Iran’s Economic Conditions: U.S. Policy Issues

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Summary

The Islamic Republic of Iran, a resource-rich and labor-rich country in the Middle East, is a central focus of U.S. national security policy. The United States asserts that Iran is a state sponsor of terrorism and that Iran’s uranium enrichment activities are for the development of nuclear weapons. To the extent that U.S. sanctions and other efforts to change Iranian state policy target aspects of Iran’s economy as a means of influence, it is important to evaluate Iran’s economic structure, strengths, and vulnerabilities.

Since 2000, Iran has enjoyed broad-based economic growth. However, strong economic performance has been hindered by high levels of inflation and unemployment and low levels of foreign investment. Some contend that President Ahmadinejad’s expansionary monetary and fiscal policies have worsened unemployment, inflation, and poverty in Iran.

Iran has long been subject to U.S. economic sanctions, and more recently, to United Nations sanctions, over its uranium enrichment program and purported support for terror activities. Such sanctions are believed by many analysts to contribute to Iran’s growing international trade and financial isolation.

Iran’s economy is highly dependent on the production and export of crude oil to finance government spending, and consequently is vulnerable to fluctuations in international oil prices. Although Iran has vast petroleum reserves, the country lacks adequate refining capacity and is highly dependent on gasoline imports to meet domestic energy needs. To reduce this dependency, the country is seeking foreign investment to develop its petroleum sector. While some deals have been finalized, reputational and financial risks may have limited other foreign companies’ willingness to finalize deals.

While Iran-U.S. economic relations are limited, the United States has a key interest in Iran’s relations with other countries. As some European countries have curbed trade and investment dealings with Iran, other countries, such as China and Russia, have emerged as increasingly important economic partners. Iran also has focused more heavily on regional trade opportunities, such as with the United Arab Emirates.

High oil prices have increased Iran’s leverage in dealing with international issues, but the country’s dependence on oil and other weak spots in the economy have to come to light by the 2008 international financial crisis, which may portend a slowing down of Iran’s economy.

Members of Congress are divided about the proper course of action in respect to Iran. Some advocate a hard line, while others contend that sanctions are ineffective at promoting policy change in Iran and hurt the U.S. economy. In the 110th Congress, several bills were introduced that reflect both perspectives. Policies toward Iran likely will remain a key issue for the 111th Congress. This report will be updated as events warrant.
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Introduction

The Islamic Republic of Iran is a central focus of U.S. national security policy. The United States has designated the Iranian government as a state sponsor of terrorism. The Administration’s 2006 *U.S. National Security Strategy* argues that the United States “may face no greater challenge from a single country than from Iran.”1 The United States contends that Iran is a destabilizing force in the Middle East and expresses concern about its growing influence in the region and internationally. The Bush Administration has accused Iran of arming Shiite militias in Iraq, providing support to Hezbollah and Hamas, and inflaming sectarian strife in the Middle East. The Administration also has decried Iran’s uranium enrichment activities, which it alleges are being used to develop nuclear weapons.

This report provides a general overview of Iran’s economy, addresses related U.S. policy concerns, and discusses policy options for Congress. The purpose of this report is two-fold. First, it provides insight into important macroeconomic trends, policy reforms and objectives, key economic sectors, international trade patterns, and sources of foreign exchange.2 Second, in the context of U.S. economic sanctions imposed for national security and foreign policy reasons, it evaluates Iran’s economic structure, strengths, and vulnerabilities and discusses issues and options for Congress.

Iran boasts the word’s third largest petroleum reserves, following Saudi Arabia and Canada, and the second largest gas reserves, after Russia. Iran also has the Middle East and North Africa region’s second largest economy, after Saudi Arabia, and the second largest population, after Egypt (see Table 1). Nevertheless, Iran faces a number of significant economic challenges. Internal challenges include dependence on oil export revenues to finance government spending and vulnerability to oil price fluctuations; dependence on gasoline imports to meet domestic energy needs; high inflation, unemployment levels, and poverty levels; reported domestic economic mismanagement; and widespread economic inefficiency. External challenges include U.S. and United Nations (U.N.) sanctions and other forms of U.S.-led financial pressure and the fallout from the recent global economic downturn. This report will be updated as warranted by events.

<table>
<thead>
<tr>
<th>Table 1. Iran Country Overview</th>
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<tbody>
<tr>
<td><strong>Indicator</strong></td>
</tr>
<tr>
<td>Land Area</td>
</tr>
<tr>
<td>Population</td>
</tr>
<tr>
<td>Median Age</td>
</tr>
<tr>
<td>Head of State</td>
</tr>
<tr>
<td>Capital</td>
</tr>
</tbody>
</table>

2 Economic data for this report are drawn from data from the International Monetary Fund (IMF). As a member of the IMF, Iran reports on its economy to the IMF. The economic data are limited in their means of independent verification by the IMF. In addition, this report relies on data from the Economist Intelligence Unit (EIU) and Global Insights, international economic research and forecasting agencies. U.S. government sources of data include the Central Intelligence Agency for general economic indicators and the Census Bureau for trade data.
## Iran’s Economic Conditions: U.S. Policy Issues

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Life Expectancy at Birth</td>
<td>70.9 years (CIA, 2008 estimate)</td>
</tr>
<tr>
<td>Gross Domestic Product (GDP)</td>
<td>$768 billion (purchasing power parity) (EIU FY2007);</td>
</tr>
<tr>
<td></td>
<td>$724 billion (real GDP translated into U.S. dollars using PPP exchange rate in 2005) (EIU, FY2007 estimate)</td>
</tr>
<tr>
<td>GDP Real Growth Rate</td>
<td>7.8% (EIU, FY2007 estimate)</td>
</tr>
<tr>
<td>GDP Per Capita</td>
<td>$10,781 (EIU, FY2007 estimate)</td>
</tr>
<tr>
<td>GDP Composition at Factor Cost (Current Prices)</td>
<td>Oil and gas, 27%; industry, 17%; services, 46%; agriculture, 10% (IMF, 2008)</td>
</tr>
<tr>
<td>Unemployment Rate</td>
<td>12%, reported by Iranian government (CIA, 2007 estimate)</td>
</tr>
<tr>
<td>Population Below Poverty Line</td>
<td>18% (CIA, 2007 estimate)</td>
</tr>
<tr>
<td>Inflation Rate (Consumer Prices)</td>
<td>17.1% (EIU, FY2007)</td>
</tr>
<tr>
<td>Exports</td>
<td>$91 billion (IMF, FY2007)</td>
</tr>
<tr>
<td>Export Commodities</td>
<td>Petroleum, chemical and petrochemical products, fruits and nuts, carpets (CIA)</td>
</tr>
<tr>
<td>Imports</td>
<td>$55 billion (IMF, FY2007)</td>
</tr>
<tr>
<td>Import Commodities</td>
<td>Industrial raw materials and intermediate goods, capital goods, foodstuff and other consumer goods, technical services (CIA)</td>
</tr>
</tbody>
</table>

**Sources:** Central Intelligence Agency (CIA) Factbook; IMF, Direction of Trade Statistics  
**Note:** The Iranian fiscal year runs from March 21st to March 20th.

### Historical Context

The 1979 Islamic revolution changed Iran’s modern political and economic history. Ayatollah Ruhollah Khomeini and his supporters transformed Iran into an Islamic state with a public sector-dominated economy that was increasingly internationally isolated. With the Iran-Iraq war (1980-1988), Iran faced negative rates of real economic growth, declines in oil production and revenue, and high levels of inflation. This represented a reversal of economic prosperity in 1960s and 1970s, during which Iran’s economy experienced real economic growth rates nearing 10%, one of the world’s highest, along with growth in per capita income and low inflation levels.3

During the 1990s, Iran strived to rebuild war-torn local production, attract international investment, enhance foreign relations, liberalize trade, and, more recently, redistribute wealth under a series of a five-year economic plans. Post-war economic growth included recovery in oil output, but the country faced a severe economic downturn in the latter part of the decade due to a drop in international oil prices.4

4 Ibid.
Iran is the second largest oil producer in the Organization of the Petroleum Exporting Countries (OPEC). The country’s oil and gas reserves rank among the world’s largest. Iran’s economy is largely dependent on oil and is highly susceptible to oil price shocks.

Since the 1979 U.S. embassy hostage crisis in Tehran, Iran has been subject to various U.S. economic sanctions. Such actions have been motivated over time by concerns regarding Iran’s nuclear program and support for terrorist organizations. More recently, the United States increasingly has focused on targeted financial measures to isolate Iran from the U.S. financial and commercial system. Sanctions have been imposed in order to change the Iranian government’s policies with respect to its nuclear program and support to terrorist organizations. To that end, the United States has imposed sanctions to curtail the development of Iran’s petroleum sector and constrain Iran’s financial resources in a way that motivates policy change in Iran. The United States also has applied diplomatic pressure on foreign countries and companies to limit business with Iran. In addition to the United States, some European Union states and other countries have imposed sanctions on Iran in line with moves by the United Nations (U.N.).

The United States also has pushed for stronger international sanctions against Iran in the U.N. Most recently, in March 2008, the United Nations Security Council (UNSC) passed a third round of sanctions against Iran through Resolution 1803, calling for the inspection of suspicious international shipping to and from Iran that are suspected of carrying prohibited goods. It encourages greater monitoring of named Iranian financial institutions, travel bans for named Iranians, and freezes of additional assets related to Iran’s nuclear program.

In June 2008, the five permanent members of the UNSC (Britain, China, France, Russia, and the United States) and Germany offered to suspend further sanctions against Iran if Iran agreed to halt its uranium enrichment program and to begin negotiations on constraints of its nuclear activity. The six countries considered Iran’s response unclear, and in August 2008, they agreed to pursue a fourth round of U.N. sanctions against Iran.

Iran has opposed U.S. and U.N. sanctions vehemently. The country has long maintained that the purpose of its uranium enrichment program is to produce fuel for nuclear power reactors, rather than fissile material for nuclear weapons. The government asserts its right to develop nuclear energy for peaceful purposes. Iran increasingly has questioned the justification of the sanctions in light of some recent positive reports on its nuclear activities. A November 2007 U.S. National Intelligence Estimate (NIE) assesses that Iran stopped its nuclear activities for weapons proliferation in 2003. Iran and the International Atomic Energy Agency (IAEA) agreed in August 2007 on a work program that would clarify the outstanding questions regarding Tehran’s nuclear program. Iran has clarified some questions, but a May 2008 report by the IAEA raised major new questions about Iran’s nuclear intentions.

