

The Relationship between Economy and Foreign Policy: The Case of Iran (2011-2016)^x

Sayyad SADRI ALIBABALU

Sakarya University

Received: 2018-07-27

Accepted: 2018-10-24

Abstract

Since 2011, Iran has had two problems in its state-run and oil-dependent economy. The first problem was a set of severe sanctions against Iran for its nuclear program. The second was the war in the Middle East after the Arab uprisings in which Iran was engaged directly or indirectly. Along with other factors, especially the corrupt management in the economy, Iran's economy suffered structural bankruptcy. The statistics show the depth of the impact of these two factors. The comparison between the two periods of 2005-2010 and 2011-2016, shows that in the second period the Iranian economy has damaged seriously. In fact, Iran's foreign policy was facing serious challenges before 2011, and UN Security Council resolutions also put pressure on it. Under the effects of these fluctuations, the non-oil economy's production capacity declined, and Iran's currency lost its value especially after Donald Trump rising to power in the United States. The effects of these problems are concretely seen in the Iranian economy. In these few years, a huge number of factories were affected by the crisis. But, after assignment of an agreement named The Joint Comprehensive Plan of Action in July 2015, some economic indicators are recovering. The purpose of this study is to identify the relationship between Iran's economy and foreign policy, especially in the case of Syria and Iraq, which has been conducted in a descriptive-analytical manner. The results of the study indicate that Iran's economy is strongly linked to foreign policy, and if the crisis continues in the Middle East, Iran's economy will suffer more.

Keywords: *Iran, economy, foreign policy, stagnancy, crisis*

JEL Code: *F51*

^x Expanded Conference Article, Presented in I. InTraders International Conference on International Trade, 10-12 May 2018, Sakarya, Turkey

Introduction

Iran's economy is always tied to foreign policy. Since 1979, the country's economy has undergone massive fluctuations. This is due to various fluctuations in foreign policy as well as the tendency of deployed governments. The important thing is that the United States imposed sanctions on Iran since the revolution that lasted without interruption (www.state.gov). The Iraqi invasion of Iran and war between two countries during 1980's was a huge hit to Iran's economy. Thus the government could not continue the economic plans that were implemented in the previous regime.

According to Iranian authorities, Iran's direct loss in that time was about \$ 440 billion, which Iran could not recover (www.khabaronline.ir). Of course, Iranian officials say the losses were about \$ 1 trillion. The low oil price also crippled the economy but the government, with its interference controlled totally the economy. Therefore, the Iranian economy became state-owned and the government managed the economy with oil sales. This situation is still ongoing and the government is trying to reduce its dependence to oil sales which has not been successful. These problems have been linked to the problem of the Iranian nuclear program since 2002. Along with these problems, the war in the Middle East since 2011 has caused another extra charge imposed on Iran, which is discussed in this article.

Literature review

There is not sufficient academic research on the effects of foreign policy on Iran's economy. Nader Habibi (2008) believes that Iran has been able to gain experiences from many years of international sanctions. Iran has tried to change the effect of sanctions by providing incentives to foreign investors. But with all of the actions, the Iranian economy has suffered greatly from international sanctions. Therefore, Iran's foreign economy suffered serious damage even before the war in the Middle East.

Jennifer Hsieh et al. (2015) believe that international sanctions reduced oil exports and locked the Iran's economy in 2012 and 2013. However the Hassan Rouhani's policy has led to positive developments in the Iranian economy. The authors further argue that international sanctions have tightened Iranian foreign policy and Iranian policymakers have been forced to negotiate with the West, especially on the nuclear program issue.

Most articles and books related to Iran's foreign policy have been written on international sanctions related to Iran's nuclear program. There is no specific academic work on Iran's foreign policy in the Middle East and its impact on the Iranian economy.

Iranian Foreign Policy

From the beginning of the 1979 revolution, Iran's foreign policy aim has been the export of the revolution and confronting with the US-led the West axis (Gharayag Zandi, 2008:281). This policy opposed the United States in the region and imposed costs on Iran. Under these pressures, Iran could not expand its markets and industries, and it was forced into the investment on infrastructure industries to reduce the dependence of domestic economy to abroad. Therefore, Iran tried to gain some degree of economic independence in order to carry out its revisionist foreign policy. The damages of 8 years war and the complete control of the economy by the government caused the backwardness of the rapid development process that had begun in the previous regime.

