

Special Report

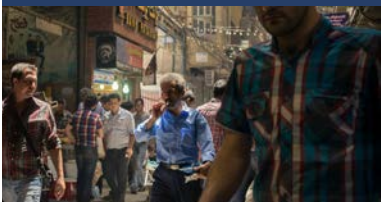
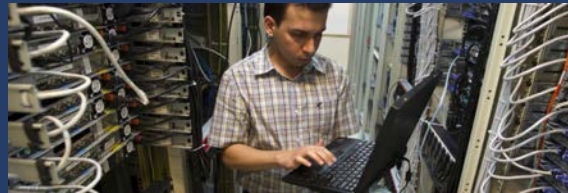
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Bourse & Bazaar

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Great Expectations, Delayed Implementation

A Special Report on the “Economic Implementation”
of the Joint Comprehensive Plan of Action



Executive Summary

The story of Iran's post-sanctions economic recovery is so far one of great expectations and frustrating delays. On the two-year anniversary of the implementation of the Joint Comprehensive Plan of Action, this report examines the "economic implementation" of the nuclear deal. Multinational companies remain committed to the Iranian market, but the much-needed flow of external finance, including foreign direct investment, has yet to materialize. The provision of external finance has been hampered primarily by external factors, and not challenges endemic to Iran's business environment. Drawing on a unique survey commissioned by International Crisis Group and including over sixty senior executives, this report details how the risk of sanctions snapback and rising political tension, largely amplified by the rhetoric of the Trump administration, have caused material delays in the Iran investment plans of some of the world's largest companies. While Trump has this week opted to reissue the sanctions waivers that keep the United States in the nuclear deal, the act of decertification alone has already compounded delays—51 percent of executives report that their company's investment plans were adversely affected by Trump's October announcement. Against this backdrop, the nuclear deal is sliding into "zombie state." Neither totally dead, nor totally alive, the deal exists in an ambiguous position that stymies most commercial actors. To address chronic uncertainty, European stakeholders ought to spearhead a technical, programmatic dialogue on the obstacles preventing external finance flows to Iran. In doing so, business leaders will be better positioned to bring their stubborn optimism and valuable pragmatism to bear in support of the quid-pro-quo that underpins the nuclear deal. This rare optimism should not be taken for granted—a staggering 91 percent of executives surveyed for this report still believe that their companies can be commercially successful in Iran. Given the recent protests in the country, which have made the political imperatives of job creation and economic reform absolutely clear, policymakers should extend every effort to support the success of these companies, whose investments were expected by Iranians as a central outcome of the nuclear deal.

About Bourse & Bazaar:

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Bourse & Bazaar is a media company that supports "business diplomacy" through events, publishing and research focused on Iran's economic future. It is the organizer of the Europe-Iran Forum, a leading economic summit held in London (2014), Geneva (2015), and Zurich (2016, 2017). Bourse & Bazaar supports a global dialogue on Iran trade and investment and held round table meetings in Tehran, Copenhagen, Stockholm, Moscow, Washington D.C. and Tokyo last year.

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I. Introduction

In the two years since the implementation of the Joint Comprehensive Plan of Action, Iran has consistently upheld its commitments under the so-called “nuclear deal.” The International Atomic Energy Agency (IAEA) has confirmed Iran’s compliance with the deal’s provisions nine times.¹ Despite this, on October 13, 2017, President Trump elected to de-certify Iran’s compliance with the nuclear deal.² Though he issued the sanctions waivers necessary for the United States to remain in the deal both in October and once again upon the mid-January certification deadlines, keeping the United States in the deal, Trump’s continued acquiescence cannot be taken for granted, at least until Congress amends the Iran Nuclear Agreement Review Act (INARA) to free Trump from the burden of issuing these waivers.

In the assessment of U.N. Secretary General António Guterres, President Trump’s move and Congress’ lack of intervention to date “have regrettably created considerable uncertainty regarding the future of the Joint Comprehensive Plan of Action.”³ That this uncertainty relates primarily to the possible re-imposition of American secondary sanctions—an event called “snapback”—and thereby to the continued legality of trade and investment activity by foreign (particularly European) companies in Iran, speaks to the underappreciated economic dimension of the nuclear deal.