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5 For more information on U.S. sanctions against Iran, see CRS Report RL32048, Iran: U.S. Concerns and Policy Responses, by Kenneth Katzman.
Overview of Iran’s Economy

Since FY2000, Iran’s economy has experienced real economic growth rates of about 6.4% on average annually. The annual change in real GDP reached a high of 7.8% in FY2007 (see Table 2). Recent economic growth has been driven by government spending on priority sectors, expansionary monetary and fiscal economic policies, increased growth in credit, and private consumption. Despite high international oil prices, the contribution of the oil and gas sector to economic growth has been more modest; real oil and gas GDP growth was estimated to be 1% in FY2007. The oil economy has been faced with low levels of production and inadequate investment. U.S. and UN sanctions levied against Iran, along with the poor domestic business environment, may contribute to low levels of investment. Iran’s economic growth is expected to slow in the coming months, owing to the decline in international oil prices in late 2008, domestic economic mismanagement, and limited oil revenue savings to weather the recent global economic turndown.

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Average Annual Growth (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>5.1</td>
</tr>
<tr>
<td>2001</td>
<td>3.7</td>
</tr>
<tr>
<td>2002</td>
<td>7.5</td>
</tr>
<tr>
<td>2003</td>
<td>7.1</td>
</tr>
<tr>
<td>2004</td>
<td>5.1</td>
</tr>
<tr>
<td>2005</td>
<td>4.7</td>
</tr>
<tr>
<td>2006</td>
<td>5.8</td>
</tr>
<tr>
<td>2007</td>
<td>7.8</td>
</tr>
<tr>
<td>2008 (estimate)</td>
<td>6.5</td>
</tr>
<tr>
<td>2009 (forecast)</td>
<td>3.5</td>
</tr>
</tbody>
</table>

Source: Economic Intelligence Unit (derived from World Bank, World Development Indicators).

Iran’s economic growth has been hampered by consistently double-digit rates of inflation. Although high inflation is widespread among the oil-exporting countries in the Middle East and Central Asia, Iran has one of the highest. Iran’s average Consumer Price Index (CPI) inflation reached 17.1% in FY2007 and is projected to grow to 28.0% for FY2008. By some estimates, Iran’s inflation level is over 30% presently. Iranians struggle with the rising cost of basic foods, such as rice, chicken, and eggs, and housing prices, which have eroded real wages. The poor are

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10 Iran’s fiscal year runs from March 21st to March 20th.
11 Ibid.
14 EIU Country Data.
15 “Oil falls pile pressure on Tehran,” Middle East Economic Digest, December 5, 2008.
hit hardest by inflation. It is the poor, mainly from rural areas, who supported President Ahmadinejad in the 2005 presidential election. Support for Ahmadinejad weakened marginally during the March 14, 2008 parliamentary elections, despite Iran’s economic difficulties.

Domestic factors contributing to the rise in inflation include expansionary government economic policies and growing consumption demands. External factors include international sanctions against Iran and rising international food and energy import prices. Inflation levels have been associated with Ahmadinejad’s efforts to curb banking interest rates for loans to sub-inflation levels. The Central Bank has opposed these hikes. Inflation levels are expected to ease in the coming months due to the decline in international prices for oil and other commodities.

The unemployment rate remains high, reaching 12.1% in FY2007. Some observers contend that the unemployment rate is higher than figures reported by the Iranian government. At least one-fifth of Iranians lived below the poverty line in 2002. Iran has a young population and each year, about 750,000 Iranians enter the labor market for the first time, placing pressure on the government to generate new jobs. The emigration of young skilled and educated people continues to pose a problem for Iran. The IMF reports that Iran has the highest “brain drain” rate in the world.

**Economic Policy and Reform Efforts**

Over the past few decades, Iran has engaged in a series of five-year economic plans in order to shift its state-dominated economy into an economy that is market-oriented, private sector-led, and economically diversified. Reform efforts have experienced resistance from various elements of Iran’s political establishment.

Significant strides toward trade liberalization, economic diversification, and privatization took place under the Khatemi administration (1997-2005). The government introduced some structural reforms such as tax policy changes and adoption of new foreign investment laws to promote Iran’s global market integration and attract investment. Iran shifted to a unified managed float exchange rate system in March 2002. At various times previously, Iran has had different combinations of exchange rates, including official, export, parallel market, and Tehran stock market versions. The exchange rate reform is considered to have improved Iran’s trading environment and to have enhanced public sector transparency modestly.

President Ahmadinejad has taken a more populist approach with his economic policies, with promises of “bringing the oil money to people’s tables” when he took office in 2005. Some critics

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20 About 30% of the population estimated to be under age 15 and less than 5% above age 64 in 2004.
maintain that policies under President Ahmadinejad have been a major contributor to budget deficits and are ineffective tools for combating inflation, unemployment, and poverty.\textsuperscript{25}

In line with Ahmadinejad’s populist agenda, fiscal policy has been expansionary. The government provides extensive public subsidies on gasoline, food, and housing. Energy subsidies alone represent about 12% of Iran’s GDP. Some observers estimate total subsidies to reach over 25% of GDP. When including implicit subsidies, the government’s spending on subsidies may be even higher. In addition to subsidies, President Ahmadinejad has provided cash handouts to the poor. Subsidies and cash handouts are considered by many to be un-targeted and ineffective at helping the poor. The IMF has encouraged Iran to reduce its subsidies.\textsuperscript{26}

Monetary policy also has been expansionary under Ahmadinejad. The government has provided low-interest loans for agriculture, tourism, and industry and has instituted loan forgiveness policies. Other activities include the creation of a number of social programs to assist farmer and rural residents.\textsuperscript{27} Ahmadinejad’s cabinet established the $1.3 billion Imam Reza Mehr Fund (Imam Reza Compassion Fund) to assist youth with marriage, housing, and education in 2006.\textsuperscript{28} As in other Middle Eastern countries, the rising cost of marriage is financially prohibitive to many young Iranians. Interest-free loans are available to youth for marriage through the fund. Some economists contend that Ahmadinejad’s efforts to lower the interest rate have led to excessive liquidity and inflation.\textsuperscript{29}

The government has used oil export revenues from the Oil Stabilization Fund (OSF) to support expansionary fiscal and monetary policies. The OSF was created by Iran’s Central Bank, the Bank Markazi, in 2001 to store surplus oil revenue and to smooth economic vulnerabilities associated with oil price fluctuations.\textsuperscript{30} Iran has been drawing down on its OSF to finance discretionary spending, such as for public subsidies, cash handouts to the poor, and low-interest loans. Of primary concern to the United States and the international community is the purported use of oil export revenues to finance Iran’s nuclear program and alleged support for terrorist groups.

Economic concerns continued to erode President Ahmadinejad’s political support base in the weeks before the March 2008 parliamentary elections.\textsuperscript{31} Ahmadinejad’s party appeared to emerge from the elections with significant continued support, but some allege that this is because many reformist candidates were disqualified from running. Others say that Ahmadinejad’s faction successfully painted Iran’s economic difficulties as caused by U.S. pressure. Presidential elections

\textsuperscript{25} Fredrik Dahl, “Iranians worry about high food prices before vote,” Reuters, March 6, 2008.


\textsuperscript{28} Najmeh Bozorgmehr and Gareth Smyth, “Coping with the rising cost of marriage, Iranian-style: The new president is set up a fund to deal with rising expectations of the good life,” Financial Times, November 8, 2005.

\textsuperscript{29} EIU, “Iran: Monetary shrinkage,” April 1, 2008.


are planned for March 2009, and while Ahmadinejad is favored to win, his position is weakening, in part because of economic concerns.32

Analysts debate the extent to which Iran’s economic policies are a result of poor decisions by the Iranian government and sub-optimal choices taken by the government in response to U.S. and international sanctions. Some economists believe that the sanctions augment the government’s tendency toward state-led rather than private sector-oriented market policies.33

**Iran and the Recent Global Economic Turndown**

The recent global economic turndown has placed downward pressure on international oil prices. Given that oil exports account for the bulk of Iran’s exports and government revenue, the economic downturn is expected to lead to slower economic growth, with annual growth in GDP expected to decline from an estimated 6.5% in FY2008 to a forecasted 3.5% in FY2009.34 The economic downturn also may lead to higher levels of unemployment and a reduction in foreign exchange reserves for Iran. On the upside, lower oil prices may ease inflationary pressures. In a reversal of previous public stances, in December 2008, Ahmadinejad admitted for the first time that the decline in international oil prices will have a negative effect on Iran’s economy.35

While estimates vary about the size of the Oil Stabilization Fund (OSF), many observers express concern that there are no longer sufficient funds in the OSF to cushion against the global economic turndown.36 Ahmadinejad has been drawing down on the OSF to fund his expansionary economic policies and, reportedly, to fund Iran’s uranium enrichment program and terror support. In light of the recent fluctuations in oil prices, the government may revise its budget estimates for next year. Previously, the government planned to base the budget on an oil price of $50 to $60 per barrel, but now may use an oil price estimate of $37.50 per barrel.37 Ahmadinejad has proposed a plan to eliminate energy subsidies and to provide monthly allowances to the poor instead. Critics contend that the plan would push inflation higher and is an effort to boost Ahmadinejad’s election-year support.38 There are also concerns that elimination of government subsidies may lead to social instability.

Iran’s isolation from the financial world due to U.S. and international sanctions has provided some insulation for Iranian banks and the Tehran Stock Exchange (TSE) from the global financial crisis. However, between October and December of 2008, the TSE fell by nearly 20%, with investor confidence shaken by the global economic turndown and the impact of declining oil prices on Iran’s economy.39 Moreover, as world credit markets dry up, Iran has faced decreased options in circumventing U.S. sanctions and accessing foreign investment.40 Iran’s weakened

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34 Economic Intelligence Unit (derived from World Bank, World Development Indicators).
37 “Iran: Oil Minister Says Iran to Base Budget on Oil Price of $37.50,” Thai News Service, January 5, 2009.
40 “Tehran suffers as finance dries up,” Middle East Economic Digest, November 1, 2008.
economic position may reduce its leverage against the U.S. and other foreign countries over its uranium enrichment program and reported terror financing.

**Economic Stakeholders**

Iran’s economy is heavily dominated by the state, which is the recipient of revenues from crude oil exports, and quasi-state actors, such as the *bonyads* and the commercial entities of the Islamic Revolutionary Guard Corp (IRGC). Private sector activity is limited, although the government is engaged in some privatization efforts.

**Bonyads**

Sometimes referred to as “Islamic conglomerates,” *bonyads* (Persian for “foundation”) are semi-private charitable Islamic foundations or trusts that are believed to wield enormous political and economic power in Iran. They were among the institutions used by the regime to help nationalize Iran’s economy after the 1979 revolution. *Bonyads* are not subject to the Iranian government’s checks and balances. *Bonyads* report directly to the Supreme Leader and are not subject to parliamentary supervision. They do not fall under Iran’s General Accounting Law and, consequently, are not subject to financial audits. Because *bonyads* are not required to disclose their financial activities, it is not known exactly the magnitude of their wealth.

