



IRAN'S ECONOMY OF
RESISTANCE:
IMPLICATIONS FOR FUTURE
SANCTIONS

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Executive Summary

Economic sanctions have not changed Iran's nuclear policy, although they have pressured Tehran to engage in negotiations. The Iranian economy, however, has contracted severely, partly because of the sanctions, but mostly as a result of former President Mahmoud Ahmadinejad's bad economic policies. President Hassan Rouhani and Supreme Leader Ayatollah Ali Khamenei have identified restoring Iran's economic health as a top priority for the regime. They fear that popular frustration about economic opportunities could cause street protests, similar to those that followed the 2009 presidential elections, and threaten the regime's survival.

Iran's leaders see economic sanctions as part of a larger attempt to destroy their regime and Westernize Iranian society. They discuss the sanctions as part of the "soft war" supposedly being waged by the West against the Islamic Republic through television, the internet, and targeted Western media outlets like BBC Persian and America's Radio Farda. Government institutions have gone so far as to identify a "cultural NATO" that supposedly directs and supports these efforts to undermine the morality, religiosity, and national loyalty of the Iranian people. They explain that America's military failures in Iraq, Afghanistan, and around the region have deprived the U.S. of any hard-power capability to coerce Iran, forcing it to turn to soft power—or rather, "soft war." Iran's economy, culture, and media environment, therefore are simply new fronts in the Islamic Republic's war with the West.

Having defined Iran's economic crisis as a security problem, the regime is seeking economic solutions within a security framework. Khamenei announced the "Economy of Resistance" doctrine as his "soft war" response to sanctions, thus subordinating Iranian economic policymaking to a national security doctrine.

The Resistance Economy doctrine is intended to make the Iranian economy resistant to all external economic shocks in the long term, including Western sanctions and global financial crises. Iran's economic plans currently aim to boost foreign investment in order to develop the energy sector, as well as to build a "knowledge economy" around Iran's information technology sector. Creating the necessary space for the private sector's growth means a fundamental transition away from a state-dominated economy. Reforming the domestic financial market and preventing integration with the international financial system serves to reduce vulnerability to global crises while establishing a self-sufficient system of capital flow. Tehran is taking measures to boost ties with Beijing and Moscow in order to insulate Iranian trade against Western economic pressures, but both China and Russia have proven to be unreliable trading partners.

Rouhani and Khamenei appear to disagree on the degree to which Iran should be integrated into the global economic community under the Resistance Economy doctrine. Rouhani speaks of economic normalization in a way that suggests strong economic ties to the rest of the world, including the West. Khamenei, however, remains highly suspicious of such ties, fearing that they would leave Iran vulnerable to renewed economic pressure over time.

The President and Supreme Leader also appear to disagree somewhat about the need to have the current sanctions lifted in order to proceed with Economy of Resistance policies. Rouhani and his technocratic allies argue that Iran's economy is in such dire straits that it is unlikely to improve without an influx of Western cash and technology. Khamenei, on the other hand, never ceases to express skepticism that the West will lift sanctions even if a nuclear deal is made. The Resistance Economy, therefore, is ostensibly designed to work even if sanctions remain in place, although it seems that Rouhani has little confidence that it can do so.

Rouhani is almost certainly right. It is nearly impossible to imagine the Resistance Economy doctrine succeeding in the long run while sanctions remain in place because they hamper sustainable growth. Rouhani, as a result, is positioning Iran to take full advantage of any sanctions relief by internally restructuring the economy to reduce Iran's susceptibility to the continuation or re-imposition of sanctions in the long term.

Rouhani's efforts to "sanctions-proof" the Iranian economy raise the stakes for the West in the current nuclear negotiations. It has long been an article of faith among advocates of sanctions relief that the West could re-impose economic penalties on Iran should Iran fail to abide by the terms of a nuclear deal. We can no longer take that assumption on faith. Rouhani may succeed in using significant sanctions relief to harden Iran against future sanctions enough to make them unattractive to the West, particularly if he is also able to build meaningful economic linkages between Iran and the world. The West must therefore approach the prospect of a "final" nuclear deal that significantly reduces sanctions pressure on Iran as the beginning of the end of sanctions as an effective tool of policy toward Tehran. Such an agreement can transform future relations between the Islamic Republic and the West.

Introduction

Economic sanctions against the Iranian nuclear program have not derailed that program, although they have brought Iran to the negotiating table. The West imposed sanctions in stages, dramatically intensifying them between 2011 and 2013 and effectively driving Iran from the global dollar economy. Sanctions would have damaged the Iranian economy in any event, but former President Mahmoud Ahmadinejad's economic policies significantly amplified that damage, particularly his consumer-oriented policies that increased reliance on imports and undercut domestic industrial output. President Hassan Rouhani's new government therefore sees sanctions as only one component of Iran's economic crisis. It has already begun trying to address other structural problems, some caused by Ahmadinejad's populist policies, others by more fundamental elements of the Iranian political-economic system. Rouhani is attempting to implement a coherent and well thought-through suite of economic reforms, in fact, dubbed the "Resistance Economy," which was approved by Supreme Leader Ayatollah Ali Khamenei in February 2014.¹ The future of the Iranian economy, as well as the future ability of the West to harm it through sanctions, depends on the success or failure of this new economic doctrine.

The securitization of the Iranian economy is the central pillar of the "Resistance Economy" program. Iranian leaders do not see the economy as something independent of or parallel to national security policy. They see economic growth and stability, rather, as a key but subordinate element of national security. The Islamic Republic's ideology in this respect is therefore much more like Soviet economic doctrine than like any Western understanding of economics. Iran's leaders see a poor economy as a potential cause of internal unrest that could threaten the regime, and they see Western efforts to harm the economy as part of a larger Western plot to overthrow the regime.

Iran's leaders have, in fact, described sanctions as the West's economic tactic in the broader "soft war" aimed at spreading Western political and cultural values and undermining the Iranian regime. Khamenei has often said that fighting this "soft war" must be "the country's main priority."² Economic reforms are part of that fight, not an independent effort. The Iranian national security apparatus comprehends all Western policies, actions, and gestures within the paradigm of soft war and has even described a Western "cultural NATO" that it believes is coordinating and executing this soft war strategy. Islamic Republic officials have launched a series of defensive measures to counter the perceived threat of soft war, including controlling the flow of Western media into the country by banning satellite dishes, filtering the internet, and even launching their own intranet, dubbed "the National Information Network," to safeguard Iranian citizens against the "harmful" effects of the World Wide Web.³

The "Economy of Resistance" doctrine is the economic component of the regime's attempts to counter the West's soft war. It is not simply a defensive doctrine, but it also aims to support the Islamic Republic's foreign policy ambition: to establish Iran as a regional hegemon that leads Muslim countries. While it is likely that Khamenei and Rouhani collaborated on developing Resistance Economy policies when Rouhani led the Expediency Discernment Council, they appear to disagree

about the desirability of full Iranian reintegration into the global economy and the necessity of having sanctions lifted in order to implement Resistance Economy programs. Rouhani has therefore tried to devise economic policies that could work should the nuclear negotiations fail, but he and his allies have made clear that a comprehensive nuclear deal with the West is by far Tehran's best option for achieving its long-term objectives.

The impact of lifting sanctions on Iran's economy cannot be overemphasized. Access to the international economic system including the ability to conduct financial transactions, grow the private sector, and develop the Iranian energy sector could transform the Iranian economy. Rouhani aims to ensure that any such transformation hardens Iran against the re-imposition of sanctions in the long-run. His ability to carry out such an ambitious plan is unclear, but American policymakers should head into any "final deal" assuming that sanctions will be less effective in future confrontations with Iran. Future relations with Iran may never be the same. American policymakers must be sure, in other words, that the state of political and military tension with Iran during the past decade will end with a nuclear deal.

Defining "Soft War" and "Cultural NATO"

Tehran's prioritization of the American threat has shifted from military to soft war over the past five years. Khamenei delineated the perceived threat of the West's soft war in November 2009, six months after the presidential election protests:

Everyone today understands and knows that the confrontation between the Arrogance [West] with the Islamic Republic is no longer like the confrontation [during] the first decade of the Revolution. In that confrontation, they exercised their power and were defeated. That was a hard confrontation...[Their] priority today is what is called soft war; that is war using cultural tools, through infiltration [of our society], through lies, through spreading rumors. Through the advanced instruments that exist today, communication tools that did not exist 10, 15, and 30 years ago, have become widespread. Soft war means creating doubt in people's hearts and minds.⁴

The Islamic Development Organization of Iran (IDOI), an institution created to promote the values of the Islamic Revolution, further defines soft war:

[A]ny kind of psychological warfare action and media propaganda which targets the society and induces the opposite side to accept failure without making any military conflict...This war intends to weaken the intelligence and thought of the given society and also causes the socio-political order to be annihilated via the media propaganda.⁵

Khamenei's narrative sees sections of American civil society and culture—like Hollywood, Google, Facebook, and Twitter—as tools of the U.S. government used to influence regime change in Iran. It

is noteworthy that this narrative emerged and expanded dramatically during President Barack Obama's tenure and despite his various efforts to reach out to Tehran. Khamenei's view assumes that "Western culture is a strategy deliberately designed to undermine the Islamic Revolution."⁶

Iran's senior leadership viewed the 2009 presidential election protests as a materialization of this external soft war threat, despite the passivity of the Obama administration during that crisis. Commander of the Islamic Revolutionary Guards Corps (IRGC) Major General Mohammad Ali Jafari, along with scores of other senior officials and commanders, have linked the protests directly to the perceived shift in U.S. hard power policies to soft power: "The enemies of this people and revolution realized that they would not get anywhere with a military measure against our country. [Afterwards], they sought to destabilize our country's internal situation, which led to the [2009] sedition."⁷ Linking domestic dissent to a foreign conspiracy justifies the government's crackdown on domestic political opposition as a defense of its promoted Islamic values. The Islamic Republic considers these values fundamental to its legitimacy.