There is a growing sentiment among members of the Iranian political establishment, the Iranian business community, and among the Iranian public, that the P5+1 have failed to uphold their key sanctions related commitments in the nuclear deal and have yet to adequately support Iran’s economic recovery after years of hardship under sanctions. The political costs of the country’s continued economic stagnation are high. The wave of recent protests that has swept across Iran has made the frustration of the Iranian public very clear. Centered in Iran’s second-tier cities, and largely comprised of members of the working class, the protests were spurred by frustrations over the rising cost of living, chronic unemployment, and anger over perceived corruption in the economy, and were further fueled by a sense of inaction on the part of the political establishment. Data from the Center for International and Security Studies at the University of Maryland shows a clear rise in pessimism about the economy among the Iranian public over the last two years. In an August 2015 poll, taken just a few weeks after the JCPOA was agreed, 57 percent of Iranians felt “economic conditions in Iran” were getting better and just 29 percent felt conditions were getting worse. By June of 2017, only 39 percent of those surveyed felt conditions were improving and 50 percent felt conditions were getting worse.⁴ Growth projections support the rising pessimism. According to the International

¹ “Speech by High Representative/Vice-President Federica Mogherini at the European Parliament plenary session on the Iran nuclear deal (JCPOA).” *HR/VP Speeches*, EEAS, 12 Dec. 2017, eeas.europa.eu/headquarters/headquarters-Homepage/37259/node/37259_me.

² Lander, Mark, and David E. Sanger. “Trump Disavows Nuclear Deal, but Doesn’t Scrap It.” *New York Times*, 13 Oct. 2017, www.nytimes.com/2017/10/13/us/politics/trump-iran-nuclear-deal.html

³ *Fourth report of the Secretary-General on the implementation of Security Council resolution 2231*. United Nations Security Council, 8 Dec. 2017, www.un.org/en/ga/search/view_doc.asp?symbol=S/2017/1030.

⁴ Mohseni, Ebrahim, et al. *The Ramifications of Rouhani’s Re-Election*. The Center for International and Security Studies at Maryland, July 2017, www.ciissm.umd.edu/sites/default/files/CISSM_percent20full_percent20Iran_percent20PO_percent20report_percent20-percent20072717-Final2.pdf.

Monetary Fund (IMF), Iran achieved 12.5 percent economic growth during previous Iranian fiscal year. Yet, growth is expected to fall to 4.2 percent in the period from March 2017 to March 2018, well below the 8 percent target included in the Iranian government's current five-year development plan, which runs from 2017 to 2022.⁵

Short-term pessimism is likewise rising in the business community. As 2017 came to a close several multinational corporations, whose early commitments to pursue business in Iran heralded the prospects for Iran's post-sanctions growth, hit new roadblocks. Boeing and Airbus, whose contracts to sell commercial aircraft to Iran are among the most commercial valuable and most politically meaningful, are facing new legislative hurdles raised by the Trump White House and the Republican-controlled Congress.⁶ Total, the international oil company with a history of making bold investments in Iran and the company which signed the first major energy contract following the lifting of sanctions, is reportedly preparing a contingency plan which would see its consortium partners, China's CNPC and Iran's Petropars, takeover its share of the USD 4.8 billion South Pars gas field deal.⁷ French construction giant Bouygues has cancelled its contract to build a new terminal at Tehran's international airport, citing uncertainty over snapback and the difficulty in securing financing for the project.⁸

Against this backdrop, the nuclear deal is sliding into "zombie state." Neither totally dead, nor totally alive, the deal exists in an ambiguous position that stymies most commercial actors. Iran's compliance with the deal remains intact, meaning that the agreement continues to meet its aims of improving regional and international security by eliminating the risk of Iranian nuclear proliferation. But the deal is failing to fulfill its fuller promise as a turning point for relations between Iran and the West, particularly through renewed economic ties.

Key Iranian stakeholders have made it clear that Iran intends to abide by the nuclear deal, despite the Trump administration's de-certification of Iran's compliance with the agreement. In a recent television address, Iranian President Hassan Rouhani declared, "The nuclear deal will not collapse... Those who hope that Trump will cause its collapse are wrong."⁹ Nonetheless, just as in the United States, the evaluation of the deal in Iran centers on an idea of "technical compliance." The U.S. administration concedes Iran's technical compliance with the JCPOA, while denying that Iran has lived up to the deal's spirit. The Iranians see a reciprocal failing on the American, and increasingly European

⁵ "IMF Staff Completes 2017 Article IV Mission to Islamic Republic of Iran", IMF, 17 December 2017. <https://www.imf.org/en/News/Articles/2017/12/15/pr17499-imf-staff-completes-2017-article-iv-mission-to-islamic-republic-of-iran>

⁶ Schwartz, Felicia, and Ian Talley. "Boeing, Airbus Sales Imperiled as Trump Administration Formulates Iran Plan." *Wall Street Journal*, 15 Dec. 2017, www.wsj.com/articles/boeing-airbus-sales-imperiled-as-trump-administration-formulates-iran-plan-1513360961.