The largest Iranian charitable trust is the Foundation of the Oppressed and War Veterans (*Bonyad* e-Mostazafan va Janbazan, MJF). With more than 200,000 employees and 350 subsidiaries, the MJF has an estimated value of more than $3 billion, at least 10% of Iran’s gross domestic budget (GDP). The MJF provides financial assistance, medical care, and recreational opportunities to Iran’s poor and individuals wounded or disabled from the Iran-Iraq war. Through its company affiliates, the MJF is involved in both Iran’s domestic economy and foreign economies. The MJF’s domestic economic scope is expansive, with affiliates involved in economic areas such as agriculture, construction, industries, mining, transportation, commerce, and tourism. Since 1991, the MJF has invested in energy, business, engineering, and agricultural activities in Europe, Russia, Asia, the Middle East, and Africa. Some allege that the MJF is used for Iranian intelligence activities for buying dual-use products for proliferation of weapons of mass destruction (WMDs).

Many believe that *bonyads* enjoy a significant advantage over private companies. Prior to the unification of Iran’s exchange rate system, the *bonyads* were able to access foreign exchange at deep discounts compared to private enterprises. Presently, *bonyad* officials have longstanding connections with politicians, and frequently get special access to credit at state-owned banks. In addition, *bonyads* get privileges on taxation and import duties. Some critics contend that economic and political reform in Iran will not be significant unless *bonyads* are reformed. Some also contend that they contribute to political corruption and limit the funneling of oil wealth to the poor. *Bonyads* also may limit privatization, because shares for many of Iran’s national companies undergoing privatization are given to *bonyads*, rather than wholly private enterprises.

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Islamic Revolutionary Guard Corps

The Islamic Revolutionary Guard Corps (IRGC) was founded in 1979 by the Ayatollah Khomeini and is a branch of the Iranian government’s military. The IRGC is comprised of five branches: the Grounds Force, Air Force, Navy, Basij militia, and Qods Force special operations.43

The Islamic Revolutionary Guard Corps increasingly is becoming an important player in the Iranian economy. The IRGC’s initial economic involvement consisted of postwar reconstruction activities, largely infrastructure projects. More recently, the IRGC has become involved in commercial activity in the construction, oil and gas, and telecommunications sector.44 Elements of the Iranian private sector have expressed displeasure with the IRGC. Through its powerful connections, the IRGC frequently acquires business contracts for new projects at the expense of private sector businesses. The IRGC also serves as a leading investment tool for many of Iran’s leaders.

Some Iranians express concern that the IRGC is involved in Iran’s underground economy. The IRGC has significant control over Iran’s borders and airports. The IRGC is allegedly involved in smuggling alcohol and other low-level contraband into Iran. Some report that the IRGC smuggles gasoline, which is heavily subsidized in Iran, to other countries for profit.45

Some analysts believe that the Revolutionary Guard benefits from Iran’s economic isolation. With foreign businesses unwilling or unable to enter into deals, the Revolutionary Guard faces less competition for acquiring new contracts. However, because the IRGC frequently does not have the technical expertise that many international companies do, the IRGC sometimes subcontracts to international companies, making a profit as an intermediary in the transaction.46

The United States contends that the IRGC is involved in proliferation of weapons of mass destruction (WMDs). Under Executive Order (E.O.) 13382, the United States can sanction entities for proliferation concerns. The sanctions prohibit all transactions between U.S. persons and the sanctioned entity and freeze any assets that the sanctioned entity has in the United States.47 On October 25, 2007, under E.O. 13382, the U.S. Department of State designated the IRGC for proliferation concerns. The U.S. embargo on the IRGC represented the first time that the United States has sanctioned a foreign country’s military. Also on the same day and under the same executive order, the U.S. Treasury identified nine companies either owned or controlled by the IRGC and five individuals associated with the IRGC for proliferation concerns.48 These companies all are reportedly tied to Iran’s energy sector.49 They are listed below:

45 Ibid.
46 Ibid.
49 “U.S. dilemma: Targeting Iran’s oil industry could hurt Iran more,” International Herald Tribune, November 5, (continued...)
Companies:

- Khatam al-Anbya Construction Headquarters: Main engineering headquarters of the IRGC; secured deals of at least $7 billion in oil, gas, transportation, and other sectors; owned or controlled by the IRGC
- Oriental Oil Kish: Drilling company; owned or controlled by the IRGC
- Ghorb Nooh: Owned or controlled by the IRGC
- Sahel Consultant Engineering: Owned or controlled by the IRGC
- Sepasad Engineering Company: Owned or controlled by the IRGC
- Omran Sahel: Owned or controlled by the IRGC
- Hara Company: Engineering firm associated with Khatam al-Anbya; owned or controlled by the IRGC
- Gharagahe Sazandegi Ghaem: Business services company owned or controlled by the IRGC

Individuals:

- General Hosein Salimi: Commander of the Air Force, IRGC
- Brigadier General Morteza Rezaie: Deputy Commander, IRGC
- Vice Admiral Ali Akhbar Ahmadian: Former Chief of the IRGC Joint Staff
- Brigadier General Mohammad Hejazi: Former Commander of Bassij resistance force
- Brigadier General Qasem Soleimani: Commander of the Qods Force

In addition to WMD proliferation concerns, the United States asserts that the IRGC is involved in terrorist activities. E.O. 13224 permits the President to freeze the assets of terrorists and their supporters. On October 25, 2007, the United States sanctioned the IRGC-Qods Force under E.O. 133224. The United States asserts that the Qods Force provides to Hezbollah’s military and terrorist activities, with assistance ranging between $100 to $200 million a year.

Private Sector

Prior to the 1979 revolution, Iran boasted a vibrant, significant private sector. However, under the leadership of the Ayatollah Khomeini, the bulk of private sector companies, including commercial...

(...continued)

2007.

banks, were taken over by state and quasi-state institutions. Foreign participation in Iran’s economy was prohibited.

Currently, wholly private enterprises are present in agriculture, trade, small-scale manufacturing, and mining, but play a minimal role in large-scale economic activity. In an effort toward more private sector development, Iran began a major privatization initiative in July 2006. It allowed issuances of up to 80% of shares in strategic industries through the stock market, including downstream oil sector businesses, banks, insurance, utilities, and transportation. Iran is also working to privatize state-run oil and gas companies.

Iran’s private sector competes with the businesses operated by the bonyads and the IRGC. For example, Iranian officials have encouraged foreign companies to enter into the Iranian market. However, many business contracts have been won by quasi-state actors, such as the bonyads and commercial entities of the IRGC. In addition, the private sector is critical of the government’s use of assets in the OSF to fund state-run companies at the expense of loans to private businesses.

Some observers are critical of the Iranian government’s continued strong involvement in the country’s economy. Some Iranians believe that the government needs to invest oil export revenues in Iran’s private sector rather than spending revenues on imports and socially minded programs.

Historically, Iran has been a society of trade merchants, the bazaari class. As manufacturing in Iran is limited, merchants import goods, mark up the goods for profit, and then sell. In order to be economically viable, the bazaaris need low employment costs, low rents, free trade, and low regulation. The bazaaris tend to be skeptical of a large government role in the economy. They are supportive of Iranian trade with foreign countries. However, they tend to be critical of foreign investment because it would open up their companies to foreign competition.

**Economic Sectors**

Iran’s economy has a number of key sectors. In FY2007, oil and gas represented about 27% of the country’s GDP. Industry, which includes petrochemicals, steel, textile, and automotive manufacturing, accounted for 17% of the GDP. The services sector, including financial services, represented 46% of Iran’s economy. Agriculture constituted about 10% of Iran’s economy. Agriculture continues to be one of the economy’s largest employers, representing one-fifth of all jobs based on a 1991 census. Some analysts have expressed concern that excessive focus on the

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54 Ibid.
56 Ibid.
57 Kenneth Katzman, Specialist in Middle Eastern Affairs, Congressional Research Service, Joint Economic Committee Hearing on Iran, July 25, 2006.
oil and gas sector is crowding out investment and expansion opportunities in other sectors and opportunities for economic diversification.60

Oil and Natural Gas

Holding an estimated 10% of global proven oil reserves, Iran boasts the world’s third largest proven petroleum reserves following Saudi Arabia and Canada. Most of Iran’s crude oil reserves are in the southwestern region near the Iraqi border. Among the Organization of the Petroleum Exporting Countries (OPEC) members, Iran is the second largest oil producer following Saudi Arabia. Presently, Iran produces about 4 million barrels of crude oil per day (mbd), approximately 5% of total global production. While oil export revenues have spiked in recent years due to a surge in oil prices, Iran’s crude oil output has remained essentially flat. The government has set a goal of 5 mbd, which is still below the 6 mbd pre-revolution capacity.

Iran’s oil production levels are limited by a number of factors. The oil industry faces a high rate of natural decline of mature oil fields and low oil recovery rates. It is believed that millions of barrels of oil are lost annually because of damage to reservoirs and these natural declines. Iran also has been plagued by aging infrastructure and old technology. Structural upgrades and access to new technologies, such as natural gas injections and other enhanced oil recovery efforts, have been limited by a lack of investment, due in part to U.S. sanctions.61 The United States is restricted from oil development investments in Iran, but other countries, until recently, have actively invested in Iran’s oil sector development.

With an estimated 15% of the world’s gas reserves, Iran has the second largest natural gas reserves globally, following Russia.62 Despite its vast gas resources, Iran has been unable to become a major international gas exporter. In fact, Iran was a net importer of natural gas as late as 2005. Natural gas production could be used for domestic consumption, exports to European and Asian markets, and development of Iran’s petrochemicals industry.63 Iran has been seeking international investment to help build its natural gas sector. However, U.S. sanctions have limited Iran’s access to technologies from abroad that are necessary for developing liquified natural gas plants. The intellectual property for these technologies belong to a small network of U.S. and Japanese companies. Providing such technologies to Iran would violate the U.S. trade ban on Iran.64

The oil and gas sector is heavily state-dominated. Iran is engaging in efforts to privatize nearly 50 state-run oil and gas companies, estimated to be worth $90 billion, by 2014 through the Tehran Stock Exchange. Both domestic and foreign investors would be able to buy shares. Privatization of these energy companies may make it easier for investors to circumvent U.S. sanctions, which complicate investors’ ability to engage in business transactions with Iran directly.65

65 “Tehran opens energy sector to overseas investment,” Middle East Economic Digest, February 8, 2008.
Agriculture

Iran is a major world provider source of caviar and pistachio nuts, a significant non-oil export for Iran. The country’s climate and terrain also support tobacco, tea, wheat and barley, among other food commodities. Iran’s agriculture production is vulnerable to periodic droughts, including a severe drought in 2008. In addition to climate change, the agricultural sector faced setbacks in production during the 1979 revolution and the war with Iraq. Overfishing and environmental degradation also threaten the agriculture sector.

Iran typically has used oil export revenues to pay for agricultural imports. However, rising international food commodity prices combined with a large population increase have placed pressure on Iran’s economy, despite high international oil prices. Other Middle Eastern countries are experiencing similar economic strains.

Manufacturing

Iran is working to build up various industries within its manufacturing sector, including steel, automotives, food products, and petrochemicals. There is some concern that Iran’s manufacturing sector has declined because oil export revenues have increased Iran’s exchange rate, making the manufacturing sector less competitive. Manufacturing activity reportedly has been impeded by international sanctions. Iranian manufacturing units rely on imported parts and services from Europe. Access to imported intermediate goods has been complicated because a number of European banks have scaled down financial transactions with Iranian businesses.