Iran's leaders have gone so far as to describe the formation of a "cultural NATO" that supposedly coordinates the activities of many Western countries in the soft war against Iran. IDOI states that all soft war operations are carried out through a "cultural NATO," representing a coalition of Western state and non-state actors organized to subvert Iran's moral, civil, and revolutionary culture, leading to the collapse of the current regime.⁸ Its functions are "long-term, convenient, and inexpensive," while military actions are "short-term, troublesome, and more expensive."⁹ Sanctions fit into the concept of soft war as a tactic in the economic realm to weaken the Islamic Republic's structure by targeting its major sources of revenue (oil) and threatening the state by attempting to push Iran's economy off a cliff.

There is no "cultural NATO," of course. The West does not control Iran's internet or media, and is not waging a deliberate campaign to weaken the morality, values, and revolutionary ideals of Iranians. Enterprises like BBC Persian and Radio Farda are elements of a public diplomacy campaign intended to present other viewpoints to Iranians, but they are hardly the vanguard of a media/cultural juggernaut that some Iranians make them out to be. The concepts of "soft war" and "cultural NATO" are the inventions of a paranoid regime trying to externalize its inherent contradictions. American policymakers must keep that fact in mind as they try to affect Tehran's decision-making calculus, which is driven in significant part by an inaccurate perception of Western intentions and capabilities.

Economy of Resistance Policies as a Response to Sanctions within the Soft War Context

The word “resistance” has an intellectual connotation and emotional importance that is central to the Islamic Republic’s identity. Iran’s security strategy fundamentally rejects compromise with the United States and aspires to withstand the various military, economic, cultural, and political pressures of the U.S. and its regional allies. For Iran and its “Axis of Resistance”—its proxies in Lebanon, Iraq, Syria, and the Palestinian Territories—this strategy of resistance is “a fundamental component of the regime’s security because [Khamenei] operates under the assumption that the U.S. will always subvert Tehran’s interests.”¹⁰ The Supreme Leader shunned the September 2014 International Conference on Peace and Security in Iraq, which was organized to discuss strategies to defeat the Islamic State (IS), underscoring Khamenei’s deep cynicism about any cooperation with the U.S., even against a common enemy. Adopting the phrase “resistance” in the state’s economic policies highlights the importance of a strong economy to the Islamic Republic’s overall security.

If “resistance” represents the securitization of Iranian economic policymaking at the doctrinal level, then a recent change in the focus of the Ministry of Intelligence Services (MOIS) embodies this phenomenon at the institutional level. Statements from senior MOIS officials between June–July 2014 during Iraq’s IS crisis indicated “institutional or personal insecurity” about the organization’s role in Tehran’s national security decision-making.¹¹ Since the 1979 Revolution, the agency has focused heavily on cracking down on political opposition (in addition to its role in international espionage), but has also been tasked lately with keeping officials from interfering in the private sector’s growth.

Corruption is more than an economic problem; it undermines regime legitimacy in the eyes of the people. Article 19 of the Resistance Economy Doctrine addresses this aspect of counter-corruption, calling to “create transparency in the economy” and “prevent corrupt measures, activities, and conditions in the monetary, trade, currency, etc. sectors.”¹² This provision underscores the state’s focus on combating corruption. The People’s Republic of China took a similar step beginning in 1978 to preserve the government’s legitimacy and the economy’s long-term solvency.¹³ Given the depth of corruption in the Islamic Republic, the necessity for Iranians to address this problem is even more paramount.

Corruption reached unprecedented levels in Iran between 2005 and 2013 under Ahmadinejad, even by Iranian standards. Parliament Investigation Committee member MP Gholam Ali Jafar Zadeh announced in May 2014 that the committee was “reluctant to publicly reveal the widespread corruption” of the Ahmadinejad government at the “national level” for fear of arousing “social shock.”¹⁴ To deal with this systematic corruption, President Rouhani has tasked MOIS with fulfilling the Supreme Leader’s orders in the Economy of Resistance doctrine.¹⁵ MOIS head Hojjat al-Eslam Mahmoud Alavi has accompanied President Rouhani on provincial tours where economic recovery plans are typically unveiled, and has assured investors that government officials who impede private sector development will face the wrath of the state’s security institutions.¹⁶ Systematic and

unprecedented corruption is undermining the Islamic Republic's ability to fulfill its strategic objectives by spurring and fortifying the economic structure against future external pressures. The regime's willingness to focus a major component of its security intelligence apparatus on this problem is a marked departure from the past and demonstrates a high degree of seriousness about tackling this problem. It also highlights the degree to which the regime sees economic challenges as fundamentally security problems.

Establishing an Islamic Power Block in a Future Multipolar World

Islamic Republic officials designed the Economy of Resistance doctrine to ultimately support Iran's long-term foreign policy objectives. Khamenei said that the doctrine stems from "our persistence in preventing ourselves from being influenced by the policies of global powers."¹⁷ Rejecting compromise with the United States and the West, the Supreme Leader is taking steps to lower the costs of pursuing regional hegemony by reducing economic vulnerability to Western economic pressures. Khamenei thus follows Ayatollah Ruhollah Khomeini's approach to economic growth, considering such concerns secondary to revolutionary political objectives.¹⁸

The Islamic Republic's top leadership and the IRGC aspire to transform Iran into a regional hegemon, establishing a modern Islamic civilization that leads the Muslim world. Khamenei has called for the emergence of a grand Islamic civilization on multiple occasions in the last few years.¹⁹ He and the senior Iranian leadership believe that their emphasis on spirituality makes the Islamic civilization superior to its Western counterpart. In a rare speech in February 2014, the Commander of the IRGC Qods Force—the elite unit that conducts covert operations abroad—Major General Qassem Soleimani boasted of the Islamic Republic's unique capability to lead the Islamic countries, hailing founder Khomeini's Islamic Revolution as an "eternal permeation" that blossomed at the vertex of the Islamic world's regressive decline.²⁰ The IRGC's political machine encompassing its public relations and educational doctrine frequently frames its efforts within this context.²¹ This framework guides Khamenei's and IRGC senior leaders' decisions. Supreme Leader Khamenei has placed great emphasis on the IRGC's political education, ensuring that these values will be passed on to the next generation of senior IRGC cadres, who are tasked with protecting the revolution and carrying its torch into the 21st century.

Iranian leaders foresee the rise of a new, multipolar global order tilted towards Asia. President Hassan Rouhani addressed the Shanghai Cooperation Organization in September 2013 shortly after winning the presidential election: "Following the end of bipolar power tensions, the trend of cooperation and competition has taken the place of absolute competition or absolute cooperation. Regional cooperation and regional gravitation, alongside the use of intra-regional capacities, bring the promise of a multipolar world order."²² Rouhani's statement was echoed a month later by the Supreme Leader's Senior Military Aide and Head of the World of Islam Futures Studies Institute,

IRGC Major General Yahya Rahim Safavi: “In all likelihood, the world, including the powers of the Asian continent, is heading towards multipolarity. There will not be any superpower on a global scale by 2030, and [we] will move in a world of multipolar powers or networks and coalitions of power.”²³ Rouhani and Safavi have both led institutions that conduct research and advise the state on Iran’s future strategic ecosystem. This power-based paradigm of future international relations can rationalize the rise of an Iranian-led Islamic power-block in the Middle East. The Economy of Resistance doctrine aspires to ensure that Iran’s economic system can withstand external pressure and support the objective of becoming one of the poles in the new world order in the long run. Its policy formulation process can shed light on how Iranian policymakers seek to materialize this vision.

Internal Factors Forcing the Supreme Leader to Take the Reins of Economic Policymaking

The Economy of Resistance doctrine binds Iranian economic policymaking to its goals. Its stipulations are exactly like “traffic signs,” said the Supreme Leader, ensuring “that the path will be taken in the right way.”²⁴ This statement reflects Khamenei’s concern that present or future economic policies may undermine the state’s strategic objective of establishing regional hegemony. Economy of Resistance policies define the operational environment of Iran’s economic arena. It is also the first component of a coherent, long-term, and binding economic policy in the Islamic Republic.

