil and finance to re-enter the global

economy. Iran will also get access to funds frozen in international banks, estimated by the U.S. at over $100bn. These rewards for Iran came after it substantially reduced the scope of its nuclear program, including shipping abroad 98% of its stockpile of enriched uranium and shutting down a heavy water reactor. While the U.S. embargo on trade with Iran remains, the U.S. made exceptions for U.S. imports of food and carpets and U.S. exports of passenger aircraft.

Opportunities

At first glance, foreign businessmen saw the nuclear deal paving the way for a flood of new business deals, opening up foreign investment and international trade in crucial sectors such as oil and gas, car production, aviation, tourism, technology, mining the stock market and banking. Iran's potential emergence from economic isolation could be the most significant opening of an economy since the fall of the Soviet Union and the U.S. rapprochement with China. The potential of Iran is huge.

As one of the last markets to be opened up to the world, its allure is unmistakable. Its nearly 80 million residents—60% of whom are under 30 years old—already have an affinity for Western brands, especially American ones like Coca-Cola and Chevrolet. Some shops in affluent urban areas, particularly the nation's capital, are stocked with everything from Western-made sunglasses and designer jeans to laptops. The population is tech-savvy. Internet penetration is 53% across the population and 77% in Tehran. About 11 million Iranians have mobile Internet access. Many senior businesspeople were educated in the U.S. and still prize American engineering. And Iran's market for technology products and services is roughly $4 billion a year.

FDI Soars

It didn't take long for the post-sanctions economic potential to materialize. By April 2016 Iranian oilfields were doubling their production. Iran pumped almost 3.6m barrels of oil, a level last reached in November 2011 before sanctions over Tehran's nuclear program were tightened. Crude oil exports surged to 2m b/d, just 200,000 b/d below late 2011 levels.

In addition, lifting UN sanctions reopened the country's economy to a stream of new investments. Before UN sanctions were lifted, Iran was ranked 12th out of the 14 Mideast nations for foreign direct investment (FDI) between January 2003 and December 2015, equating to a market share of 1.62%. Since sanctions were lifted in 2016, Iran has climbed to number three in the rankings, with a market share of 11.11%, placed only behind regional powerhouses like the United Arab Emirates and Saudi Arabia. Iran also won 22 FDI projects during the first quarter of 2016, the highest rate of investment since FDI Markets began recording data in 2003.
Since sanctions were lifted the leading sector for investment into Iran has been financial services. Iran has also attracted investments from the automotive sector, business services, consumer electronics and textiles. The principal countries investing in Iran during the period were South Korea and Germany, which invested $2.15bn.

Total: Ice Breaker

Then on 8 November 2016 Iran signed a preliminary $4.8 billion deal with France's Total SA to help develop an offshore gas field. This agreement marks the first Western energy investment there since international sanctions were lifted this year. Under the deal, Total, China National Petroleum Corp. and Iran's state-owned Petropars plan to develop part of a giant gas field in the Persian Gulf known as South Pars.

Renewed Uncertainty

Before the U.S. presidential election, Iran's economy enjoyed an "impressive recovery" after the sanctions were lifted. But IMF notes renewed uncertainty surrounding the durability of the nuclear agreement and worsening Iranian relations with the U.S. could deter investment and trade with Iran and short-circuit Iran's anticipated recovery. In fact, if the nuclear agreement is derailed, IMF says Iran could fall into another recession.
Donald Trump's repeated criticism of the deal triggered new concerns over the durability of the nuclear agreement. President Trump's staff also warned Tehran that it is "on notice" and imposed new sanctions on Iranian individuals and entities because of Iran's missile testing and its role in regional conflicts. That said, Western diplomats in Tehran and Iranian

businessmen believe the deal is unlikely to unravel since it enjoys strong support from its other signatories, including the UK, France, Germany, Russia and China.

Shell

There was especially concern that international energy groups might somehow be deterred by renewed uncertainty over President Trump's election. But Shell was not deterred. In fact, on 7 December, 2017 Royal Dutch Shell signed a memo of understanding with Iran to explore potential investment in three of the country's biggest oil and gas fields. Shell plans to carry out studies of the giant oilfields of Azadegan and Yadavaran in south-west Iran as well as the Kish gas fields in the Gulf. This marked the 1st public commitment by a large Western oil company to work with Iran since Donald Trump was elected U.S. president.

Oil and Gas Opportunity

Few Western oil firms can ignore the multi-billion oil and gas "candy store" that is Iran. There are lots of reasons why Iran is a golden opportunity. Iran is preparing to open a multi-billion shop window for 50 oil and gas projects that are now up for grabs. Iran has the world's 4th largest crude oil reserves and 2nd largest natural gas reserves, or more than 250bn barrels of oil equivalent in reserves. Its energy resources have been mapped and production costs are low. Production costs are just $10 to $15 a barrel.