Steel

Iran is the largest producer of steel in the Middle East. In 2006, Iran ranked as the 20th largest producer of crude steel globally. Despite Iran’s high production levels, the country is a net importer of steel. There has been a ramp-up of growth in demand for steel in the Middle East, fueled by the need for investments in energy project infrastructure and expansion of construction activity.

Automotives

Iran is the 15th largest motor vehicle producer in the world and the largest automaker among the Middle Eastern countries. Iran produces both light and heavy vehicles. Its two biggest

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automakers are Iran Khodro and Sapia.\textsuperscript{73} Auto plants frequently have outdated technology and parts must be imported through third countries. Cars frequently are not fuel-efficient, contributing to pollution.\textsuperscript{74} Despite Iran’s high level of automotive production, domestic demand for motor vehicles exceeds supply. Iran imports a variety of vehicles, including basic models, luxury vehicles, and vehicles for construction and mining. Iran reduced the tariff rate on auto imports in 2006. Iran recently began joint ventures with foreign companies for auto production, including Peugeot and Citroen (France), Volkswagen (Germany), Nissan and Toyota (Japan), Kia Motors (South Korea), Proton (Malaysia), and Chery (China).\textsuperscript{75} Foreign companies have entered the Iranian auto market with some caution in light of concerns about U.S. reaction and reputational risks.

**Food Products**

Additionally, there has been a growth in agriculture-related manufacturing, such as rice milling and manufacturing of canned food and concentrates, fruit juices, and confectionary. Foreign companies, such as Nestle, Coca Cola, and Pepsi have signed deals for production with local Iranian businesses.\textsuperscript{76} Under U.S. sanctions regulations, foreign subsidiaries of American companies are able to trade or engage in business in Iran.

**Petrochemicals**

Iran is the second largest manufacturer of petrochemicals in the Middle East, following Saudi Arabia. About half of Iran’s petrochemical product sales are for its domestic market.\textsuperscript{77} In an attempt to diversify its exports, Iran also is building up its petrochemicals industry.\textsuperscript{78} The industry reportedly faces some challenges from state intervention and price-fixing. Additionally, international sanctions have reduced commercial banks’ willingness to finance international deals to build the petrochemical sector.\textsuperscript{79}

**Financial Sector**

Iran’s financial sector has been heavily dominated by large, public banks since the nationalization of the banking system after the 1979 revolution. Over the past couple of decades, Iran has engaged in some privatization and liberalization of its financial sector. In 2001, Iran’s Central Bank approved licenses for three full functioning private banks. Efforts toward privatization have been thwarted frequently by the Guardian Council.

The government has direct control over lending and investment activities of commercial banks. The Bank Markazi, Iran’s Central Bank, is not able to conduct a “proactive” monetary policy and

\textsuperscript{73} Eric Ellis, “Made in Iran,” Fortune Magazine, September 12, 2006.

\textsuperscript{74} Ibid.


\textsuperscript{76} EIU, “Country Profile 2007: Iran,” 2007, p. 46.


\textsuperscript{78} EIU, “Country Profile 2007: Iran,” 2007, p. 44.

has no control over the government’s fiscal policy. In addition, the Central Bank is limited in its ability to issue direct instruments to combat inflationary pressures. The Central Bank must obtain approval from the Majlis in order to issue participation papers.\footnote{80 EIU, “Iran economy: Quick View—Monetary strife—Country Briefing,” ViewsWire, April 21, 2008.}

State-owned banks are considered by many to be poorly functioning as financial intermediaries. Private banks are hampered by extensive regulations and the government’s populist policies, including controls on rates of return and subsidized credit for specific regions. In May 2007, President Ahmadinejad capped lending rates to 12% for state-owned banks and 13% for commercial banks, despite strong opposition from the Central Bank. Setting interest rates below the rate of inflation reportedly has placed many commercial banks under financial duress.\footnote{81 Ibid.} In addition, most of the financial intermediaries’ loan portfolios are comprised of low-return loans to state-owned enterprises and quasi-government agencies, such as the bonyads. Some believe that the financial system has stifled domestic business and has lowered Iran’s attractiveness to foreign businesses.

**Tehran Stock Exchange**

In 1967, Iran began operating the Tehran Stock Exchange (TSE). With initially six companies, the TSE now lists over 300 companies. Capitalization through the TSE is permitted for the automotive, mining, petrochemical, and financial sectors. Since 2005, foreign investors have been able to participate in the TSE. Foreign investors are permitted to hold a maximum of 10% of shares of each company listed and are not allowed to withdraw their capital for three years after purchases. However, foreign activity in the TSE is low. Aside from concerns about the international tensions associated with Iran’s nuclear standoff, low foreign activity may also reflect concerns about liquidity, transparency, and the poor legal environment protecting foreign holdings.\footnote{82 Ibid.}

The TSE index performed strongly between 2000 and 2004, but declined following President Ahmadinejad’s election in 2005. During the 2007, the TSE market stabilized, but was still 20% lower than before Ahmadinejad came into power.\footnote{83 EIU, “Iran risk: Financial risk,” April 23, 2008.} At the end of 2007, TSE market capitalization stood at $46 billion.\footnote{84 Global Insight, “Iran Country Analysis,” updated July 10, 2008.} It is hoped by the Ahmadinejad government that privatization plans will help to revive the stock market.

Because the TSE is not extensively integrated into the world market, it has been somewhat insulated from the global financial crisis. However, between October and December of 2008, the TSE fell by nearly 20%, with investor confidence shaken by the global economic turndown and the impact of declining oil prices on Iran’s economy.\footnote{85 Global Insight Daily Analysis, “Iran’s Bourse Pummelled by Worrying Economic News,” December 16, 2008.}
Financial Sanctions

The U.S. Department of Treasury recently has employed targeted financial measures against Iran. The United States is attempting to isolate Iran from the international financial and commercial system in an effort to promote policy change in Iran regarding its nuclear program and purported terror financing. The United States also hopes that financial isolation will limit Iran’s resources for its nuclear program and its alleged support for terrorist organizations. In recent congressional testimony, the Treasury Deputy Assistant Secretary for Terrorist Financing and Financial Crimes stated, “Iran utilizes the international financial system as a vehicle to fund these terrorist organizations... the Iranian regime operates as the central banker of terrorism, spending hundreds of millions of dollars each year to fund terrorism.”

Several major Iranian banks are under U.S. and U.N. sanctions. Under E.O. 13224, the Treasury has designated several Iranian entities for supporting terrorism. On October 25, 2007, the Treasury designated Bank Saderat, a major Iranian state-owned financial institution, for terrorism support. Iranian authorities contend that two external audits of Bank Saderat conducted in Lebanon and London found no evidence of such allegations.

On January 9, 2007, the Treasury sanctioned Bank Sepah, another major Iranian financial enterprise, under E.O. 13382 for assisting with Iran’s missile program. U.N. Security Council Resolution 1747 named Bank Sepah and Bank Sepah International as financial institutions involved in financing nuclear or ballistic missile activities. Subsequently, on October 25, 2007, under E.O. 13382, the Treasury Department sanctioned Bank Melli and Bank Mellat, other major Iranian financial institutes, as WMD proliferators or supporters. In June 2008, the European Union also decided to sanction Bank Melli.

In a signal to Arab countries, the United States sanctioned the Bahraini Future Bank B.S.C. in March 2008 under E.O. 13382 for reportedly assisting in Iran’s nuclear and missile programs. The United States contends that Future Bank B.S.C. is controlled by the embargoed Bank Melli.

In a move to further restrict Iran’s access to the U.S. financial system, the Treasury revoked the “U-turn” license for U.S. financial institutions on November 6, 2008. With respect to Iran, “U-turn” fund transfers are financial transactions that pass through the U.S. financial system only en

86 Daniel Glaser, Testimony before the House Committee on Foreign Affairs Subcommittee on the Middle East and South Asia and the Subcommittee on Terrorism, Nonproliferation, and Trade, April 17, 2008, HP-933.
route from one offshore non-Iranian financial institution for another, conducted for the direct or indirect benefit of the Iranian government, banks, or individuals. Previously, U.S. financial institutions were allowed to process such financial transactions.

The United States and some European countries assert that certain Iranian banks and their branches are attempting to circumvent international financial sanctions in order to engage in proliferation-related activity and terrorist financing. Iranian government officials have denied these claims.94

Financial sanctions reportedly have affected the profitability of Iranian banks and damaged Iran’s credit ratings. Financial intermediaries have faced challenges financing development projects, such as building oil infrastructure.95 Iran is taking steps to protect its foreign assets from future international sanctions. For instance, Iran reportedly has started shifting billions of dollars from European banks to Iranian and Asian banks and purchasing gold and equities. However, some economists express concern that Asian banks may not be reliable because of their close relationship to Europe’s economy.96

Money Laundering

Iran’s financial system may be vulnerable to money laundering. Since 2002, the Central Bank of Iran has engaged in efforts to combat money laundering. In January 2008, Iran passed its first anti-money laundering law, which criminalized money laundering. Critics contend that Iran’s money laundering framework is not adequate to combat the terrorist financing through Iran’s financial system. There is international concern that these vulnerabilities pose a threat to the international financial system.

On March 3, 2008, the U.S. Treasury’s Financial Crime Enforcement Network (FinCEN) issued a statement emphasizing concern about ongoing deficiencies in Iran’s efforts to combat money laundering and the financing of terrorism through its financial system. The U.S. Treasury advisory stated that, using state-owned banks, Iran “disguises its involvement in proliferation and terrorism activities through an array of deceptive practices specifically designed to evade detection.” Of particular concern to the U.S. Treasury is that Iran’s central bank and commercial banks have requested their names to be removed from international transactions in order to make it more difficult to track their involvement.

The Treasury advisory noted 59 major Iranian banks or their branches in international financial cities that pose threats, including Iran’s central bank. None of the banks listed currently face U.N. or U.S. sanctions.97 The advisory encouraged all financial institutions to consider the risks associated with doing business with the specified Iranian financial institutions.98 Additionally, the Financial Action Task Force (FATF), a Paris-based “international financial watchdog,” called on

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95 “Investment shortfall ‘threatens Iran oil output,’” *AFX Asia*, July 9, 2007.
its 34 member states to encourage banks to monitor their financial interactions with Iran. The FATF alleges that Iran has not taken adequate actions to combat money laundering and terror financing.\textsuperscript{99} Iranian officials assert that the Bank Markazi complies with international best practices and that it vigilantly regulates domestic financial institutions.

**Informal Finance Sector**

Many Iranian businesses and individuals also rely on *hawala*, an informal trust-based money transfer system that exists in the Middle East and other Muslim countries. *Hawala* transactions are based on an honor system, with no promissory instruments exchanged between the parties and no records of the transactions. Some analysts consider the *hawala* system as particularly susceptible to terrorist financial transactions.