Khamenei has set short- and long-term economic goals for most of his tenure as Supreme Leader. The Five Year Development Plans [FYDP] are a set of intermediate economic development policies that began under Shah Mohammad Reza Pahlavi in 1947 and continued after the 1979 Revolution, reflecting the Islamic Republic’s retention of pre-revolutionary bureaucratic institutions.²⁵ For the duration of their existence, Iranian FYDPs have had practical inconsistencies and have not addressed structural issues, meaning that Tehran has pursued policies that do not conform to economic realities, undercutting sustainable growth.²⁶ As a consequence, chronic economic issues, including high unemployment and continued dependence on oil exports, have compounded over the decades, complicating current and future efforts to overcome them.

Other policies such as Article 44 of the Constitution, which set out to privatize state-owned enterprises in 2005, were not executed properly by the Ahmadinejad administration. State assets were instead diverted to state-owned enterprises and transferred back into the pockets of government officials and politically-connected individuals.²⁷ Khamenei called these privatization efforts a failure in March 2014.²⁸ In addition, Ahmadinejad ignored Khamenei’s long-term economic policy goal for a 21st century Iran, the Vision 2025 document.²⁹ Major policies included in the Vision 2025 document have been included in the Economy of Resistance doctrine, highlighting Khamenei’s

frustration with Ahmadinejad's economic mismanagement. Ahmadinejad's failures led Khamenei finally to take the reins in economic policymaking.

Supreme Leader Ali Khamenei has historically taken a hands-off approach to economic policymaking, in contrast with his frequent direct intervention in security matters. The Supreme Leader derives his legitimacy from a theological argument while the Iranian presidency derives his from nationwide elections in which economic factors have normally determined the winners.³⁰ Khamenei keeps a tight hold on the state's security policies and has a high degree of control over the outcome of decisions issued to military and security bureaucracies.³¹ On the other hand, he has little control over economic policy outcomes. Economic uncertainty is inherently higher in oil-exporting countries, which are at the mercy of the highly volatile global oil market. The populace tends to blame poor economic performance on the political figure associated with running the government, regardless of his actual responsibility for it. Khamenei has sought to avoid taking responsibility and blame for sluggish economic growth and chronic unemployment by keeping away from economic matters, at least in public.

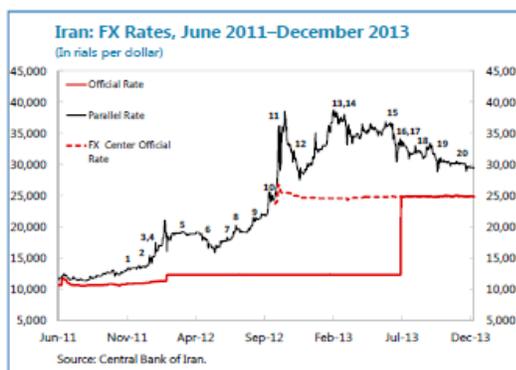
The Supreme Leader maintained this distance when signs emerged in 2012 of the deleterious effects of sanctions and Ahmadinejad's economic policies. Box 1 is a timeline of tightening Western sanctions and the Ahmadinejad administration's poor adaptation to these external shocks. Government currency policy, for example, led to the rial's 80% depreciation against the dollar between January and October 2012. Figure 1 exhibits the 75% reduction in Iranian oil exports between June 2011 and July 2012. The petroleum sector at that time generated 20% of Iran's Gross Domestic Product (GDP), 80% of its foreign exchange earnings, and 50% of its government revenue.³² In absolute figures, sanctions cut Iranian oil exports from \$114.75 billion in 2011 to \$61.92 billion in 2013.³³ Figure 2 shows approximately 14% decline in non-oil manufacturing growth between 2011 and the beginning of the 2013, with the economy contracting at a rate of -5.6%.³⁴ The data portray intense external shocks across critical Iranian sectors within a rather short time span. If Khamenei had taken ownership of the economy at that time, it could have shifted public anger from Ahmadinejad to him, weakening the core pillar of the regime. It was better politics for Khamenei to ride out the last year of Ahmadinejad's term and neutralize his administration by permitting the Parliament and state security organs to attack Ahmadinejad's inner circle. When Khamenei ordered the Expediency Discernment Council to draft a comprehensive reengineering of the economy, it reflected his anxiety of the security threats created by economic malaise, but he waited until Ahmadinejad had departed the scene before promulgating it.

Box 1

Box 1. A Chronology of Significant Economic and Political Events, 2011–13

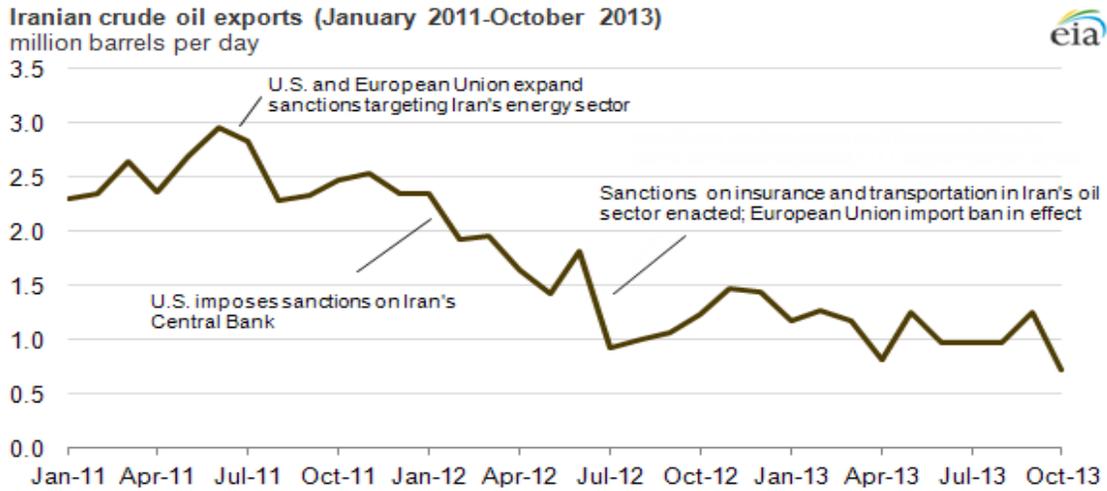
A series of significant external and domestic events took place since the last Article IV Consultation in 2011. These events have shaped the course of economic policy making.

1	November 2011	U.S. identifies Iran as a jurisdiction of primary money laundering concern and determines that Iran's financial system, including the central bank, constitutes a threat to governments or financial institutions that do business with these banks. Britain and Canada stopped doing business with Iranian financial institutions as well as the central bank.
2	December 2011	The U.S. adopts legislation to sanction foreign banks that deal with Iran's central bank unless the parent country of the bank significantly reduces its oil purchases from Iran, which is to be reviewed every six months. The new sanctions start to apply to non-oil transactions with the central bank by end February 2012 and to oil related transactions by end June 2012.
3	January 2012	The EU decides to freeze new contracts to purchase Iranian oil and to wind down existing contracts by July 1, 2012. Also, the EU decision bans insurance for shipping oil or petrochemical products, stops all trade with Iran in petrochemicals and precious metals and stones and freezes the assets of the central bank.
4	January 2012	The parallel market exchange rate depreciates by 25 percent. In response, the central bank depreciates the official exchange rate by 8.5 percent and increases profit rates for deposits by 5 percentage points.
5	March 2012	Society of Worldwide Interbank Financial Telecommunications (SWIFT) cuts off sanctioned Iranian banks from its network.
6	May 2012	A new U.S. Executive Order gives the U.S. Treasury Department the ability to identify and sanction foreign persons who help Iran evade U.S. and other multilateral sanctions.
7	June 2012	U.S. regulators fine a large financial institution in violations of the sanctions regime.
8	July 2012	The EU oil embargo and accompanying insurance ban on shipping of oil or petrochemical products, and the U.S. legislation requiring reductions in oil imports from Iran and banning purchase of Iranian petrochemical products take effect.
9	August 2012	U.S. regulators fine another large financial institution in violations of the sanctions regime.
10	September 2012	Parallel market exchange rate depreciates by about 30 percent and the central bank introduces a Foreign Exchange Center for foreign exchange transactions.
11	October 2012	The rial depreciates sharply in the parallel market. The EU bans transactions between European and all Iranian banks unless specifically authorized, prohibits provision of short term export credits, guarantees, and insurance to Iran and forbids provision of flagging and classification services for Iranian tankers and cargo vessels.
12	November 2012	The U.S. Treasury Department announces that financial transactions with National Iranian Oil Company would be sanctioned.
13	February 2013	New U.S. measures take effect preventing Iran from bringing its hard currency back to Iran and barring transfer of those proceeds to a third country for payments, thereby compelling Iran to buy the products of the oil importing country. U.S. legislation also bans supplying or transferring precious metals, in particular gold, to Iran.
14	February 2013	The EU General Court rules that the EU should lift the sanctions imposed on one of Iran's largest banks.
15	June 2013	Presidential elections take place in Iran. The parallel exchange rate appreciates by about 10 percent.
16	July 2013	The U.S. adopts new measures sanctioning companies that supply goods or services to Iran's automotive sector or finance transactions with this sector. Also, the U.S. measures banning provision of underwriting, insurance and reinsurance services for broad range of activities in Iran including shipping of oil and shipbuilding take effect.
17	July 2013	Central Bank of Iran unifies its two official exchange rates at the more depreciated official rate.
18	August 2013	President Rouhani's government takes office. The parallel market exchange rate appreciates by an additional 10 percent after the Presidential elections.
19	September 2013	The EU General Court rules that measures against Iran's largest shipping company should be lifted.
20	November 2013	Iran reaches an interim agreement with P5+1 over its nuclear program.