Many Questions

This ambitious oil production goal will hinge on that will depend not only on sanctions relief but the terms under which Western companies will be permitted to invest. What kinds of activities will be permitted in Iran, and with Iran, and by whom, are among questions being asked by the oil and gas industry.

During the sanctions period, Chinese oil companies continued to invest in Iranian oil fields at a low level. But China's oil technology is unimpressive and Iranians are unhappy with its performance. And as we've seen, European oil firms such as Shell and Total believe in early re-entry into the Iranian market. Total's long history in Iran undoubtedly helped Total get reconnected.

U.S. Holding Back

That said, the Iranians want U.S. major oil companies (such as Exxon Mobil, Chevron and ConocoPhillips) for political and technical reasons. But these U.S. oil firms are well behind their European rivals because U.S. sanctions and concurrent legal restrictions on trade with Iran are far more restrictive. U.S. firms have been disconnected from Iran for longer and the threat of legal action against any U.S. oil firm that tries to invest there before sanctions are lifted are far more severe. But at some point they may be allowed to re-enter. However, the problem for U.S. firms and the U.S. economy is that the rest of the world, especially the European Union, will have a significant jump on U.S. firms.

Difficult Oil Talks

Western oil companies also have frustrating memories of dealing with the Iranian energy industry. The Iranians, therefore, are likely to find Western oil companies difficult to deal with. The big question is whether or not the oil and gas contracts will be sufficiently attractive. Iranian law forbids foreign ownership of oil and gas reserves. In addition, Iran offered unpopular one-sided contracts back in the late 1990s and early 2000s. These old contracts put too much risk on the investor. In a buyer's market driven by lower oil prices, this old contract needs adapting. The new Iranian Petroleum Contract needs to be more attractive. Capital, investment, output and financing risk should be shared.

Can Iran Change?

The Iranian oil industry is well aware that its business climate has been poor in the past. Will this situational awareness matter? Can the Iranian oil industry improve enough to offer more attractive production-sharing contracts? At a minimum, they will need to enhance the old contracts or else U.S. oil companies will just say no. Iran is currently finalizing a new contract system to initially secure about $100 billion of new oil and gas deals with Western companies. The new contracts will enable foreign companies to set up joint ventures with Iranian state run oil companies. The new contracts will likely look more like production sharing deals, with foreign companies winning the rights to output and reserves, and risk is shared. Even when the terms and conditions are sorted out,

actual implementation of the projects will take years to roll out.

Iran's Choices

President Trump's victory has also emboldened U.S. hardliners. They see Iran as a regional threat and look at Iran with historic determinism. They argue that it is "inevitable" that Iran will use the "lion share" of its $100 billion in unfrozen assets to fund instability. But the past does not have to be a precedent for the future. In fact, Iran has two choices: Option 1: use the money to finance more instability or Option 2: use the money to rebuild its infrastructure and revive its economy. Iran's support for instability is not inevitable. Iran can choose re-entry into the global economy. Moreover, the U.S. government is not a helpless bystander. It can work with the U.S. private sector and shape Iran's decision to benefit from a web of economic interdependence as a responsible stakeholder. The U.S. and its allies can tilt the playing field and shape Iran's decision to pursue Option 2. But instead of wishing for Iran to choose Option 2, we need to work for it with the Iranians. America should provide incentives for Iran to use the $100bn in unfrozen assets from the nuclear deal to rebuild its infrastructure and revive the economy.

Washington needs to work closely with the U.S. oil companies, U.S. carmakers, etc. to boost investment and trade with Iran. When this happens, a web of economic interdependence occurs. Iran develops a stake in shared prosperity. Once it becomes a responsible stakeholder, Iran would think twice before it does anything blatant to destabilize the region and throw it all away.

Implications for Africa

During most of the years that the UN had sanctions against Iran for its nuclear program, Africa was a key battleground for Iran. President Ahmadinejad tried to undermine Western influence in the region. But Iran was unsuccessful. In 2010 the Gambia broke diplomatic ties with Tehran. And Gabon, Nigeria and Uganda voted in favor of the sanctions against Iran. Similarly, Iran struggled to undermine the regional influence of Saudi Arabia in Africa. In 2015 Sudan – which had close ties with Iran for almost three decades – did a diplomatic U-turn and supported Saudi Arabia's military actions in Yemen. Since then, President Rouhani's strategic priority has been to improve relations with America and the West and get a nuclear deal which would lift economic sanctions and open the country to foreign investment. Therefore, it's unlikely that close ties with Africa would all of a sudden become a strategic priority for Iran.

About Author

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