After a decade, in 1990's Iran has made its foreign policy soften and tried to adapt to global realities. In another side, Iran has taken steps to neutralize sanctions, including offering commercial privileges to foreign investors and foreign companies wishing to trade with Iran. As a result, sanctions have become a process of dynamic and complex economic war between Iran and western countries especially the United States (Habibi, 2008:1). Therefore, Iran was forced to abandon aggressive and revisionist policy and adopted a defensive policy in various fields up to day.

With the election of Mahmoud Ahmadinejad to the presidency in 2005, the conflict resumed with the West. At the same time, Iran's nuclear energy problem became an international hot topic. Ahmadinejad called for a revision of the global order and the structure of the United Nations and the Security Council (Irna, 2012). The result of these actions was the issuance of six Security Council resolutions against the activities of Iran in 2006 (Irna, 2015).

With the election of Hassan Rouhani as Iran's president, the talks finally came to an end in 2015. The Joint Comprehensive Plan of Action signed and Iran and the West agreed to lift sanctions related to Iran's nuclear program in exchange for waiving part of the nuclear program (Borger, 2014).

Iranian Engagement in Syria and Iraq (2011-2018)

But, the Middle East crisis in 2011 has added a new case to the problems of Iran. Iran's officials believed the demonstrations in the Arab countries inspired by Iran's Islamic revolution. But with the Western intervention, the Arab revolutions deviated from their goal (Sadri Alibabalu, 2017). So the US used the crisis against Iran, targeting Iran's regional allies. In this way, Iran's foreign policy was based on countering Western efforts for any regional change. At the end in one side Iran entered into a bloody war in Syria and Iraq and tried to make proxies in the region for fight in different fronts.

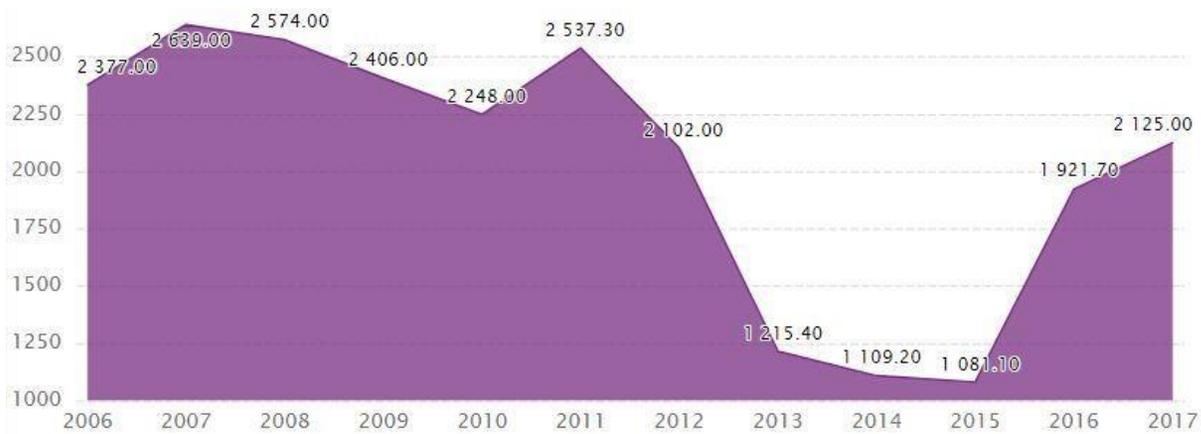
Given that the Iraqi government did not lose its coherence, Iran's spending in Iraq is not comparable to Syria. Iran's largest spending has been in Syria, according to estimates, Iran has spent at least \$ 6 billion a year in Syria since 2011. Of course, some sources estimate it much more (Lake, 2015). It can be claimed that Iran has spent near to \$ 50 billion up to date in Syria.