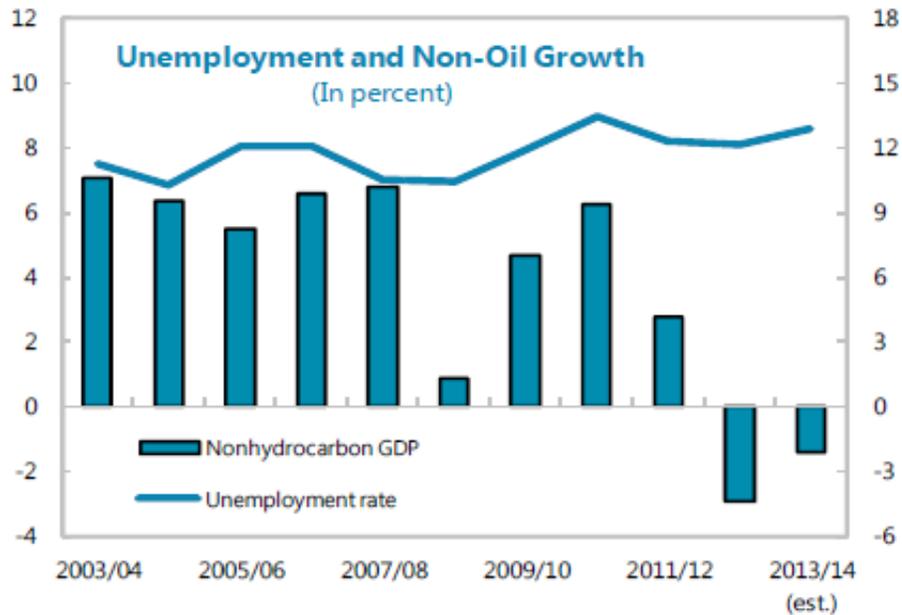
Source: International Monetary Fund³⁵

Figure 1



Source: Energy Information Administration³⁶

Figure 2



Source: International Monetary Fund³⁷

Khamenei and Rouhani Collaborate on Economy of Resistance Policies

Rouhani's electoral victory in 2013 turned popular frustration with Ahmadinejad and the economy into a more hopeful atmosphere. That atmosphere, in turn, stabilized an Iranian polity that had been at risk of fracture since the 2009 crisis. Khamenei therefore waited for an opportune moment to unveil his new economic policy and, more strikingly, to announce it himself publicly. But he had set the formation of the policy in motion two years earlier.

It appears that President Rouhani has cooperated with Supreme Leader Khamenei in drafting the Economy of Resistance policies since at least 2012. The Supreme Leader first raised the idea to adopt a "Resistance Economy" in 2010, encouraging authorities to develop a revolutionary paradigm of economic policymaking that could nullify the negative effects of Western sanctions.³⁸ He raised the matter again in August 2012 with a heightened sense of urgency, weeks after the European and American embargo against the entire Iranian oil industry led to a reduction of exports by 50%.³⁹ Khamenei fundamentally viewed this crisis as an opportunity to address the decades-old problem of oil dependency.⁴⁰ It was also a call to action by senior Iranian officials and their first public acknowledgement that sanctions were hurting the economy. Expediency Discernment Council (EDC) Secretary and former IRGC Commander Mohsen Rezaei reported to *Financial Times* in September 2012 the formulation of "a new economic system...an economy that will be within economic theories to address conditions under sanctions."⁴¹

At the time of the interview, Rouhani was the head of the EDC Strategic Research Center, the Expediency Discernment Council's in-house think tank. He also had an established relationship with Khamenei as the Supreme Leader's Representative to the Supreme National Security Council for 16 years.⁴² Explicating the Economy of Resistance policies to senior government officials in March 2014, Khamenei discussed and praised the central role of the EDC in devising the doctrine.⁴³ It is not hard to imagine that Rouhani influenced the policy formulation process. As this doctrine is primarily concerned with Iran's role in the international economic system, discussing the perspectives of Rouhani and Khamenei on trade is of paramount importance.

Khamenei and Rouhani Diverge on Trade

Supreme Leader Khamenei and President Rouhani have expressed divergent views with regards to international trade; the former is skeptical while the latter welcomes it. The Supreme Leader does not oppose "global trade in principle" but is concerned that joining the World Trade Organization (WTO) without a strong economic foundation would lead to "ingestion...drowning in a superior economy."⁴⁴ Khamenei is pessimistic about the WTO, calling it "a vehicle for dissolving the Islamic system in the international material system," leading to the loss of Iran's monetary and financial independence.⁴⁵ An aversion to depending on Western countries lies at the core of Khamenei's political and economic concerns. Although the Supreme Leader has acknowledged his intention to

“preserve” a connection to the global economy, he will not compromise the state’s political objective of establishing regional hegemony in order to expand Iran’s trade. He seeks, instead, an economic system “resistant” to external shocks, including sanctions and global financial crises.⁴⁶

Rouhani, on the other hand, invited world leaders at the Davos Economic Forum in January 2014 to “come and visit Iran [and] see the investment opportunities.”⁴⁷ The president has hired many former technocrats, such as Oil Minister Zanganeh, who pushed for economic liberalization reforms through foreign investment in the 1990’s.⁴⁸ By flaunting Iran’s investment potential and hiring those in favor of economic liberalization, Rouhani is likely trying to persuade the Supreme Leader that Iran can achieve its long-term strategic and economic objectives by integrating into the global economy once sanctions are lifted. The fundamental objectives of Economy of Resistance policies should clarify the extent to which the Supreme Leader’s long-term economic objectives are achievable under the sanctions imposed as a result of the Iranian nuclear program controversy.

Reengineering the Iranian Economy

Lifting sanctions will make a significant difference in the Iranian economy’s growth. “Sustainable growth” is, in fact, the explicit objective in the preamble of the Supreme Leader’s Economy of Resistance doctrine.⁴⁹ A nuclear deal that lifts sanctions is the most viable and sustainable avenue facing Islamic Republic policymakers. Tables 1 and 2 are the International Monetary Fund’s (IMF) projections of Iran’s macroeconomic indicators from 2013-2020, with the continuance of

Table 1

Medium-Term Baseline Scenario, 2011/12–2019/20 1/									
	2011/12	2012/13	Projection						
			2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20
	(Annual percentage change)								
Real GDP at market prices	2.7	-5.6	-1.7	1.5	2.3	2.3	2.3	2.3	2.4
CPI inflation (average)	21.5	30.5	35.2	23.0	22.0	20.0	20.0	20.0	20.0
	(In percent of GDP; unless otherwise indicated)								
Overall general government balance	-1.4	-2.0	-2.2	-2.5	-2.5	-2.9	-3.2	-3.5	-3.7
Non-oil balance in percent of non-oil GDP	-16.8	-10.5	-10.3	-8.3	-7.4	-6.9	-6.6	-6.3	-6.0
External current account balance	11.0	6.6	8.0	5.0	2.7	1.8	1.1	0.6	0.4
Gross official reserves (in billions of U.S. dollars)	92.2	104.4	107.7	110.1	110.0	106.9	104.3	99.6	93.7
M2 growth (in percent)	19.6	30.6	24.9	24.1	24.5	20.1	19.3	18.9	18.9
Private sector credit growth (in percent)	20.1	17.7	24.6	19.6	22.9	18.6	16.8	15.9	15.6
Memorandum items:									
Oil and gas sector									
Total oil and gas exports (in billions of U.S. dollars)	118.2	62.9	56.3	52.8	46.5	41.1	36.5	32.4	28.7
Crude oil production (in millions of barrels/day)	4.0	3.2	2.8	2.7	2.6	2.6	2.5	2.4	2.3

Sources: Iranian authorities; and Fund staff estimates and projections.
1/ The Iranian fiscal year ends March 20.

Source: International Monetary Fund⁵⁰

international sanctions as the baseline scenario and the removal of sanctions as the alternative scenario. While accurately predicting economic performance is notoriously difficult, these calculations are helpful in highlighting the centrality of sanctions to Iran's future economic performance.