Since the imposition of recent U.S. and U.N. financial sanctions on Iran, the use of *hawala* by Iranians reportedly has increased. It is considered by many Iranians to be a more cost-effective way to transfer money in light of the added expenses incurred through working through the formal financial system in light of the sanctions. According to an Iranian merchant, “If we wanted to send money through the banking system it would cost a small fortune, so we move money to dealers and they send the money through Dubai to China.” While some assert that the use of *hawala* shows that Iran is able to circumvent international sanctions successfully, others suggest that the increased use of *hawala* is a sign of the sanctions’ effectiveness in making it more difficult for Iran to finance transactions.\textsuperscript{100}

**International Trade**

International trade contributes significantly to Iran’s economy and has increased dramatically over the past few years. Between 2004 to 2007, Iran’s total trade in goods (exports plus imports) nearly doubled, reaching about $147 billion in 2007. Iran enjoys a growing and positive trade balance in goods, benefitting from high international oil prices. This trade surplus registered at about $36 billion in 2007. Exports totaled about $91 billion, while imports reached about $55 billion that same year (see Table 3). Some analysts point out that Iran’s trade with the world may actually be higher due to transshipment or black market trade. Overall, Iran’s external sector position has strengthened in recent years. The current account balance reached an estimated $29 million in 2007, about 10% of Iran’s GDP at market price.\textsuperscript{101} The current account surplus is expected to decline in 2009 with the drop in international oil prices.

**Major Goods Traded**

Oil and gas exports dominate Iran’s export revenues, constituting about 80% of total exports and are the most important source of foreign exchange earnings for the country. Other major export commodities are petrochemicals, carpets, and fresh and dried fruits. Top destinations for Iran’s non-oil exports, including natural gas liquids, are the United Arab Emirates (UAE), Iraq, China, India,

\textsuperscript{99} Jeannine Aversa, “Treasury warns banks that Iran is engaging in deceptive practices to skirt sanctions,” Associated Press, March 20, 2008.

\textsuperscript{100} Anna Fifield, “No problem,” *Financial Times*, April 14, 2008.

Japan, and India. Major imports for Iran include gasoline and other refined petroleum products, industrial raw materials and intermediate goods used as manufacturing inputs, capital goods, food products, and other consumer goods.

### Table 3. Iran Merchandise Trade, FY2004-FY2007

(\text{millions of U.S. dollars})

<table>
<thead>
<tr>
<th>Merchandise</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007$^a$</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Exports</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Oil and gas</td>
<td>44,364</td>
<td>64,366</td>
<td>75,537</td>
<td>91,289</td>
</tr>
<tr>
<td>Non-oil and gas</td>
<td>7,537</td>
<td>10,546</td>
<td>13,079</td>
<td>14,431</td>
</tr>
<tr>
<td><strong>Imports</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gasoline$^b$</td>
<td>38,199</td>
<td>43,058</td>
<td>49,292</td>
<td>55,352</td>
</tr>
<tr>
<td><strong>Trade Balance</strong></td>
<td>6,165</td>
<td>21,281</td>
<td>26,245</td>
<td>35,938</td>
</tr>
<tr>
<td><strong>Total Trade</strong></td>
<td>82,563</td>
<td>107,451</td>
<td>124,829</td>
<td>146,641</td>
</tr>
</tbody>
</table>


$^a$ All data for 2007 are estimated.

$^b$ Gasoline imports data, based on the “2006 Article IV Consultation,” are preliminary for 2005 and projected for 2006 and 2007. The “2008 Article IV Consultation” does provide an update on gasoline imports data.

### Importance of Oil Exports to Iran’s Economy

Despite low production levels, Iran remains the fourth largest exporter of crude oil worldwide, after Saudi Arabia, Russia, and Norway.\textsuperscript{102} Net crude and product exports in 2006 totaled 2.5 million barrels per day and $54 billion revenues. Top export markets for Iran are Japan, China, India, South Korea, and Italy. More than 40% of the world’s oil traded goes through the Strait of Hormuz, a channel along Iran’s border. The Strait of Hormuz is considered a global “chokepoint” because of its importance to global energy security. It is a narrow channel with a width of only 21 miles at its widest point through which large volumes of oil are shipped.\textsuperscript{103}

Oil revenue accounts for the majority of export earnings and represents the bulk of government revenue (about 40%). Iran’s dependence on oil export revenues makes the country highly susceptible to the volatility of international oil prices. The quadrupling of global oil prices since 2002 has given Iran enormous economic and political leverage, cushioning the extent to which Iran’s economy has been affected by international sanctions and domestic policy mismanagement. However, the recent decline in oil prices may highlight weaknesses in Iran’s economy.

There is debate about the extent to which the recent decline in oil prices will affect Iran’s economy. Oil price declines would reduce government revenue and spending and potentially increase Iran’s vulnerability to sanctions. Oil price drops also would affect the private sector, as

\textsuperscript{102} Ibid.

\textsuperscript{103} Ibid.

Iran imports a significant portion of its capital and machinery goods from abroad. A fall in oil prices and subsequent economic downturn may increase political dissent among Iranians, already facing high unemployment and inflation levels.

**Iran’s Dependence on Gasoline Imports**

Despite Iran’s vast oil reserves, the country must import close to half of all refined petroleum products to meet domestic consumption needs. Iranian gasoline imports were projected to total $5.7 billion in FY2006 and $6.1 billion in FY2007.\(^{104}\) Extensive government subsidies on gasoline have contributed to high gasoline consumption rates. Many analysts contend that high subsidies do not give Iranians an incentive to conserve. In addition, there has been an increase in vehicle sales, particularly of fuel-inefficient older models. Import levels are also high because Iran has limited domestic refinery capacity to produce light fuels.\(^{105}\) However, gasoline’s share of imports has fallen recently, from 18% in FY2005 to 6% during the first eleven months of FY2007, according to Iran’s Customs Administration. In June 2007, the government implemented a gasoline rationing system to reduce gasoline consumption. This policy was extremely unpopular and led to public riots, but has led to a drop in gasoline consumption. Oil consumption also is declining as consumers are moving more toward natural gas use.

Major gasoline suppliers to Iran historically have been India, Turkmenistan, Azerbaijan, the Netherlands, France, Singapore, and the United Arab Emirates. Iran also imports gasoline from multinational companies (MNCs), particularly Europe-based wholesalers. Based on data from 2005 through 2006, Turkmenistan was Iran’s only supplier of natural gas.\(^{106}\) In 2006, Vitol, a MNC based in Switzerland, supplied Iran with 60% of its total gasoline cargo imports. In December 2007, Vitol reportedly declined to renew long-term contracts with Iran, but still provides gasoline to Iran on the spot market. Major gasoline suppliers to Iran include BP, Royal Dutch/Shell (Netherlands), Total (France), Lukoil (Russia), and Sinopec (China). In addition, Venezuela supplies small quantities of gasoline from time to time in a show of political solidarity with Iran. Iran and Venezuela have sought to counter U.S. global influence and strengthen their own international standing and reputation through strategic alliances.\(^{107}\)

Iran would be threatened if it was cut off from imports of gasoline, which allows Iran to meet domestic energy consumption demands. This vulnerability was highlighted in December 2007, when Turkmenistan halted natural gas supplies to Iran in a pricing dispute. Millions of Iranians suffered from the bitter cold with lack of gasoline for heating during one of the coldest winters in recent Iranian history. Turkmenistan has since resumed supplying gasoline to Iran.

**Key Trading Partners**

In 2007, Iran’s top overall trading partner was China. Iran’s next overall largest trading partner is Japan, followed by Italy, South Korea, and Germany. Significant export markets for Iran are

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\(^{106}\) Telephone conversation with EIA official, April 29, 2008.

China, Japan, Turkey, and Italy. Major merchandise suppliers for Iran include Germany, China, the United Arab Emirates, and South Korea (see Table 4).

<table>
<thead>
<tr>
<th>Country</th>
<th>Total Trade</th>
<th>Exports</th>
<th>Imports</th>
<th>Trade Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>China</td>
<td>20,135</td>
<td>12,188</td>
<td>8,017</td>
<td>4,101</td>
</tr>
<tr>
<td>Japan</td>
<td>13,064</td>
<td>11,599</td>
<td>1,465</td>
<td>10,134</td>
</tr>
<tr>
<td>South Korea</td>
<td>8,421</td>
<td>5,139</td>
<td>3,282</td>
<td>1,857</td>
</tr>
<tr>
<td>Italy</td>
<td>8,039</td>
<td>5,215</td>
<td>2,824</td>
<td>2,391</td>
</tr>
<tr>
<td>Turkey</td>
<td>7,539</td>
<td>6,013</td>
<td>1,526</td>
<td>4,487</td>
</tr>
<tr>
<td>Germany</td>
<td>6,066</td>
<td>621</td>
<td>5,445</td>
<td>-4,824</td>
</tr>
<tr>
<td>UAE</td>
<td>5,915</td>
<td>747</td>
<td>5,168</td>
<td>-4,421</td>
</tr>
<tr>
<td>France</td>
<td>5,334</td>
<td>3,069</td>
<td>2,265</td>
<td>804</td>
</tr>
<tr>
<td>Russia</td>
<td>3,272</td>
<td>282</td>
<td>2,990</td>
<td>-2,708</td>
</tr>
</tbody>
</table>

Source: IMF, Direction of Trade Statistics

Iran’s trading relations have changed over time as international concern over Iran’s nuclear program has affected economic activity. Historically, Iran has had strong trade ties with Germany. In 2007, Iran’s exports to Germany increased by 50%, while imports from Germany declined by 4%. Despite the increase in exports, Iran’s total trade with Germany dropped by 0.3% in 2007. Along with Germany, other European countries also have scaled down trade with Iran lately.

Iran’s trade has shifted from Western countries to the developing world. Asian countries, particularly China and Japan; Russia and other Central Asian countries; and Middle Eastern countries, especially the United Arab Emirates, have emerged as growing and important trading partners for Iran. Figure 1 shows the shift in Iran’s exports to trading partners is shown in from FY2000 to FY2007, while Figure 2 shows the change in Iran’s import relationships during the same period.

108 International Monetary Fund (IMF), Direction of Trade Statistics.
Facing challenges in trading with Western countries, Iran has sought to strengthen ties with Asian countries, most notably China and Japan. Between 2000 and 2007, total trade between Iran and China grew more than nine-fold, reaching about $20 million in 2007. China was Iran’s biggest exporter in 2007, followed by Japan and Turkey. Iran benefits from low-cost imports from China. Major Chinese exports to Iran include mechanical and electrical equipment and arms. Iran’s growing trade relationship with China also may be rooted in strategic reasons, such as China’s position as one of five permanent UNSC members.109

Russia is becoming an important trading partner for Iran. While Iran-Russia trade is low compared to Iran’s trade with other countries, this relationship has grown significantly. Iranian imports from Russia more than tripled from 2000 to 2007 and registered at about $3 million in 2007. In addition, several countries in central Asia have declared their interest in boosting

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economic engagement with Iran, including Tajikistan. Iran, Turkey, and Azerbaijan have held discussions on building a joint railway through the three countries in order to enhance relations, trade, and travel.