Iran-Saudi Arabia Oil War

In 2011, Saudi prince Turki Al-Faisal, along with British and American officials, announced that Riyadh was preparing to launch a flood of oil to reduce Iran's oil revenues to prevent Iran from acquiring a nuclear bomb. He said they have so much production capacity that they can replace Iranian oil if Iran cut its exports (Helman, 2011). Saudi Arabia has saturated the oil market to defeat its regional opponents, especially Iran. Thus the oil prices of the Organization of Petroleum Exporting Countries fell from \$ 130 in 2008 to \$ 30 in 2016 (Krauss, 2017).

Therefore Iran faced many income constraints. Although part of these restrictions was due to the sanctions related to the nuclear program since 2012, but the decline in oil prices was a huge loss for Iran. The war showed its impact in 2012 and Iran's oil revenue fell by \$ 62 billion. But the Iran's oil economy experienced a shock in 2015, and Iran's oil revenue fell to \$ 17 billion (shargdaily.ir). Although most oil producers have suffered from the oil war, the Iranian economy suffered serious damage due to Iran's costs on regional wars and the severe sanctions imposed by the UN Security Council since 2011.

Graph 1. Iran's oil exports

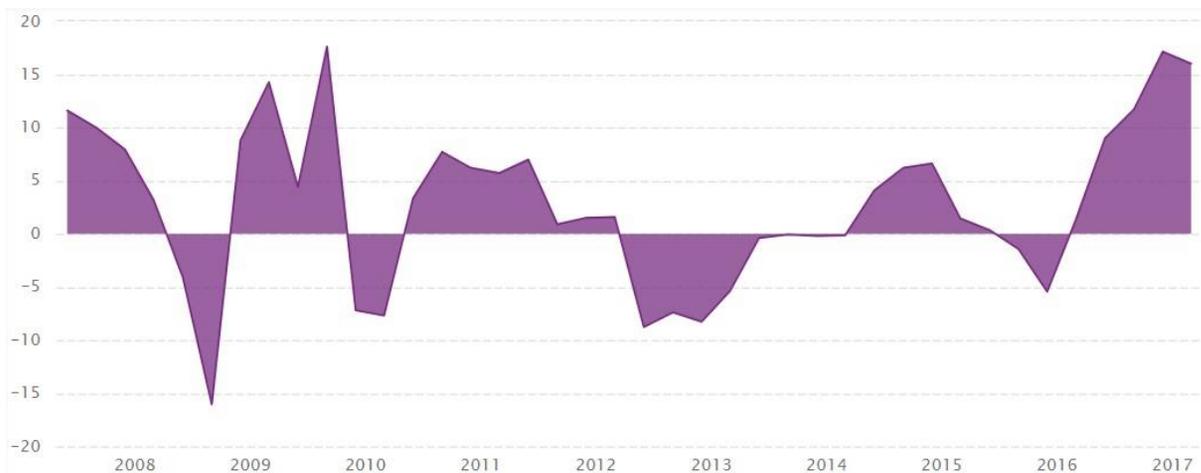


Source: <https://www.ceicdata.com/en/indicator/iran/crude-oil-exports>

Iranian Economic Indexes

Iran's GDP growth fell by -10% in mid of 2012, compared to 9% in 2011. Only in 2016, the Iran's GDP experienced a 17% increase in the positive impact of the nuclear deal. The following table shows the annual GDP growth rate of Iran.

Graph 2. Iran's GDP growth



Source: <https://www.ceicdata.com/en/indicator/iran/real-gdp-growth>

The comparison between the two periods of 2005-2010 and 2011-2016, shows that in the second period the Iranian economy has fallen sharply. This fall showed its impact on all aspects of Iran's

economic life. In the first period, Iran's average economic growth without oil was 5.6 % while in the second period it fell to -0.3 %.

Iran's GDP decreased from \$ 590 billion in 2011 to \$ 393 billion in 2015 (<https://tradingeconomics.com/iran/gdp>). The following table shows how Iran's GDP fell sharply.