⁷ Aizhu, Chen, and Ron Bousso. "China's CNPC weighs taking over Iran project if Total leaves." *Reuters*, 15 Dec. 2017, www.reuters.com/article/us-iran-oil-exclusive/exclusive-chinas-cnpc-weighs-taking-over-iran-project-if-total-leaves-sources-idUSKBN1E90KI?il=0.

⁸ Guillaume, Gilles. "Bouygues deal to build Tehran airport terminal canceled." *Reuters*, 5 May. 2017, <https://www.reuters.com/article/us-bouygues-iran/bouygues-deal-to-build-tehran-airport-terminal-canceled-idUSKBN1811OJ>

⁹ Hafezi, Parisa. "Iran says Trump cannot cause collapse of nuclear deal." *Reuters*, 19 Dec. 2017, www.reuters.com/article/us-iran-usa-nuclear/iran-says-trump-cannot-cause-collapse-of-nuclear-deal-tv-idUSKBN1ED0PO.

sides. While in technical terms, the sanctions relief promised in the nuclear deal remains in place, the spirit necessary to spur trade and investment is seen to be actively undermined by the United States, and allowed to degrade by Europe. From the Iranian standpoint, it is now possible to remain in technical compliance with the deal and to receive little-to-no tangible benefits, namely those benefits that pertain to the economic promise of the deal.

Importantly, the notion of an “economic implementation” of the JCPOA is not some Iranian invention—it is outlined in language the agreement itself. Annex II of the agreement deals exclusively with “sanctions-related commitments” and outlines concrete actions to be taken to lift most sanctions on Iran. Section 3 of the annex then details specific activities that “will be allowed beginning on implementation day.”¹⁰ These include financial transactions, the opening of Iranian bank branches in Europe, the establishment of new joint ventures, and technology transfers across sectors, among other activities. Section 7 makes similar stipulations in regards to the lifting of U.S. secondary sanctions and the removal of entities from the U.S. Department of Treasury’s Specially Designated Nationals (SDN) list. Iranians read Annex II as a list of broken promises.

As stakeholders within Europe and the United States seek to protect the nuclear agreement and preserve a hard-fought victory of diplomacy, it is of vital importance that the economic dimension of the nuclear deal is introduced as a central consideration of ongoing policy formation. Given the content of Annex II, the ability to insist on compliance from a technical, non-proliferation standpoint, as demonstrated nine times by the IAEA, is insufficient as a means to demonstrate that the deal is really working from the Iranian standpoint.

Should deal-supporters be unable to demonstrate the value of the nuclear deal in the near term, the most damaging consequence is unlikely to be the deal’s collapse or a renewed Iranian nuclear program. At stake is the more urgent idea; the notion that increased economic relations between Iran and the international community can serve to credibly incentivize political compromise and mutual understanding. This is the notion that underpins the true “spirit” of the nuclear deal—its protection as the central motivation for constructive Iranian behavior in the international system is arguably far more important than the technical aspects of any particular international agreement, even one that aims to prevent nuclear proliferation.

This report examines the economic implementation of the JCPOA, and proposes that a new effort must be made to engage commercial actors in the implementation of the nuclear deal. It argues that implementation of the nuclear deal is failing because key sanctions related commitments are not being met. To examine these failures, this report draws on a first-of-its-kind survey of senior executives at multinational companies doing business in Iran. These executives are conceptualized as the critical facilitators of the economic dividends of Iran’s engagement with the global economy, and subsequently, of a significant portion of the economic security promised by the Iranian government to the

¹⁰ “Annex II – Sanctions-Related commitments .” *Archives*, EEAS, July 2015, eeas.europa.eu/archives/docs/statements-eeas/docs/iran_agreement/annex_2_sanctions_related_commitments_en.pdf.

Iranian people. Lending greater support to these commercial actors will not only empower them to move more decisively and successfully as they seek to engage in compliant trade and investment with Iran, but will also help establish “business diplomacy” as a new pillar in support of the multilateral political consensus around the utility and durability of the nuclear deal.

II. Survey Results

In December 2017, International Crisis Group and Bourse & Bazaar jointly designed and implemented an online survey of senior managers with direct responsibilities for Iran business at multinational companies. A total of 63 executives responded to the survey.¹¹ Half of those surveyed work at organizations with 10,000 or more employees globally, among them leading global energy, automotive, mining, technology, chemicals, consumer goods, and pharmaceutical companies. In effect, this is the first detailed survey of senior executives whose work in Iran is driving post-sanctions trade and investment. The experiences of these country managers and regional vice presidents offer a powerful indicator of the success in implementing the sanctions-related commitments outlined in the JCPOA. The survey results were supplemented with interviews of several respondents in order to gather further qualitative insights. These interviews are quoted in this report anonymously, given the commercially sensitive nature of the information shared.