Iran also has pursued increased integration with its neighbors in the Middle East. Merchandise trade with the Middle East has grown. Arab nations may be weary of Iran’s nuclear ambitions, but they appear to value trade and investment relations with Iran. Many are hoping that positive economic engagement with Iran will mitigate international tensions over Iran’s nuclear ambitions.

**United Arab Emirates and Transshipment Trade**

The UAE is a major trading partner for Iran, with trade largely dominated by UAE exports to Iran. According to the UAE Ministry of Economy, total non-oil trade between UAE and Iran was upwards of $6 billion in 2006. The bulk of merchandise supplied to Iran by the UAE is believed to be products imported into the UAE from foreign markets, including the United States, European Union, China, and India, and subsequently repackaged for shipment to Iran. Iran represents about 14% of the UAE’s total exports, including re-exports. According to the Dubai Chamber of Commerce and Industry, re-exports accounted for about 60% of the UAE’s $6.8 billion trade with Iran in 2006. The rest of the trade came from the UAE’s free trade zones. Iran’s foreign investments in Dubai are more difficult to verify, but may have neared $300 billion, about a quarter of Iran’s total foreign investments.

The UAE thrives as a central re-exporting and distribution center in the Persian Gulf because of its low tax rates, free trade zones, lower delivery times, enhanced handling and service capacity, and a perception of lax export controls. Dubai, in particular, is Iran’s economic lifeline to the rest of the world. Through Dubai, Iran is able to import goods that the country cannot import directly due to international and U.S. sanctions. Although U.S. businesses are outlawed from operating in Iran, many reportedly can circumvent U.S. sanctions by sending their investments through Dubai.

The United States increasingly has pressured the UAE to make its export controls more stringent. Generally speaking, the UAE has resisted such pressure. In recent months, the UAE appears to be taking actions to regulate trade and investment relations with Iran in a more stringent manner. In September 2007, the UAE passed a law permitting it to place restrictions on dual-use technologies, chemical and biological weaponry, and military equipment. The UAE recently used the new law for the first time to impound a vessel at Jebel Ali that was delivering merchandise to be transshipped to Iran. About 40 Iranian companies were closed in 2007 based on UAE efforts to reduce trade in goods with potential “dual use.”

Financial institutions in the UAE reportedly are restricting Iran’s access to credit, making it harder for Iranian businesses to trade goods with the UAE. Some UAE banks reportedly have frozen the assets of Iranian firms and have reduced opening letters of credits to Iranian

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110 “Tajik speaker says Tajikistan keen on active cooperation with Iran,” ASIA-Plus Information Agency, March 27, 2008.
111 “Iran, Azerbaijan, Turkey to build joint railway,” BBC Monitoring Caucasus, March 27, 2008.
112 Ibid.
114 “UAE/Iran: Trade squeeze, or business as usual?”, EIU—Business Middle East, January 16, 2008.
businesses. UAE-based banks may be wary of reputational and financial risks associated with such transactions. Consequently, some Iranian businesses have had to shift to other regional banks or have had to engage in cash-based transactions, raising the costs of goods on the end-user. Dubai continues to be an important transshipment hub for Iran, but some parts of the Iranian business community are concerned about the potential implications of a more stringent UAE approach to commercial ties with Iran. There is a possibility that trade diversion to Iran may take place through other countries if the UAE is perceived as a hostile business environment.

Ahmadinejad asserts that foreign interference would not affect expanding economic relations between Iran and the UAE, Iran’s most important trading partner. While bilateral trade between the United States and the UAE is significant, the UAE’s trade with Iran is far greater. Both Iran and UAE officials maintain that they would protect their relations from foreign pressure.

U.S.-Iranian Trade

U.S. trade with Iran is limited, receding drastically with the 1987 U.S. ban on imports from Iran and the 1995 ban on U.S. exports to and investments in Iran. Before 1995, major U.S. exports to Iran included machinery and industrial equipment. U.S. exports virtually came to a standstill with the 1995 embargo on U.S. trade and new investment in Iran. Sanctions were relaxed to a certain extent in 2000, with the election of President Khatami in Iran.

While U.S. trade with Iran is low compared to U.S. trade with other countries, there has been notable growth in U.S.-Iranian trade. In 2007, U.S. exports to Iran totaled $145 million, close to double 2006 export levels and more than eight times greater than 2000 export levels (see Table 5).

<table>
<thead>
<tr>
<th>Year</th>
<th>U.S. Exports</th>
<th>U.S. Imports</th>
<th>Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>17</td>
<td>169</td>
<td>-152</td>
</tr>
<tr>
<td>2001</td>
<td>7</td>
<td>143</td>
<td>-136</td>
</tr>
<tr>
<td>2002</td>
<td>32</td>
<td>156</td>
<td>-124</td>
</tr>
<tr>
<td>2003</td>
<td>99</td>
<td>161</td>
<td>-62</td>
</tr>
<tr>
<td>2004</td>
<td>85</td>
<td>152</td>
<td>-67</td>
</tr>
<tr>
<td>2005</td>
<td>96</td>
<td>175</td>
<td>-79</td>
</tr>
<tr>
<td>2006</td>
<td>86</td>
<td>157</td>
<td>-79</td>
</tr>
<tr>
<td>2007</td>
<td>145</td>
<td>173</td>
<td>-28</td>
</tr>
</tbody>
</table>

116 Ibid.
117 Ibid.
119 “Iran president says no third party can harm Iran-UAE ties,” BBC Monitoring Middle East, February 18, 2008.
Currently, the primary U.S. exports to Iran are pharmaceuticals, tobacco products, wood pulp, and optical and medical instruments. The top U.S. imports from Iran are textile and floor coverings, art and antiques, fish and seafood (caviar), prepared meat and fish, and edible nuts and foods (pistachios). There is evidence that Iran is able to obtain embargoed U.S. goods through the re-export trade, mainly through Dubai.\footnote{GAO-08-58, “Iran Sanctions: Impact in Furthering U.S. Objectives Is Unclear and Should Be Reviewed,” p. 18, December 2007.}

In general, entities targeted by U.S. sanctions do little business with the United States. Consequently, the United States must depend on other countries to reduce trade and investment with Iran in an effort to change Iran’s policies. In December 2005, President Bush remarked, “We are relying on others because we have sanctioned ourselves out of influence with Iran.”\footnote{Daniel Dombey and Stephanie Kirchgaessner, “Fresh ways of turning the screw on Iran,” Financial Times, October 22, 2007.}

According to U.S. Secretary of State Condoleezza Rice, the targeted financial sanctions are a “powerful deterrent to every international bank and company that thinks of doing business with the Iranian government.”\footnote{“Iran sanctions put west’s unity at risk,” Financial Times, October 26, 2007.} Such sanctions would have little effect on U.S.-Iran trade since such trade is already limited. However, the action would send a strong signal to foreign countries and may hurt Iran’s trade with major trading partners.\footnote{Glenn R. Simpson, “Democrats Urge Sanctions on Iran’s Central Bank,” The Wall Street Journal, March 5, 2008.}

### International Sanctions and International Trade

Since 2006, European Union countries, including France, Germany, and Britain, have curtailed export credits to companies doing business in Iran.\footnote{Danielle Pletka, “Congress’s Ill-Timed Iran Bills,” Washington Post, August 28, 2007.} For example, in 2007, German export credits backing trade with Iran totaled about $730 million, about half the value of German export credits in 2006 and one-fifth that in 2004.\footnote{Ibid.} Germany does not actively dissuade companies from doing business in Iran, but it is conducting extra scrutiny of export authorizations requests and evaluating the financial risks of doing business with Iran more closely.\footnote{Bertrand Benoit, “Berlin hardens trade stance with Iran,” Financial Times, February 11, 2008.}

Some large European banks have reduced businesses with sanctioned Iranian bodies. For instance, Germany’s Commerzbank and Deutsche Bank, have been reducing or stopping business with Iran. The United Kingdom’s HSBC and Standard Chartered have also reduced business with Iran.\footnote{“German imports from Iran up despite nuclear row-paper,” Reuters News, January 8, 2008.} Many European banks that have curtailed business with Iran are leaving offices open on a minimal basis in case there is a change in the international climate towards Iran.\footnote{Samuel Ciszuk, “UN Security Council Tightens Iran Sanctions, Complicating Oil and Gas Developments and Trade,” Global Insight Daily Analysis, March 4, 2008.}

The merchant class has particularly been hurt by the international sanctions. Iranian businessmen reportedly have increased difficulty opening bank accounts abroad and getting foreign banks to honor letters of credit. According to Iranian officials, over half of the banks in Dubai no longer...
provide credit to businesses based in Iran. As Iranian businesses experience setbacks in obtaining trade financing from international banking partners, they may turn to lesser known banks or to other banking partners not susceptible to international pressure, but potentially raising the cost of business. In particular, the Islamic Republic has turned toward banks in Gulf Cooperation Council (GCC) countries.

Sanctions against Iran’s shipping industry also may pose challenges for Iran’s trade with the rest of the world. U.S. sanctions imposed on the shipping company Islamic Republic of Iran Shipping Lines (IRISL) and its affiliates likely will have limited affect on Iranian trade, as the IRISL and its subsidiaries do little business in U.S. waters, the bulk being in China and other Asian countries. U.N. sanctions, which allow for the inspection of Iranian vessels suspected of carrying embargoed goods, may have more impact on Iran’s international trade. To avoid being stopped, Iranian vessels may choose to sell under foreign flags, which are subjected to a 10% import duty by the Iranian government. While the Transportation Minister exempted Iranian vessels sailing under foreign flags from the import tax, the provision has yet to be implemented. Consequently, if the U.N. sanctions are followed closely, they may ramp up the cost of business for Iranian shipping companies and raise the price of imports for Iranian consumers.

Trade Liberalization

In 1995, Iran became a WTO observer state and, since then, has repeatedly put forth applications to become a permanent WTO member. Accession to the WTO is a stated priority of the Iranian government. Iran cites the more favorable treatment that WTO members give to one another and competition from Asian countries in textiles and manufactures as important challenges to Iranian exports. The United States repeatedly blocked Iran’s bids to join the WTO over concerns about Iran’s nuclear program and support for terrorist activities. On the other hand, many European Union countries and developing countries have supported Iran’s accession. Iran and many other countries maintain that WTO membership should not be based on political reasons, but rather, on economic and business grounds.

In a significant policy shift toward Iran in May 2005, the United States agreed to stop blocking Iran’s attempts to join the WTO as part of economic incentives to Iran to resolve the nuclear program issue. However, the most recent negotiations for accession have ceased because of political reasons and Iran continues to not be a member of the WTO. The WTO accession process is lengthy and some Iranians have expressed concern that domestic momentum for the reforms necessary for accession has waned. Iran, along with Russia, now remain the two largest economies outside of the WTO.