Graph 3. Iran's GDP



Source: <https://tradingeconomics.com/iran/gdp-growth-annual>

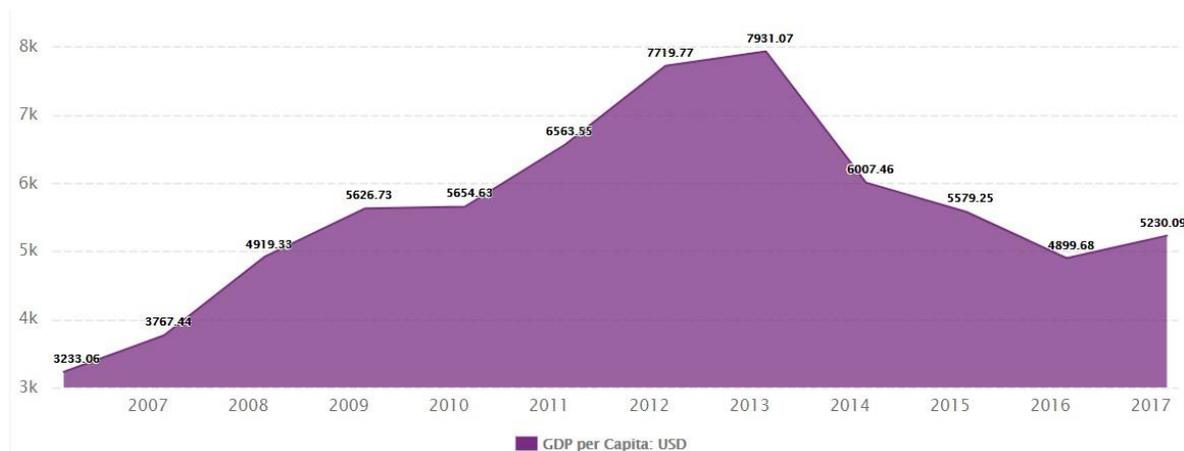
Iran's GDP per capita has been severely damaged as a result. In 2012, the value of the Iranian currency dropped by 60% in 8 days, resulting in a high price tag (O'brien, 2012). During these few years, the Iranian Rial has become the third low-value currency confronting the US dollar (<http://tabnakehatesadi.ir>). Under the influence of rising oil prices before 2011, the GDP per capita income had improved slightly, but international sanctions have gradually affected people's income and in 2013 GDP per capita fell from \$ 7,900 to \$ 4,900 in 2016.

Table 1. Devaluation of Iran's Currency

Devaluation of Iran's Currency (percent)	2011	2012	2013	2014	2015	2016	2017
	15.4	116.4	22	3	5.2	5.6	9.7

Source: <https://www.mashreghnews.ir/news/785406>

Graph 4. Iran's GDP Per Capita



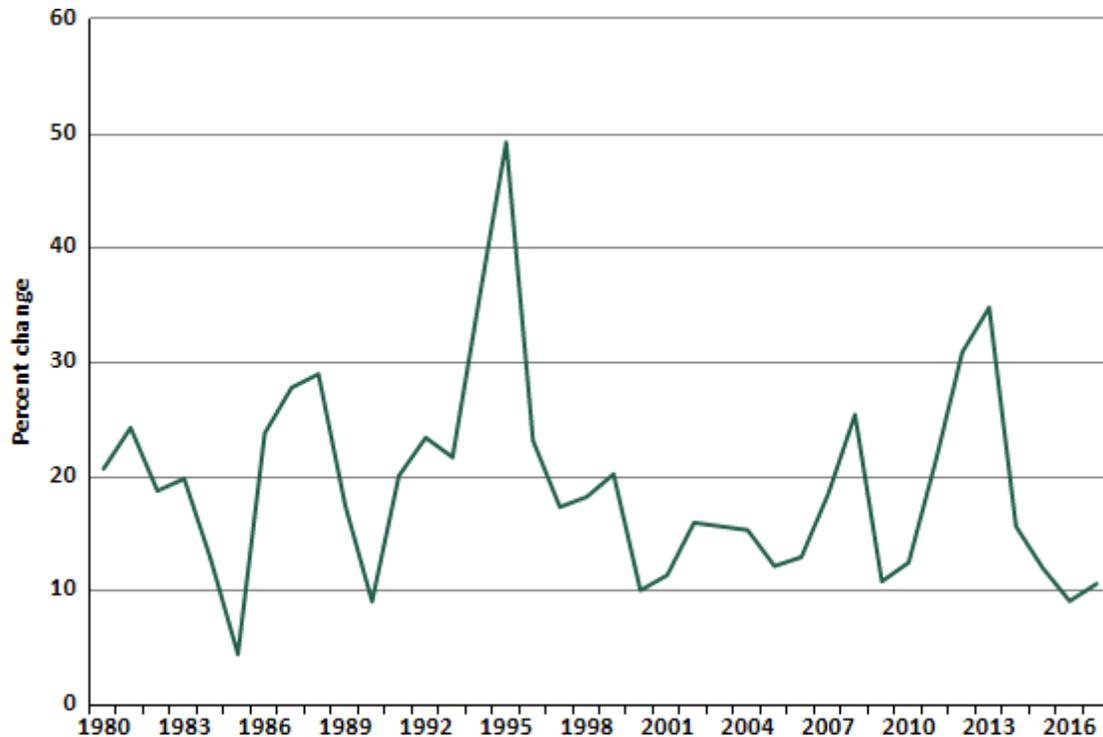
Source: <https://www.ceicdata.com/en/indicator/iran/gdp-per-capita>