The individuals surveyed work in a variety of companies, with 19 sectors represented, across organizations headquartered in 18 different countries. But the large size of many of these companies does lead to one common characteristic—57 percent of respondents report that their company has “significant business interests in the United States.”

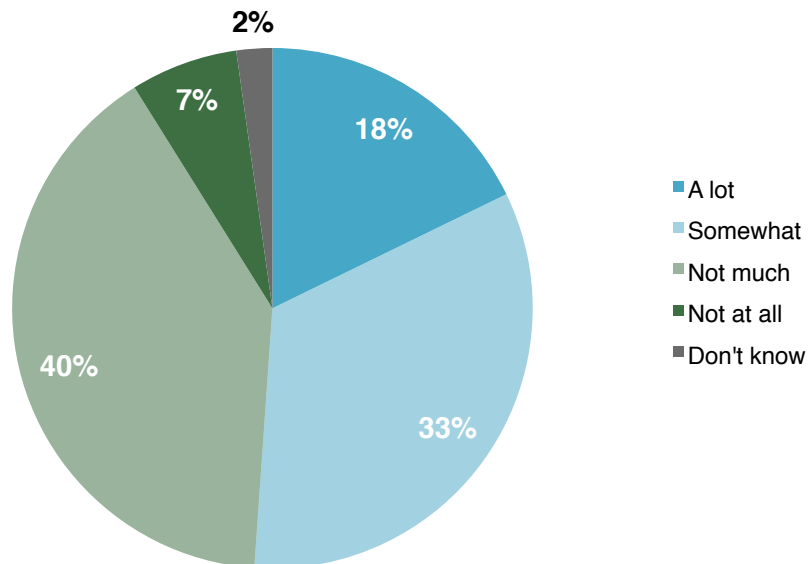
Alongside connections to the U.S. market, the companies included in this survey have a clear and often longstanding commitment to the Iranian market, with 38 percent having established Iran operations more than 20 years ago. Half of the companies surveyed maintain a permanent office in Iran. For those executives who lack a permanent office, regular travel to Iran is necessary. The same proportion of respondents who report living in Iran (27 percent), report traveling to Iran on a monthly basis.

The role of country manager can be transitory, and 57 percent of the respondents have been in the Iran-related role for less than three years. Typically, executives of Iranian heritage will have more experience working in Iran specific roles, with their career moves often typified by movement between similar Iran job roles among different companies, whereas non-Iranian executives are more likely to shift to other global markets when their Iran stint is complete. Indeed, 40 percent of respondents to this survey were of Iranian heritage.

¹¹ The survey was administered via a Computer Assisted Web Interview (CAWI) and included 42 questions. All questions were optional. Individuals were invited to participate on the basis of their senior position at a company pursuing commercial opportunities in Iran. Bourse & Bazaar and Crisis Group intend to continue fielding responses over the coming year in order to track sentiments among a wider sample of executives.

Overall, this survey provides a snapshot of decision-making on Iran at companies across a range of industries, headquartered in different countries, and with different levels of ambition for the Iranian market. In an important indicator, 51 percent of executives surveyed report that their companies have “delayed a major commercial decision in Iran” in the last five years. Of these companies, 33 percent delayed their commercial plans because of the “possible snapback of secondary sanctions,” whereas 29 percent delayed because of a more general reason of “rising political risk and risk of conflict,” suggesting that external risks have proven more difficult to manage than risks arising from Iran’s business environment. In a recent example, 51 percent of executives report “President Trump’s decision... to decertify the nuclear deal negatively affected [their] company’s plans to engage the Iranian market in the coming year.”

Chart 1: To what extent did President Trump’s decision in October to decertify the nuclear deal negatively affect your company’s plans to engage the Iranian market in the coming year?



Trump’s decertification was not unexpected in the business community. Large multinational companies were able to draw on their networks and government relations expertise to gauge the likelihood of decertification. In the words of a senior energy executive, “We had been running on the assumption that Trump would de-certify the deal in October. But, I must say I am quite concerned with the road ahead as it becomes clearer.”¹² The same methods that predicted de-certification are contributing to the pessimism. He continues, “It would not surprise me if President Trump would not waive sanctions in January and this would likely make it impossible for us to proceed with our investment plans.” As companies slowed their investment decisions in the face of such uncertainty, a snowball effect took place. A considerable 67 percent of executives report

¹² Bourse & Bazaar Email Interview: “Senior Energy Executive- London,” December 2017

that “the apparent movement of other companies in the market” is somewhat or very important to their company’s decision-making.