Table 2

Islamic Republic of Iran: Medium-Term Alternative Scenario, 2011/12–2019/20 1/									
	2011/12	2012/13	Projection						
			2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20
	(Annual percentage change)								
Real GDP at market prices	2.7	-5.6	-1.7	2.2	4.2	4.3	5.4	5.7	5.7
CPI inflation (average)	21.5	30.5	35.2	21.5	18.0	12.5	8.7	6.3	5.0
	(In percent of GDP; unless otherwise indicated)								
Overall general government balance	-1.4	-2.0	-2.2	-0.5	0.5	0.8	1.0	1.3	1.3
Non-oil balance in percent of non-oil GDP	-16.8	-10.5	-10.3	-8.8	-9.3	-7.9	-6.8	-5.5	-4.7
External current account balance	11.0	6.6	8.0	4.2	5.2	3.2	2.4	1.3	1.0
Gross official reserves (in billions of U.S. dollars)	92.2	104.4	107.7	111.1	121.7	139.5	158.5	174.0	195.8
In months of imports of goods and services	13.8	17.2	12.8	11.5	11.3	12.1	12.8	13.4	12.1
M2 growth (in percent)	19.6	30.6	24.9	24.2	21.1	19.1	19.4	19.9	19.6
Private sector credit growth (in percent)	20.1	17.7	24.6	24.0	24.3	20.0	20.1	20.7	19.8
Memorandum items:									
Oil and gas sector									
Total oil and gas exports (in billions of U.S. dollars)	118.2	62.9	56.3	69.8	86.5	87.4	88.8	85.0	82.3
Crude oil production (in millions of barrels/day)	4.0	3.2	2.8	3.2	3.8	4.0	4.2	4.3	4.3

Sources: Iranian authorities; and Fund staff estimates and projections.
1/ The Iranian fiscal year ends March 20.

Source: International Monetary Fund¹

The Islamic Republic seeks to develop a robust knowledge-based economy through the expansion of the nascent Information and Communication Technology (ICT) sector, though the feasibility of this endeavor is doubtful. Article 2 of the Resistance Economy doctrine aspires to “pioneer” a knowledge-based economy by “increasing the exports share of knowledge-based products and services,” and “achieving first rank” in this sector among countries in the Middle East.⁵² The extent and pace of growth in translating ideas or inventions into goods and services is the distinguishing feature of developed knowledge-based economies.⁵³ The knowledge society is “a larger concept than just an increased commitment to research and development [and] covers every aspect of the contemporary economy where knowledge is at the heart of the value added from high tech manufacturing and ICTs through knowledge intensive services to the overtly creative industries such as media and architecture.”⁵⁴ ICT is a key pillar of knowledge-based economies, as reflected in the World Bank’s Knowledge Index and Knowledge Economic Index metrics.⁵⁵ Technological

development is but one of the components of a knowledge-based economy. The Resistance Economy thus seeks to drive Iran's transition into a knowledge-based economy via the development of its ICT sector. President Rouhani is pushing measures to support this sector, aiming to create more than 100,000 ICT jobs by 2017.⁵⁶ Government officials have asserted that Iran has the human capital to support a vibrant ICT sector, claiming that 20% of the country's 4.5 million university students are pursuing ICT degrees.⁵⁷ But Iran has a long way to go; the United Nations ranked the Islamic Republic 105 out of 177 in its E-Government Development Index, which assesses the ability of member states to spur ICT growth.⁵⁸ The effort to shift from an oil-based into a knowledge-based economy is probably the most difficult challenge facing Islamic Republic policymakers.

Iran's efforts to expand its ICT sector is in direct contrast to its efforts to control Iranians' use of the internet as part of the soft war doctrine. The Islamic Republic has attempted to defend against U.S. soft power and culture by controlling and tightening the medium and flow of information into Iran. The Supreme Leader established the Supreme Virtual Space Council (SVSC) in 2012 and tasked it with designing and implementing a comprehensive Internet policy. Council members included the president, parliament speaker, head of the judiciary, the IRGC commander, and the intelligence minister among others—a similar make-up to the Supreme National Security Council, which formulates the state's security policies.⁵⁹ The SVSC has yet to release details of its comprehensive Internet policy. But the state is establishing an internal infrastructure that would better control Iranians' internet access including the Information and Communication Technology Ministry's construction of 20 data centers across the country and the Islamic Republic's intent to operationalize a National Intranet Network (NIN).⁶⁰ The NIN aims to make intra-agency interactions and government services electronic and provide web service to 60% of all households, while strengthening security components against "cyber-attacks."⁶¹ The NIN and SVSC represent the Islamic Republic's desire to increase state control over the flow of information as a way of countering the perceived U.S.-led soft war.

The Iranian government's emphasis on an internal Internet network including the National Intranet Network, however, may hamper ICT sector growth, since knowledge is required to adapt to the changing global environment and improve the economy.⁶² Furthermore, economies with robust ICT sectors, such as the United States and Singapore, are wholly integrated with the international system.⁶³ It is thus doubtful that Economy of Resistance policies can successfully transform Iran into a knowledge-based economy in the long term, particularly if Tehran insists on expanding its control of the internet.

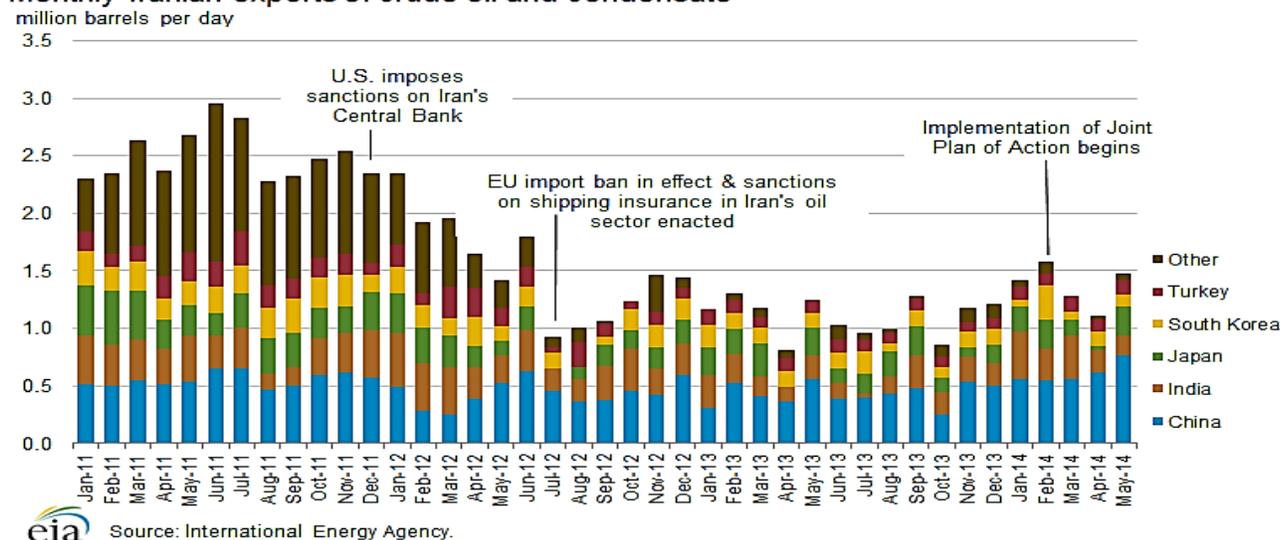
The Rouhani administration has acknowledged that foreign investment is necessary to fulfill Economy of Resistance policies stipulating energy sector diversification. Article 10 encourages "foreign direct investment for exports," and article 13 addresses "income vulnerabilities resulting from exporting oil and natural gas" and seeks to increase exportation of gas, electricity, petrochemical, and petroleum products in order to wholly integrate its primary commodity resources into production chains of secondary commodities, thereby reducing vulnerabilities associated with reliance on crude oil and natural gas exports.⁶⁴ The Rouhani administration hopes to attract at least

\$100 billion in foreign capital within the next three years to develop upstream capacities.⁶⁵ The Oil Ministry is presently making the terms of oil contracts more attractive to Western investment under the new integrated petroleum contract (IPC) model, which is scheduled for a formal unveiling in an international energy conference held in London by the end of 2014.⁶⁶ The IPC paradigm will reportedly give international oil majors direct economic stakes in the Iranian energy sector, including field or operations companies, highlighting Iran's emphasis on acquiring managerial and technological expertise in developing its oil fields. The new model would be a significant break from the previous buy-back contracts, which prohibit equity rights on Iranian hydrocarbon resources and have been generally unpopular with international firms.⁶⁷ The IPC would include provisions allowing some transfer of ownership to foreign partners, encouraging foreign investment in the Iranian energy sector.

Economy of Resistance policies seek to increase the exports of various energy products, including petrochemical and petroleum products, to reduce Iran's dependency on crude oil exports. Figure 3 demonstrates the impact Western sanctions have on crude oil exports, which significantly cut into the Islamic Republic's revenues. Iranian oil production was kept afloat by a small handful of buyers who leveraged their position to buy oil at steep discounts.⁶⁸ A diversified energy sector hedges against unstable crude oil prices and adds value to the Iranian production chain. Iran can expect to earn more revenue and increase employment by expanding its secondary petroleum market. It is an achievable measure that requires foreign investment, as Saudi Arabia and Qatar are diversifying their energy sector with the involvement of multinational energy companies.⁶⁹ Sanctions have prohibited foreign investment in Iran, however, seriously hampering Iran's ability to develop its energy sector, which suffers from aging infrastructure. Senior Iranian officials consider sanctions the main obstacle preventing the development of existing and future energy projects. President Rouhani stated that foreign capital is necessary to significantly increase Iranian production in energy fields shared with neighboring Persian Gulf states by 2017.⁷⁰ The country, according to some estimates, can expect major growth in petrochemical production by 2020 if sanctions are lifted and investment and technology flows into the sector.⁷¹ The Islamic Republic's government officials have placed a great emphasis on increasing foreign capital, technology, and managerial expertise in order to boost the energy sector's production and diversity.