In 2012, 33 percent of urban households, and in 2013, 40 percent of rural households were under the poverty line. Absolute poverty in Ahmadinejad's government (2005-2013) was greatly increased, and the villages returned to the statistics before the revolution. This increase was due to the economic mismanagement and sanctions (<http://www.eghtesadonline.com>).

According to 2015 statistics, 14,000 factories were closed, 22,000 factories operating with less than 50% capacity, 24,000 factories operating with 50-70% capacity and 21,000 factories are operating with 70% or more capacity (donya-e-eqtasad.com). An industrial activist said in 2014 that 'industrial settlements have become industrial cemeteries' (www.isna.ir). Moreover the head of

industrial cities in Iran said that in 2016 more than 5,000 small and medium-sized manufacturing units have been closed (<http://kayhan.ir>).

Graph 5. Inflation Rate in Iran



Source: <https://knoema.com/atlas/Iran/Inflation-rate#>

As illustrated in the chart, under the impact of sanctions and pressures of war spending, the inflation rate increased sharply from 12% in 2010 to 34% in 2013. But with the impact of positive policies of the Hassan Rouhani's government, and in particular the nuclear deal in 2015, the inflation rate has slowly declined to 10% in 2017.

Conclusion

In this paper, the researcher attempted to illustrate the close relationship between foreign policy and its direct and indirect effects on the economy of a country. Iran was the case of this research. The researcher attempted to review the causes of the economic deterioration of Iran from 2011 by providing a historical background. The following research shows that Iran's foreign policy has a very close and direct impact on its economy, and any change in foreign policy has positive or

negative effects on the Iranian economy. Since 2011, the political storms in the Middle East and the subsequent wars have been severely damaged the Iranian economy.

Although Iran's attempt was to fight its enemy outside the border and carry it to other territories, but in general, these wars had devastating effects on the Iranian economy. With the mismanagement and financial corruption of some statesmen, the effect of the Middle East War is clearly visible. The value of the Iranian currency in 2012 dropped by 120%, which led to price volatility in the market. Thus the value of Iran's currency has always been declining. In early 2018, the value of Iranian currency fell sharply and this trend continues. The process of rising prices and deteriorating economic condition have led to wide social discontent, as there was a massive demonstration in the cities of Iran in late 2017. These demonstrations show that people are under economic pressure.

The crisis in the Middle East seems to have no end. Iran will continue to increase spending on the continuation of the war. An important issue with the election of Donald Trump to the presidency of the United States is the West's nuclear deal with Iran in 2015. Given that Trump has threatened to quit the agreement in line with restricted regional activities of Iran; it seems Iran will experience a tough future. Although the nuclear deal gives Iran a significant breakthrough, it is clear from the statistics that many of the provisions of the agreement have not been implemented. After 3 years of the agreement, the international SWIFT system for Iran has not been activated, and Iran's international trade has many problems.