Iran and the Gulf Cooperation Council (GCC) countries\(^\text{134}\) reportedly have agreed to engage in trade negotiations. Such talks are notable given the history of tensions between the Sunni-based GCC countries and the Shia-dominated Islamic Republic. A trade agreement may help mitigate the trade impact of international sanctions.\(^\text{135}\)

**International Financial Flows**

**Foreign Exchange Reserves**

Iran’s foreign exchange reserves, which include the OSF, tend to follow international oil prices. Based on IMF estimates, Iran’s international reserves grew from $60.5 billion in FY2006 (10.2 months of imports) to $81.7 billion in FY2007 (11.5 months of imports).\(^\text{136}\) Owing to the recent drop in oil prices, Iran’s international reserves may shrink with declines in oil income. There is concern that domestic economic mismanagement has reduced funds available through the OSF to smooth economic vulnerabilities facing Iran during the current global economic and financial crisis.

The composition of Iran’s foreign reserves has changed lately. In December 2007, Iran stopped accepting payments in U.S. dollars for oil export purchases by foreign countries and is shifting to other currencies, such as the euro and the yen. Iran also called upon other OPEC members to shift away from the dollar in favor of other currencies during a November 2007 OPEC summit. Aside from Venezuela, all other member states opposed the switch.\(^\text{137}\) The Central Bank also is reducing the proportion of dollars in its foreign reserves and diversifying to other currencies.\(^\text{138}\) Iran reportedly still has a solid external reserves position.

Iran claims that this move away from dollars is in response to the recent slide of the U.S. dollar, and cited the dollar as an unreliable currency. Others contend that the shift away from the dollar is a retaliatory measure against the United States. Iran’s currency diversification also may be an effort to seek independence from the dollar in light of punitive U.S. measures against Iran, which have contributed to Iran’s isolation from the international financial system. This may mitigate U.S. ability to pressure other countries to follow along with sanctions against Iran.\(^\text{139}\) For the United States, these recent events may raise questions about the long-term viability of the U.S. dollar as the global oil currency and have potential implications for the U.S. economy. U.S. massive current account deficits are financed by foreign countries’ purchase of U.S. dollar denominated assets.

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\(^{134}\) GCC members are Saudi Arabia, Kuwait, the United Arab Emirates, Oman, Qatar, and Bahrain.


Foreign Investment in Iran’s Economy

As the most populous country in the Middle East and with vast natural resources, Iran should be a significant market for foreign businesses. However, foreign direct investment (FDI) in Iran historically has been low. In 2007, the flow of FDI into Iran stood at $754 million, compared to FDI inflows of $24.3 billion to Saudi Arabia, $22.0 billion to Turkey, and $11.6 billion to Egypt. While low, FDI inflows to Iran have fluctuated in recent years. Iran’s FDI in Iran was more than double 2006 inflows of $317 million, but down from 2005 inflows of $917 million.140

A stringent domestic regulatory environment and government reluctance to allow foreign investment have contributed to low levels of FDI. For instance, in the energy sector, foreign investment is believed to be limited due to Iran’s buy-back system. Under this system, international oil companies that contract with an Iranian affiliate pay a fee—such as an “entitlement to oil or gas from development operation.” In 2006, buybacks were projected to reach $500 million.141 Despite some widespread resistance within the Iranian parliament (the Majlis) and other parts of government, Iran is slowly letting investors into the country.

However, international sanctions and political uncertainty have clouded Iran’s economy and have made foreign business and investors wary about economic involvement in Iran. U.N. and some U.S. sanctions are targeted toward obstructing Iran’s development of its oil and gas sectors in order to constrain Iran’s resources for uranium enrichment and alleged terrorist financing.142 Foreign companies have had difficulty obtaining financing due to U.S. Treasury Department pressure on international banks to cut off ties with Iran.143 Foreign companies also have limited investment in order to avoid U.S. opposition and to maintain good relations with the United States. International investors reportedly have withdrawn from development projects in the country, such as in the oil and gas, shipping, and automotive industries.144 Iran faces a problem of significant domestic capital flight abroad, particularly to the UAE.

International energy companies that have decided to suspend development projects in Iran include British Petroleum, Total, Royal Dutch Shell, Repsol YPF, StatoilHydro, and Eni. Some companies have decided to continue current projects, but to not engage in any future projects with Iran for the time being.145 As some European companies have scaled down energy sector development projects, other European partners are stepping in (see Table 6 for selected recent deals negotiated by Iran). For instance, Iran signed gas deals in 2007 with Switzerland and Austria, deals that were strongly opposed by the United States. The State Department is evaluating the deals for possible violations of the Iran Sanctions Act.146 In addition, Germany recently announced plans to build three LNG plans in Iran.

With Western involvement in Iran’s energy sector tenuous, Iran has been turning toward Asian countries, such as China and Pakistan; Russia and Central Asian countries; and regional partners,  

140 United Nations Conference on Trade and Development (UNCTAD), Foreign Direct Investment online database.
142 See CRS Report RS20871, The Iran Sanctions Act (ISA), by Kenneth Katzman.
such as Bahrain and Turkey. While new agreements have been negotiated, their successful completion has been slow. Many speculate that the deals are not finalized because of international concerns over Iran’s nuclear enrichment program and the specter of sanctions.\(^{147}\) According to a GAO report, State and Treasury officials assert that U.S. sanctions have contributed to a delay in foreign investment in Iran’s hydrocarbon sector.\(^{148}\) The Iranian government contends that sanctions and international pressure have not slowed down foreign investment in Iran’s gas sector.

Others point out that LNG contracts with Asian and Eastern European countries may not be able to deliver the same quality as Western contracts. For instance, despite the possible termination of Shells’ LNG project with Iran, Iran appears to be “keep[ing] open the option of enlisting Shell’s technical and marketing know-how and financial input for an LNG project linked to a future phase of South Pars.”\(^{149}\)

Iran also is engaging in efforts to privatize nearly 50 state-run oil and gas companies, estimated to be worth $90 billion, by 2014 through the Tehran Stock Exchange. Both domestic and foreign investors would be able to buy shares. Privatization of these energy companies may make it easier for investors to circumvent U.S. sanctions, which complicate investors’ ability to engage in business transactions with Iran directly.\(^{150}\)

In the United States, there has been a growing grassroots movement to divest from Iran. Divestment is a decision to not hold stock in a company or bank that does business with Iran. There is a call to remove current stock from such companies. States such as Louisiana and California recently have passed measures to divest from Iran.\(^{151}\)

<table>
<thead>
<tr>
<th>Country</th>
<th>Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Switzerland</td>
<td>Swiss energy company EGL signed a 25-year LNG export deal with the National Iranian Gas Export Company (NIGC) in March 2007, reportedly valued at €18 billion. Switzerland will buy 5.5 billion cubic meters of Iranian natural gas each year, beginning in 2011. This would be Europe’s second largest gas deal.(^{152}) There is some skepticism that Iran will not be able to supply gas to Switzerland for the foreseeable future because no pipeline connects Iran to Europe at present. The State Department is evaluating the deal for possible violations of the Iran Sanctions Act.</td>
</tr>
<tr>
<td>Austria</td>
<td>Austrian partially state-owned energy company OMV signed letters of intent with Iran in April 2007 for Iran to supply Europe with gas, transactions reportedly valued at $23 billion. The State Department is evaluating the deal for possible violations of the Iran Sanctions Act.</td>
</tr>
<tr>
<td>Russia</td>
<td>In February 2008, Russian state gas company Gazprom announced a deal to establish a joint venture company to develop the offshore Iranian South Pars gas field. Iran would benefit from a build-up of its gas export infrastructure.(^{153})</td>
</tr>
</tbody>
</table>

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\(^{150}\) “Tehran opens energy sector to overseas investment,” Middle East Economic Digest, February 8, 2008.


\(^{152}\) Benjamin Weinthal, “Switzerland to sign second-largest Iran gas deal today,” The Jerusalem Post, March 17, 2008.

**Country** | **Notes**
---|---
China | A China National Offshore Oil Corporation (CNOOC) investment deal, reportedly valued at $16 billion, to develop Iran’s North Pars gas field and to build a liquid natural gas (LNG) plant, was supposed to be signed on February 27, 2008 but has been delayed. Some analysts believe that China has been hesitant to finalize the deal because of international reaction to Iran’s nuclear program and the tightening of United Nations sanctions. The state-operated National Iranian Oil Company (NIOC) and CNOOC signed a memorandum of understanding in December 2006 for the project, under which CNOOC would purchase 10 million metric tons per year of LNG for 25 years. The United States has criticized China’s pursuit of the deal with Iran. China has also looked into alternate suppliers, such as Qatar and Australia.154

Pakistan | NIGC is expected to finalize a natural gas export deal with Pakistan in April 2008, reportedly valued at $7.4 billion. Exports are set to begin in 2011. The gas would be transported through a “Peace Pipeline.” The plan initially also included exporting gas to India, but negotiations have stalled over pricing. The United States has strongly opposed the pipeline and pressured India and Pakistan to halt the project.155

Turkey | Iran is discussing gas production and export deals with Turkey. Under the plans, Turkey would assist in developing Iran’s South Pars field in exchange for cash or natural gas. Gas would be shipped from Iran to Turkey and then to other parts of the world, including Europe, via a new pipeline that Turkey plans to build.156

Germany | In November 2008, the German company Steiner recently announced plans to build three LNG plants in Iran, reportedly valued at $1.47 billion. While there has been some international criticism of this decision, German authorities point out that the deal did not violate export controls of sensitive goods.158 Iranian officials assert that it will continue to develop Iran’s gas fields, even with foreigners pulling out investment.158

Malaysia | In December 2008, Iran signed gas deals reportedly valued at $1.4 billion with Malaysia’s SKS Group. The deal included a contract to build an LNG plant.159

Bahrain | In December 2008, Iran and Bahrain drafted an agreement on the delivery of 1 billion cubic feet per day of natural to Bahrain.160

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**International Loans and Assistance**

**World Bank**

Iran receives loans from the World Bank. As of November 30, 2008, the net principle amount of World Bank loans totaled Iran $3.4 billion, of which $2.6 billion had been disbursed.161 The World Bank currently has nine active portfolios in Iran, focused on reconstruction efforts. The World Bank’s activity in Iran restarted in 2000, following a seven year halt. World Bank loans to

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158 “EU exports to Iran rising despite sanctions,” Reuters EU Highlights, August 6, 2008.
Iran come only from the International Bank for Reconstruction and Development (IBRD), the Bank’s market-rate lending facility. Iran is unable to borrow from the Bank’s International Development Agency (IDA), a concessional lending and grant-making fund, because of its per capita GDP. The United States has not made any contributions to the IBRD, which lends to Iran, since 1996. Some lawmakers call for reducing U.S. contributions to the IDA in protest of IBRD lending to Iran. However, some question the merits of penalizing other countries that receive loans from the IDA.