Figure 3⁷²

Monthly Iranian exports of crude oil and condensate



Iran's natural gas supply, however, is years away from significantly impacting the global market due to underdeveloped production. President Rouhani downplayed natural gas exports to Europe in early October 2014, telling Russian TV channel Rossiya 1 that Iranian production is “far” from supplying the European market and that the country must think about “domestic consumption” first.⁷³ Iran's share of the global natural gas market is a mere 1%, despite holding 18% of the world's proven natural gas reserves, which is the largest reserve in the world and even surpasses Russia, according to British Petroleum statistics.⁷⁴ International sanctions and lagging production have prevented increased production, to the extent that the country is a net importer just to keep up with high domestic demand.⁷⁵ The sheer volume of Iran's resources means that the country has the potential to become a big player in the international gas market. Future exports will also rely on the ability to access liquefied natural gas (LNG) technology, which is currently prohibited under international sanctions.⁷⁶ Lifting sanctions will thus be essential to the future of the Iranian natural gas sector. Analysts project that even with the removal of sanctions, Iran will not emerge as a major gas exporter until at least 2030, due to various domestic and international constraints.⁷⁷ But the possibility of political or economic turmoil and new technologies confound efforts to make quantitative predictions regarding any natural gas market beyond 2025. What is certain, though, is that reducing domestic natural gas consumption is absolutely critical for Iran to have any hopes of significantly expanding this sector.

The Supreme Leader's Economy of Resistance policies include a plan to lower domestic energy consumption. Article 4 specifically stresses that a “sharp decline” in energy consumption can be achieved by “using the capacity of implementing targeted subsidies.”⁷⁸ The Head of the Oil Ministry Research Center Hamid Katouzian warned in March 2014 that “should the current consumption procedure not change, Iran will be the largest natural gas importer in the world by 2025.”⁷⁹ Natural

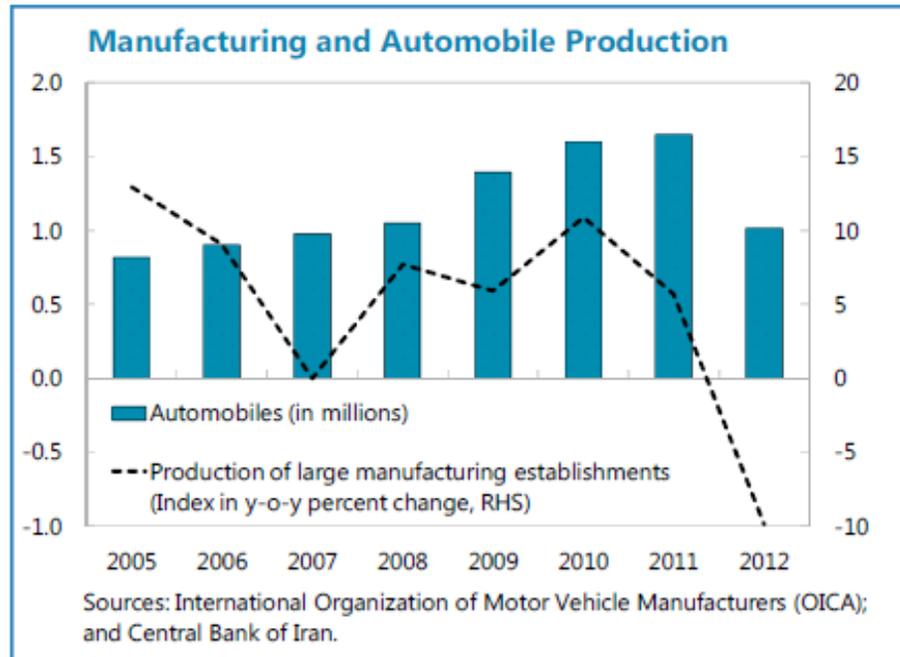
gas constitutes 61% of total Iranian domestic energy consumption.⁸⁰ Efforts to develop the natural gas sector and reduce energy consumption are therefore intertwined. Reducing domestic energy-use is even more imperative when considering that economic growth raises energy consumption in oil-exporting countries.⁸¹ If energy consumption is not brought under control, then Iran will have to expand its refinery capacity, an expensive endeavor, and continue importing natural gas at a high rate, retarding efforts to develop the economy.

Removing sanctions is the most immediate and a feasible way to achieve the Resistance Economy's objectives for non-oil manufacturing growth led by the private sector. The Ahmadinejad administration previously shrank Iran's manufacturing sector when it instituted policies focused primarily on advancing consumer-oriented policies.⁸² Its implementation of the Supreme Leader's privatization policy, Article 44 of the Constitution, diverted state assets to state owned enterprises, further crowding out the private sector. Continuing this economic liberalization policy, the Rouhani administration plans to boost Iran's much-needed growth in the short-term via private sector manufacturing. Private sector representatives, however, have criticized the policy, calling it unrealistic to expect the private sector to lead sustainable growth and economic recovery in the short-term.⁸³ Though the manufacturing process timeline varies across industries, it takes a significant amount of time for manufacturers to restart production and begin exporting their products abroad.⁸⁴ The Iranian private sector needs time and space to jumpstart the process of exporting products and earning revenue.

Recent economic developments related to the partial lifting of sanctions under the Joint Plan of Action (JPOA) agreement in 2013 underscore the impact sanctions have on the Iranian manufacturing sector. Sanctions were lifted on the automobile industry in November 2013, as part of the interim nuclear deal, and Iranian officials announced in October 2014 that automobile manufacturing grew by a whopping 80% during summer 2014, compared to the same period in 2013.⁸⁵ Figure 4, though, shows that production in this sector began its decline in 2010 and then plummeted in 2012, reflecting the damages done to manufacturing under the Ahmadinejad administration. Should a sans-sanctions environment come about, Iran could expect a jumpstart in non-oil manufacturing that would put the economy on a path of sustainable recovery while allowing it to reduce dependency on oil.

While manufacturing composes a small share of the country's GDP, Iran has a relatively well-diversified foundation for future growth.⁸⁶ The country has potential comparative advantages in a variety of sectors, including automobiles (Iran was the largest regional producer prior to the recent sanctions), tourism, handicraft, and carpet-making, and a vibrant food sector.⁸⁷ Lifting sanctions can spur economic growth by reopening access to foreign markets and creating a stable business environment for capital investment in manufacturing.

Figure 4



Source: International Monetary Fund⁸⁸

The Resistance Economy doctrine also aspires to achieve self-sufficiency in “strategic products”—food and medicine. In his March 2014 speech, Supreme Leader Khamenei emphasized that the Islamic Republic would preserve its connection to the global economy.⁸⁹ The experience of high imported basic commodity prices in the past several years weighs heavily on him. Ahmadinejad’s promotion of imports proved devastating when sanctions devalued the currency and increased the price of staple goods, leading to some protests.⁹⁰ This is particularly worrisome for the Supreme Leader, as protests over food prices precipitated the 2011 Egyptian and Tunisian uprisings.⁹¹ Article 7 of the Resistance Economy thus stipulates the increase of domestic production in basic goods, the diversification of imports, and the achievement of self-sufficiency in food and medicine.⁹² Khamenei is determined to “never face any problems in the areas of food and medicine.”⁹³ Producing basic goods domestically can safeguard against sanctions by excluding the production chain from the international economic system and prevent social unrest induced by economic challenges.

The Economy of Resistance doctrine also includes provisions to reform the financial system, which, if successful, could support the growth of Iran’s private sector without integrating it into the global financial infrastructure. Article 9 stipulates a “Comprehensive reform of the country’s financial system with the intention of responding to the national economic requirements, create stability in the national economy, and pioneer the strengthening of the real sector.”⁹⁴ Investors avoided sectors affected by financial sanctions—which includes most sectors—and put their assets in markets that

provided consistently stable returns, such as the housing and gold markets. The JPOA agreement has reignited some capital activity, but the vast majority of investors are watching the results of the nuclear negotiations with the West in order to have some measure of certainty in forecasting the Iranian business environment.⁹⁵ Corruption, corporations linked to the military, and unlicensed financial institutions are also major obstacles to the growth of Iran's financial system.⁹⁶ These are powerful domestic interests that have accumulated significant capital. But Rouhani has the support of the Supreme Leader and the population, giving him the political capital and the right tools to reform the financial system.