Trump administration's regional efforts show that he is determined to hit Iran in any possible way. The US coalition with Iran's regional rivals, including Saudi Arabia and Israel, is very dangerous for Iran. Iran is trying to avoid to giving any excuse for the United States. But the US seems to be taking every opportunity to thwart the benefits of the nuclear deal for Iran. Finally, this research shows that Iran's foreign policy has failed to meet its economic needs. Subsequent crises in foreign policy, including Iran's nuclear issue on the Security Council, the Middle East conflict, and the Saudi oil war prevented Iranian officials from addressing domestic issues. Of course, the Middle East crisis is not unique to Iran, but it has a lot of economic and social consequences for Iran. Moreover, Iranian officials say that they must fight over the borders in order not to fight extreme groups inside Iran. So they are ready to pay for any expenses.

References

Borger, Julian (2015), Iran Nuclear Deal: the Key Points, the Guardian, retrieved 26.03.2018, <https://www.theguardian.com/world/2015/jul/14/iran-nuclear-deal-key-points>

Gharayag Zandi, Davoud (2008) Islamic Republic of Iran Foreign Policy Principles: A Study on Texts, Journal of Strategic Studies, 11 (2), pp. 277-312.

Habibi, Nader (2008), The Iranian Economy in the Shadow of Economic Sanctions, Middle East Brief, Crown Center for Middle East Studies, No. 31.

Helman, Christopher (2011), Saudis Set to Bankrupt Iran with Flood of Oil, Forbes, retrieved 26.03.2018, < <https://www.forbes.com/sites/christopherhelman/2011/06/22/saudis-set-to-bankrupt-iran-with-flood-of-oil/#2f1c39ee39da>>

Hsieh, Jennifer; Rachel Ziemba, and Mark Dubowitz (2015), Iran's Economy Will Slow but Continue to Grow Under Cheaper Oil and Current Sanctions, Foundation for Defense of Democracies & Roubini Global Economics.

IRNA (2012), Seven Visits to the United Nations, Seven Emphasis on Global Justice and Permanent Peace, retrieved 25.03.2018, <<http://www.irna.ir/fa/News/377386>>

Irna (2015), Nuclear Sanctions from Start to End, retrieved 25.03.2018, <http://www.irna.ir/fa/News/81923424>

Krauss, Clifford (2017), Oil Prices: What to Make of the Volatility, The New York Times, online at <https://www.nytimes.com/interactive/2017/business/energy-environment/oil-prices.html>

Lake, Eli (2015), Iran Spends Billions to Prop Up Assad, Bloomberg, retrieved 28.03.2018, <<https://www.bloomberg.com/view/articles/2015-06-09/iran-spends-billions-to-prop-up-assad>>

O'brien, Mathew (2012), How Does a Currency Drop 60% in 8 Days? Just Ask Iran, online at <https://www.theatlantic.com/business/archive/2012/10/how-does-a-currency-drop-60-in-8-days-just-ask-iran/263159/>

Sadri Alibabalu, Sayyad (2017), Iranian Perspective on Egyptian Revolution: From Optimism to Despair, online at <https://moderndiplomacy.eu/2017/11/20/iranian-perspective-and-performance-on-egyptian-revolution-from-optimism-to-despair/>>

<https://www.state.gov/e/eb/tfs/spi/iran/index.htm>

<https://www.khabaronline.ir/detail/460408/Economy/political-economy>

<http://sharghdaily.ir/News/10653>

<https://www.ceicdata.com/en/indicator/iran/crude-oil-exports>

<https://tradingeconomics.com/iran/gdp>

<https://www.ceicdata.com/en/indicator/iran/real-gdp-growth>

<https://www.ceicdata.com/en/indicator/iran/gdp-per-capita>

<http://www.eghtesadonline.com>, link: <https://goo.gl/9UxBke>

<https://donya-e-eqtasad.com>, link: <https://goo.gl/gK7fwM>

<http://kayhan.ir/fa/news/111156>

<https://www.isna.ir/news/93042112163>

<https://knoema.com/atlas/Iran/Inflation-rate#>

<https://www.mashregnews.ir/news/785406>

<http://tabnakeghtesadi.ir/fa/news/82118>