In addition, the World Bank’s International Finance Corporation (IFC) recently invested in Iran, providing a $5 million joint venture among a Iranian private bank, a French bank, and the IFC. In addition, Iran has joined the World Bank’s Multilateral Investment Guarantee Agency (MIGA), which offers political risk insurance to foreign and domestic investors in Iran.\(^{162}\)

### Bilateral Official Development Assistance

In terms of bilateral official development assistance (ODA), major donor countries to Iran are Germany, France, the Netherlands, Norway, and Japan. On the whole, the United States does not provide foreign assistance, but does provide some humanitarian assistance, to Iran. For instance, USAID has provided disaster relief assistance following the earthquake that struck near the Iranian city of Bam on December 26, 2003. Total ODA given by countries of the Organization for Economic Cooperation and Development (OECD) to Iran amounted to $71 million in 2006 (see Table 7).

Iran has the lowest foreign debt ratio of any country in the Middle East and reportedly maintains solid external reserves. During the last oil windfall, Iran paid off a significant portion of its international debt.

<table>
<thead>
<tr>
<th>Table 7. Net ODA to Iran from OECD DAC Members, 2001-2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>(millions of U.S. dollars)</td>
</tr>
<tr>
<td>Donor</td>
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<tr>
<td>----------------</td>
</tr>
<tr>
<td>Austria</td>
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<tr>
<td>Germany</td>
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<tr>
<td>France</td>
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<td>Japan</td>
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<tr>
<td>Netherlands</td>
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<tr>
<td>Norway</td>
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<tr>
<td>United States</td>
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<tr>
<td>Total DAC Countries(^{b})</td>
</tr>
</tbody>
</table>

**Source:** OECD, “Geographical Distribution of Financial Flows to Developing Countries,” 2007 and 2008 editions.

\(^{162}\) For more information on World Bank lending to Iran, see CRS Report RS22704, *The World Bank and Iran*, by Martin A. Weiss and Jonathan E. Sanford.
a. Negative grants may be due to the return to the owner of unspent balances that were previously disbursed as grants.

b. OECD DAC members for which data is reported for are Australia, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Japan, Luxembourg, the Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, the United Kingdom, and the United States.

Congressional Issues and Options

Members of Congress appear to be divided about the United States’ course of action with respect to Iran. Some contend that the United States should pursue harsher measures against Iran, given the gravity of the real and potential threats posed by Iran’s uranium enrichment program and terrorism financing. Others suggest that perhaps the United States should consider more positive engagement with Iran through rebuilding diplomatic ties and pursuing economic engagement with Iran, such as through Iran’s accession to the World Trade Organization. They suggest that the Iranian state would be receptive to sincere positive engagement on the part of the United States.

In a move to expand economic and diplomatic pressure on Iran, some lawmakers have advocated targeting Iran’s dependency on imports of refined petroleum products. Some lawmakers have advocated directly banning international exports of fuel products to Iran. For instance, H.Con.Res. 362, which was introduced in the 110th Congress, called on the President to prohibit the export to Iran of all refined petroleum products. Others encourage eliminating U.S. support for foreign companies that supply gasoline to Iran. In November and December of 2008, two groups of Members of Congress sent letters to the Export-Import Bank advocating that the bank ends loan guarantees to companies doing key business with Iran. Since the letter, India’s Reliance Industries has announced that it will terminate gas sales to Iran once the current contract expires. Supporters of such punitive options assert that they will place pressure on the Iranian government, given Iran’s lack of refining capacity and dependence on gasoline imports. Others express concern that such action would adversely affect global energy supplies and ramp up prices for U.S. consumers. Some critics also maintain that such an action would target the Iranian populace, more so than the regime.

Unilateral and Multilateral Approaches to Sanctions

There is debate about whether or not the United States should pursue more sanctions against Iran unilaterally or through U.N. action. Some lawmakers assert that U.S. unilateral efforts to pressure Iran may detract from building multilateral consensus to widen punitive measures against Iran through the United Nations. Some maintain that unilateral efforts also might reduce Iran’s willingness to cooperate with the United Nations. Additionally, foreign countries, such as the Persian Gulf states, may not be as responsive to unilateral action by the United States as they would be to multilateral action, given the growing trade ties between the Gulf states and Iran. For instance, Arab diplomats note that while they would respect U.N. sanctions against business with

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163 H.Con.Res. 362, “Expressing the sense of Congress regarding the threat posed to international peace, stability in the Middle East, and the vital national security interests of the United States by Iran’s pursuit of nuclear weapons and regional hegemony, and for other purposes,” May 22, 2008.

Iran, it is difficult to comply with unilateral U.S. sanctions in light of growing trade relations with Iran.165

Others note that pursuing multilateral action can be a lengthy process and that it is difficult to find consensus among foreign countries with various competing interests, such as promoting international security and promoting economic growth through trade with Iran. The United Nations successfully passed the third round of sanctions against Iran only after watering them down to satisfy Chinese and Indian concerns. As industrializing countries with increasing energy demands and insufficient supplies, China and India view Iran as a critical energy supplier for their needs. Such short-term national interest priorities may override international long-term security concerns about Iranian alleged terrorist financing or nuclear technology development. Still, many lawmakers consider the recently-passed third U.N. resolution a good first step and support pushing for more punitive action through the UNSC. Others suggest that to the extent to which China and India engage in economic transactions with Iran may be muted somewhat by the two countries’ ties with the United States.

**Impact of Sanctions on Iran’s Economy and Policy**

Analysts debate the impact of sanctions on Iran’s economy. International tensions associated with Iran’s nuclear program and alleged financing for terrorist organizations undoubtedly have complicated Iran’s business environment. Some analysts point to Iran’s low levels of foreign investment, difficulties obtaining trade finance, and challenges in developing its oil and gas sectors as evidence of the impact of sanctions.

On the other hand, according to a GAO report, “Iran’s global trade ties and leading role in energy production make it difficult for the United States to isolate Iran and pressure it to reduce proliferation activities and support for terrorism.” The Peterson Institute for International Economics (IIE) writes that sanctions increasingly have been unsuccessful as globalization has allowed embargoed countries to find other suppliers and export destinations for trade and investment.166 Sanctions may not raise the costs to the point that they are crippling to the Iranian’s trade and financial interactions with the rest of the world. Iran reportedly is able to circumvent the trade ban by transshipment of U.S. exports through other countries, such as the UAE. In addition to transshipment, analysts also note that international sanctions may simply divert Iran’s trade to other countries that do not enforce sanctions against Iran.

In addition to the impact of sanctions on Iran’s economy, some lawmakers question the effectiveness of sanctions, noting that despite thirty years of sanctions, the United States has not been able to significantly shift the Iranian government’s policies. Previous studies have found that sanctions have little impact on government policy. Rather, they tend to hurt the population of a country. In congressional testimony, one observer stated, “In a broader sense, sanctions often end up hurting ordinary people while having little impact on the government leaders we are trying to influence.”167 The recent enforcement of targeted financial measures appears to signal an effort to

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167 William A. Reinsch, President of National Foreign Trade Council and Co-Chairman of USA*Engage, Testimony before the U.S. Senate Committee on Finance, Regarding S. 970, The Iran Counter-Proliferation Act of 2007,” April 8, 2008.
avoid the drawbacks of past broader trade sanctions efforts and to concentrate pressure on key negative actors. Despite the narrow focus of targeted financial sanctions, the effects of these sanctions may spill over to the broader Iranian populace. There is uncertainty about how sanctions affect the elite, and how elite views may spillover into government policy. \(^{168}\)

Congress may choose to follow with GAO’s assessment and require the U.S. Treasury and State to collect data to assess the economic impact of sanctions on Iran. According to a recent GAO report, U.S. economic sanctions on Iran have had affected Iran, but the extent of these effects on Iran’s economy and behavior are difficult to gauge. The GAO notes that assessment of the impact of sanctions is challenging because of a lack of data collection by the U.S. government and baseline information for comparability. \(^{169}\)

### Impact of Sanctions on U.S. Economy

In addition to considering the impact of sanctions on Iran’s economy, Congress may opt to evaluate how sanctions affect the U.S. economy. U.S. sanctions curtail U.S. economic activity, imposing costs on American workers and businesses and reducing U.S. exports. \(^{170}\) U.S. businesses have expressed concerns about U.S. measures against companies that are unable to control re-exports of high-technology goods to Iran and other targeted countries. Others have noted that U.S. policies in Iran may deprive the United States of significant business opportunities in Iran. Europe, China, India, and Russia are stepping in and taking advantage of Iran’s sizeable market and untapped potential. Proponents of sanctions suggest contend that the security, repututational, and financial risks associated with doing business with Iran outweigh the economic benefits. Some lawmakers question the sincerity of the Administration’s willingness to apply economic pressure on Iran in a way that harms U.S. commercial interests. They note that the United States has yet to sanction any U.S. multinational corporations that do not comply with sanctions laws.

### Action in the 110\(^{th}\) Congress

In the 110\(^{th}\) Congress, several bills were passed in the House related to Iran. House-passed bills encouraged tighter sanctions against Iran, but noted that such action does not indicate congressional support for U.S. military action against Iran. The following were some of the major pieces of legislation proposed by lawmakers:

- **H.R. 957**, “To amend the Iran Sanctions Act of 1996 to expand and clarify the entities against which sanctions would be imposed,” would stiffen existing sanctions against Iran. The bill was passed by the House on July 31, 2007 and referred to Senate committee on August 3, 2007.
- **H.R. 2347**, “Iran Sanctions Enabling Act of 2007,” and the corresponding Senate version of the bill (S. 1430) would encourage divestment from companies that conduct business with Iran. The Administration has opposed H.R. 2347 on


the grounds that it may interfere with Administration’s foreign policy efforts. The bill would allow for sanctions against countries such as China, Russia, and France for conducting business with Iran.171 H.R. 2347 was passed by the House on July 31, 2007 and referred to Senate committee on August 3, 2007.


- H.R. 2798 is a more narrowly targeted measure against Iran. It would prohibit any assistance by the Overseas Private Investment Corporation (OPIC) to individuals who have finance or investment ties to countries that are state sponsors of terror. The bill would target Iran, North Korea, and Sudan. The bill was passed by the House on July 23, 2007 and was ordered to be reported out to the Senate Committee on Foreign Relations and placed on the Senate Legislative Calendar on March 4, 2008.

- H.R. 1357, “To require divestiture of current investments in Iran, to prohibit future investments in Iran, and to require disclosure to investors of information relating to such investments,” was referred to House subcommittee on June 5, 2007.

- H.R. 7112, “Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2008,” widens current sanctions to U.S. firms with foreign subsidiaries doing business in Iran; encourages businesses to divest from Iran; and imposes penalties on countries that are involved in transhipment, re-exportation, or diversion of sensitive goods to Iran. H.R. 7112 was passed by the House on September 26, 2008 and referred to House committees. The related Senate measure, S. 3445, was introduced on September 26, 2008.

U.S. policy toward Iran likely will remain an important issue for the 111th Congress.

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