It is unlikely that the Iranian financial sector will integrate into the global financial system, as it would expose the country to sanctions and financial crises, violating the fundamental tenet of the Resistance Economy. Iranian policymakers are limiting foreign ownership in the Tehran Stock Exchange to 15%, reflecting their desire to develop a domestic financial system that can function without connection to the international financial system.⁹⁷ Restricting the entry of international competitors and capital also serves the interests of the Iranian business elite, but there are significant challenges ahead to a robust financial sector in Iran.

In addition to reforming Iran's financial system, the Economy of Resistance doctrine also addresses unemployment, which is considered to be a major security concern. The IMF warned Iranian policymakers in April 2014, "If the economy does not generate a sufficient number of jobs [in three years], social conditions would worsen and risk political support for reforms. In turn, preserving the economic status quo would exacerbate weaknesses in the corporate and financial sectors, undermining future growth prospects." The Rouhani administration has told the IMF that unemployment is its number one economic and social challenge.⁹⁸ The actual unemployment rate, according to unofficial sources, is reported to be as high as 20%. Unemployment particularly affects the female (24%) and youth (20%) populations.⁹⁹ An unprecedented 4.5 million students are expected to enter the labor market in less than five years, and Iran needs to accommodate the millions of unemployed youth whose predecessors constituted the backbone of political discontent following the 2009 presidential election. It was only a short time after the 2009 protests that the Islamic Republic's upper echelon witnessed unemployment spurring political unrest across the Middle East and leading to the Arab Spring in 2011.¹⁰⁰ Expediency Discernment Council member Ali Agha Mohammadi, addressing an Economy of Resistance workshop in September 2014, warned against the long-term effects of youth unemployment.¹⁰¹ It should therefore be no surprise that a quarter of the Resistance Economy policies directly address issues associated with the Iranian labor force.¹⁰² In fact, Article 1 emphasizes "a rise in income for middle and low income populations."¹⁰³ Unemployment is thus another macroeconomic indicator that is threatening the Islamic Republic's security, highlighting the securitization of economic policymaking in Iran.

The Supreme Leader has tied his legacy, and to some extent his continued legitimacy, with Iran's economic performance and the success of the Economy of Resistance policies. This action may make it possible to quantify some aspects of the Iranian strategic calculus, since Khamenei cannot expect simply to blame economic failure on the Rouhani administration. Table 3 demonstrates the

connection between economic indicators and Khamenei's policies. Table 4 encapsulates the extent to which the doctrine's fulfillment depends upon the lifting of sanctions.

Iran's interactions with the international economic system going forward may significantly affect Tehran's strategic calculus. The Economy of Resistance policies are about reducing vulnerability to Western economic pressures, first and foremost, and ultimately supporting the state's political objective of establishing an Iranian-led hegemony in the Middle East. Given the depth of internal economic malaise facing the country, aggressive behavior that provokes international sanctions would appear to be strategically foolish. Tehran should in theory, therefore, be inclined to pursue its foreign policy objectives without provoking isolation. This temperament is reflected in the efforts of government officials to project Iran as a stable energy provider to reliable—and strategic—trade partners.

The actual connection between Iran's interactions with the global economy and Iran's foreign policy may prove more tenuous than this pragmatic calculus would suggest. Khamenei has controlled Iran's foreign policy and has exercised that control largely through agents like Qods Force Commander Soleimani, IRGC Commander Jafari, and foreign policy adviser Ali Akbar Velayati. If those agents are not on board with a more docile regional strategy, and they do not appear to be, it is unclear whether Khamenei would side with them or with a more pragmatic approach. It is also essential to keep in mind that the goal of the Resistance Economy is to support the state's aspiration of becoming a regional hegemon, subordinating economic policy to security policy. Khamenei and his advisers could choose to continue pursuing hegemony at the expense of accelerated economic integration. The United States cannot count on economic integration to tame a foreign and security policy that remains unchanged in its objectives.

Table 3 – Several Economic Indicators Linked to Economy of Resistance Policies

Indicators	Doctrine relevance	Significance/Variables
GDP	Virtually all provisions	Indicates the success of the Rouhani administration's efforts to boost growth
Global oil prices	Directly affects state revenue, as long as crude oil constitutes a major share of total exports	Funding of state and social programs; fiscal and monetary policies adjust to total oil exports revenue
Oil by-product exports	Energy sector diversification; private sector growth; reducing dependence on crude oil exports	Successful growth in secondary commodity market reduces reliance on crude oil exports and adds more value to the production chain
Non-oil vs. oil sector share of GDP	Shift from oil-based economy to knowledge-based economy	Indicator of change in economic foundation
Unemployment	Private sector growth; shift	Preventing social unrest;

	from oil-based economy to knowledge-based economy	officials hope ICT graduates will lead transition to knowledge-based economy
Foreign Direct Investment	Energy sector diversification; private sector growth	Foreign capital is critical for energy sector, domestic capital focused on manufacturing; technology upgrade is crucial for both areas
Non-oil manufacturing	Private sector growth	Job creation and lower unemployment
ICT share of GDP	Shift from oil-based economy to knowledge-based economy	Iranian economy would generate the most of its revenues from knowledge-based activities instead of non-renewable resources
ICT sector growth	Shift from oil-based economy to knowledge-based economy	Tehran's success in developing and expanding this sector
Value of rial against the dollar	Financial sanction	CBI policy; depreciating rial means cheaper exports but more expensive imports
Currency reserves	Developing "resistant" economy	Currency reserves provide government with cushion against external shocks

Table created by author

Table 4 - Summary of Transformative Economy of Resistance Policies

Policy goals	Likelihood of realization with sanctions*	Likelihood of realization without sanctions*	Key variables
Transform from oil-based economy into inward-oriented, knowledge-based economy	Very low	Low	Iran lacks a thriving ICT sector; successful knowledge-based economies are outward-oriented
Diversify energy sector	Low	High	Flow of foreign capital and technology
Develop private sector	Low	Medium	Stable business environment; state-dominated economy
Robust inward-oriented financial system	Low	Medium	Transparency; creating investor confidence

**Assessments made by author*

Table created by author

Strategic Diplomacy

Iran is employing diplomacy to acquire and secure robust trade partnerships to insulate it from Western sanctions. Article 12 of the Economy of Resistance doctrine aims to “increase the power of resistance” and decrease “vulnerability” by “expanding strategic links, cooperation, and consultation with regional and international countries with a focus on neighboring countries,” using “diplomacy to safeguard economic interests and objectives.”¹⁰⁴ Article 10 also addresses the “diversification of economic ties with other countries, especially with regional” states.¹⁰⁵

President Rouhani has embarked on a diplomatic outreach campaign with neighboring Arab and Central Asian countries since his election in August 2013, and his efforts have produced some tangible results.¹⁰⁶ Iran is finalizing energy negotiations with the Kurdistan Regional Government and the Iraqi Federal government, and Iranian officials have announced their full support of Iranian companies seeking to reconstruct Iraqi infrastructure damaged by the Islamic State of Iraq and Levant (ISIL).¹⁰⁷ Rouhani also secured a 25-year contract to supply natural gas to Oman in March 2014.¹⁰⁸ While there may be opportunities for Iran in these developing markets, they offer less in short-term value compared to the more lucrative European markets. In the long-term, though, Iran may have a diversified set of trade partners, should these developing countries grow. Future opportunities will arise for Iran as emerging non-Western markets develop stronger middle classes and energy demands increase. Some analysts have misconstrued some of these diplomatic efforts as a change in Tehran's regional worldview and an attempt to thaw relations with Iran's neighbors.¹⁰⁹ There is little evidence to support such an interpretation. The Resistance Economy doctrine clearly establishes Iran's goal of engaging in strategic diplomacy in order to decrease vulnerability to Western economic pressures and allows Tehran to pursue its political objectives with fewer constraints.

Tehran is also projecting itself as a stable energy provider. Addressing an international energy conference in Tehran in August 2014, Parliament Speaker Ali Larijani stated, “Our national security paradigm is using energy to create lasting stability and security in the region and the world, and we are committed to that. We prefer more stable behavior for our national interests than to tactically use energy.”¹¹⁰ The statement was intended to attract energy consumers seeking a stable energy provider in the Middle East, while serving simultaneously to generate revenue and provide Iran leverage with international partners. This undertaking is only likely to succeed, however, if sanctions are removed.

It seems that the Islamic Republic is seeking non-Western clients, and the list of potential clientele is expanding as emerging markets develop strong middle classes and increase their energy demands. Iran National Gas Company Managing Director Hamid Reza Araghi announced that Iran is capable of exporting natural gas to Iraq and Pakistan via pipelines and to Japan via liquefied natural gas technology.¹¹¹ The latter endeavor is a long-term measure, though, as Iran does not possess the requisite technology. In addition, Ali Majedi, the International Affairs Deputy to the Oil Minister, announced that the Japanese have not expressed a willingness to enter serious negotiations.¹¹² The

statement does reflect, however, an Iran's intent to have a more prominent presence in the Japanese market. Iran's leaders also see opportunity in future global energy markets as various emerging markets develop strong consumer classes, particularly in India and China. As Khamenei pointed out several times during his March 2014 speech, Economy of Resistance policies are "long-term and strategic measures."¹¹³ Whether Iran becomes a stable energy provider depends, to a great extent, on the lifting of sanctions. Likely realizing this reality, Iranian officials have looked to boost their country's relationship with Russia and China in order to create some space in nuclear negotiations with the West and possibly set the groundwork for a "Plan B" if sanctions are not lifted.

Troubled Relations with Russia

Iran has long looked to Russia for support against the U.S. and the West, but Moscow has proven to be an unreliable ally. Tehran and Moscow are taking measures to evade Western sanctions by increasing bilateral trade, but neither side seems fully committed. In early August, the two countries announced a future oil-for-goods agreement worth more than \$20 billion over a five-year period.¹¹⁴ But there have been contradictory statements from both sides about the terms of the deal. There are also reports that Russia is applying for Iran's permanent membership in the Shanghai Cooperation Organization.¹¹⁵ Some Iranian officials, however, undermined the foundation of bilateral relations in mid-August by announcing that the country has the capacity to export natural gas to Europe—a development Russia would not welcome, as it would reduce European dependence on Russian gas.¹¹⁶

Russian officials also backtracked from their earlier statements on a formal agreement indicating that a memorandum of understanding was reached. Efforts to increase bilateral relations seemed back on track in September, when Iran and Russia signed a trade agreement valued at \$87.6 billion, increasing overall banking and financial ties including plans to establish a joint bank in Moscow.¹¹⁷ Iran and Russia can feasibly meet each other's economic needs in some critical areas. For example, Iran can export its agricultural products to Russia; sanctions over the Ukrainian crisis have been followed by noticeable food price increases in the Russian market, though Moscow is largely at fault in this particular case for retaliating against the Europeans with a food imports ban.¹¹⁸ Russia, in exchange, can provide Iranians with a money-laundering platform and access to US dollars via its own financial institutions, thereby alleviating some measure of international pressure exerted on Iran. The recent history of faltered agreements, however, casts some doubt on the prospect of larger and broader deals between Iran and Russia. If Russia follows through this time, it would mark a sea-change in Moscow's willingness to side with Iran against the West.

While some short-term agreements are feasible, the troubled historical relationship between the two countries and civilian resistance to expanded relations suggest that Tehran and Moscow may only be flirting with each other to increase their individual leverage vis-à-vis Western sanctions. Parliament Executive Board Spokesman MP Behrouz Nemati warned the Rouhani administration that "The

historical record of Iran's political and economic relations with the Russians shows that they are untrustworthy...The Russians in the past four decades have taken advantage of Iran's trust in various shapes. They have extended a tactical hand towards Iran now that they have been targets of the wraths of America and the West."¹¹⁹ Skeptics and IRGC commanders point to the Russians' persistent refusals to deliver the S-300 missile defense system Iran ordered and the prolonged delay in building the Bushehr nuclear power plant.¹²⁰ Many post-revolutionary business and political elite, who constitute most of Rouhani's allies, have been inclined to expand economic relations with the West, while some hardliners prefer closer ties with Russia in order to confront the West. Russia, meanwhile, has maintained its cooperation with the West during the P5+1 nuclear negotiations, even after sanctions were imposed on Moscow as a result of the Ukrainian crisis. While closer relations with Russia serve the Economy of Resistance doctrine by developing economic ties that hedge against Western sanctions, the Russians have proven to be very unreliable partners.

Future Alignment with China?

Tehran's outreach to Beijing is poised to produce tangible results, reaching a common strategic understanding and intensifying trade to meet some of Iran's dire need of cash. China has remained one of Iran's top crude oil clients and even increased its imports during the crude oil embargo, though Beijing has leveraged this fact to purchase oil at a significant discount.¹²¹ The two states recently signed a \$4 billion agreement to inject capital into lagging Iranian petrochemical projects. This is a recent development, though, as Iranian officials were complaining about Chinese reticence to invest as late as May 2014.¹²² To persuade the Chinese, the Supreme Leader dispatched his chief foreign policy advisor and the present Head of the Expediency Discernment Council Strategic Research Center, Ali Akbar Velayati, to Beijing and Shanghai in early June, coinciding with the fall of Mosul. While the world's eyes were fixated by the horrors of the Islamic State of Iraq and al Sham (ISIS), Velayati told Chinese state media that Tehran and Beijing had reached a common security understanding and signed several agreements, "elevating" their relations to a "strategic level."¹²³

Velayati's successful trip appears to have had positive effects, including President Rouhani's previously unscheduled meeting with President Xi Jinping on the sidelines of the September 2014 SCO meeting. Rouhani personally made the case for Chinese direct investment in Iranian projects, specifically unfinished private sector projects. As a result, the Chinese will reportedly invest up to \$67.6 billion in Iranian civil projects instead of paying \$22.6 billion for oil imports from Iran.¹²⁴ These measures and agreements serve Iran's long-term aspiration to decrease vulnerability to Western economic pressure. Velayati may well have reached an agreement with Beijing that will accommodate Tehran's regional hegemonic ambitions while securing Beijing's long-term energy interests.

But increasing strategic ties with China may also constrain the Islamic Republic from pursuing its revolutionary political objectives, should those efforts collide with Beijing's interests. China's leveraging of the oil embargo against Iran to drive down prices, moreover, serves as a caution for

Islamic Republic policymakers. Both sides know that bilateral trade will likely remain unaffected by present or future Western sanctions, though the continuation of these pressures would be in China's economic interests. Closer relations with Beijing may come with a high price tag for Tehran if the Iranians find themselves in a predicament similar to the recent oil embargo.

Implications

The Economy of Resistance doctrine is a concerted effort to permanently nullify the use of Western sanctions. If successful, these policies will significantly reduce the ability of U.S. policymakers to use sanctions effectively against Tehran, including sanctions for Iran's funding of terrorism and its violations of human rights. The recent sanctions have passed their peak in terms of imposing maximum economic costs on Iran. Rouhani wants to reach a nuclear deal that lifts sanctions and instills discipline in making economic policy, which can markedly impact how Iran absorbs and reacts to external shocks. Furthermore, Rouhani's predecessor, Mahmoud Ahmadinejad's, bellicose diplomacy largely persuaded a multilateral coalition to impose sanctions on the Islamic Republic. Rouhani is pursuing a much more sophisticated diplomatic approach and is improving external relations while Tehran's fundamental foreign policy objectives remain unchanged. If these trends continue, the U.S. is not likely to find a propitious environment for re-imposing sanctions even if Iranian efforts to achieve economic resilience fail partially or completely.

From Tehran's perspective, a comprehensive nuclear deal with the West provides by far the best solution to resolving Iran's economic malaise and achieving its long-term interests. A nuclear deal that removes sanctions will help Iran develop a burgeoning private sector and transition into a market economy, as well. A deal resolves Iran's biggest economic problem: access to dollars that would stimulate economic growth. The Iranians can also launder money (illegally) through Russia, though with more limitations in terms of volume and cost. And even though Iran is circumventing some sanctions, like doubling their export of gas condensates to China, a renewed multilateral effort might reverse these gains.

Iran would not be happy with having to depend on Russia and China to keep its economy afloat. Both are notoriously unreliable trading partners and will surely leverage Tehran's isolation to impose maximum discounts on purchases, causing Iran to lose significant revenues. Furthermore, such a situation does not resolve Tehran's fear of depending on foreign powers. It would be in the West's interest, in fact, to force Iran into such a situation. There is undoubtedly a greater degree of independence—the core of the Resistance Economy doctrine—in having a diverse set of robust trade partnerships with different countries than being limited to a select few. Lifting sanctions is Iran's most promising avenue towards achieving that objective.

The stakes are just as high for the West, however. Decreasing reliance on oil revenues, a burgeoning private sector, and a self-sufficient domestic capital market would make the Iranian economy, and

thus the Islamic Republic's decision-making, less vulnerable to the most effective sanctions. Although there will always be ways to sanction a country, a stronger internal economic system including a robust private sector would fortify Tehran against future Western pressure. But this also comes at a cost to Islamic Republic officials, namely less state control over the economy. A reduction in the efficacy of sanctions against Iran would mean that statecraft should no longer depend on economic measures alone to meaningfully influence Tehran's decision making. But state-level negotiations with post-revolutionary Iran have a dismal record. Khomeini and his successor Khamenei have consistently made the point that America is untrustworthy. This outlook permeates the state's upper political, security, and military apparatuses, and senior officials consistently frame every U.S. action and gesture within the broader context of an American conspiracy to overthrow the regime. Anti-Americanism has been fused into the Islamic Republic's institutional DNA. While hardly unique to Iran, perhaps no other state has made this discourse such a defining tenet of its political identity and security doctrine; without it, "resistance" falls apart. Barring a complete transformation of the anti-Western identity of the current regime, of which there is no sign, policymakers would have to look to other means to meaningfully influence Iranian strategic decision making. Hard power tools are an option, but they are risky and success is highly uncertain. A decision to lift sanctions in the upcoming nuclear negotiations can, therefore, transform future relations between Iran and the United States, but not necessarily to the benefit of American national security and interests.

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