Executives clearly believe that there has been a slowdown in Iran business. When asked to evaluate the pace of trade and investment in Iran, 83 percent of senior managers at multinational companies indicate that companies “are moving slower than they could” to engage in the Iranian market. Of those senior managers who feel that companies are being hampered, a resounding 51 percent point to “fear of the United States,” rather than the myriad complexities of Iran’s business environment, as the underlying reason for the slowdown. Significantly, this slowdown is taking place before snapback itself. Trump could conceivably continue issuing the waivers, but the mere possibility that he may at some point cease do so has proven sufficient reason for many companies to slow their market rollout. The fear of snapback remains difficult to assuage.

The magnitude of the slowdown is also significant. Of the companies that report having delayed a major commercial decision in the last five years, 39 percent report being delayed by six to twelve months, 16 percent report being delayed by one to two years, and 33 percent report delays of more than two years. This suggests that as a general rule major decisions are subject to major delays and that the slowdown currently being felt across the business community may result in lagging investment for several years.

In the assessment of one aviation finance executive, delays in aircraft sales to Iran, like other commercial deals, have an under-appreciated “human cost,” which makes it more difficult to conduct business successfully. In his assessment, aviation executives are repeatedly hitting “roadblocks out of their control.” The frustrations inherent in working with Iran mean that many of these executives and advisors may opt “to move away from Iran for the benefit of their career path.” For example, business development executives may seek to shift focus to markets where they are more likely to hit their sales targets, “in order to get their bonuses.” Likewise, lawyers working on Iran projects are “often incentivized with success fees. If those fees seem unlikely to materialize, they will move on to other projects. When asked whether he is concerned about such attrition within his own team, the aircraft finance executive notes, “I have started thinking about it. If I lose a member of my legal team, or if there is a change in the sales team at one of our client companies, it makes the Iran project really complicated. For the replacements, a learning process starts all over again and in some cases expertise won’t be easy to replicate or replace.”¹³ Nearly half of executives surveyed presently expect to work on Iran for less than five years, a level of natural churn that deserves more consideration by policymakers, whose own movements compound the problem.

The delays reported by the surveyed executives offer the most compelling proxy for assessing the extent to which Iran’s post-sanctions economic recovery has itself been delayed. The delays encountered by each individual foreign company can compound and the struggles of large multinational corporations lends credence to Iranian claims that the country is yet to see the realization of expected post-sanctions trade and investment. The survey results establish clearly that a significant group of companies share the intention to expand commercial operations in Iran and feel they have the

¹³ Bourse & Bazaar Phone Interview: “Aircraft Finance Executive- Dubai,” January 2018

means to complete such an expansion, but remain hamstrung primarily due to rising concern that the United States will renege on its sanctions relief obligations under the nuclear deal. The longer the delays, the lower the likelihood for success.

At this stage, 32 percent of executives surveyed believe that Iran's economy will only become global competitive in the next three to five years, 35 percent believe it will take six to ten years, and 20 percent feel it will take longer than ten years.

Importantly, against the backdrop of this uncertainty, multinational companies have continued to impress upon Iranian stakeholders that internal reforms to the financial sector and general improvements to the business environment are of the utmost importance. After all, should concerns about snapback and political risk subside, the primary barriers to trade and investment in Iran will once again be endemic to Iran's own business environment. This insistence of the business community on the urgency of such reforms is just one example of the manifold ways in which business leaders can engage in political claims making that supports normalized relations with the international community. Understanding that the JCPOA is a political agreement with economic ramifications, policymakers would be remiss to ignore the central role that economic implementation must play in the stewardship of the deal.

III. Implementation and External Finance

Securing external finance is of utmost importance to Iran's economic plan. The country's 2017 presidential election served as a kind of referendum on the nuclear deal and the Rouhani government's avowed policy of international engagement. But as the election campaigns unfolded, the political debate did not focus on the nuclear deal itself, the necessity of which was largely unquestioned. So-called "hardline" candidates such as Ebrahim Raeisi and Baquer Ghalibaf conceded that the nuclear deal needed to be preserved, but they disagreed with Rouhani as to the extent to which post-sanctions trade and investment could be relied upon to spur Iran's economic recovery.¹⁴ The focus on economic issues was understandable. Iranian voters consistently put the economy at the top of their voting priorities.

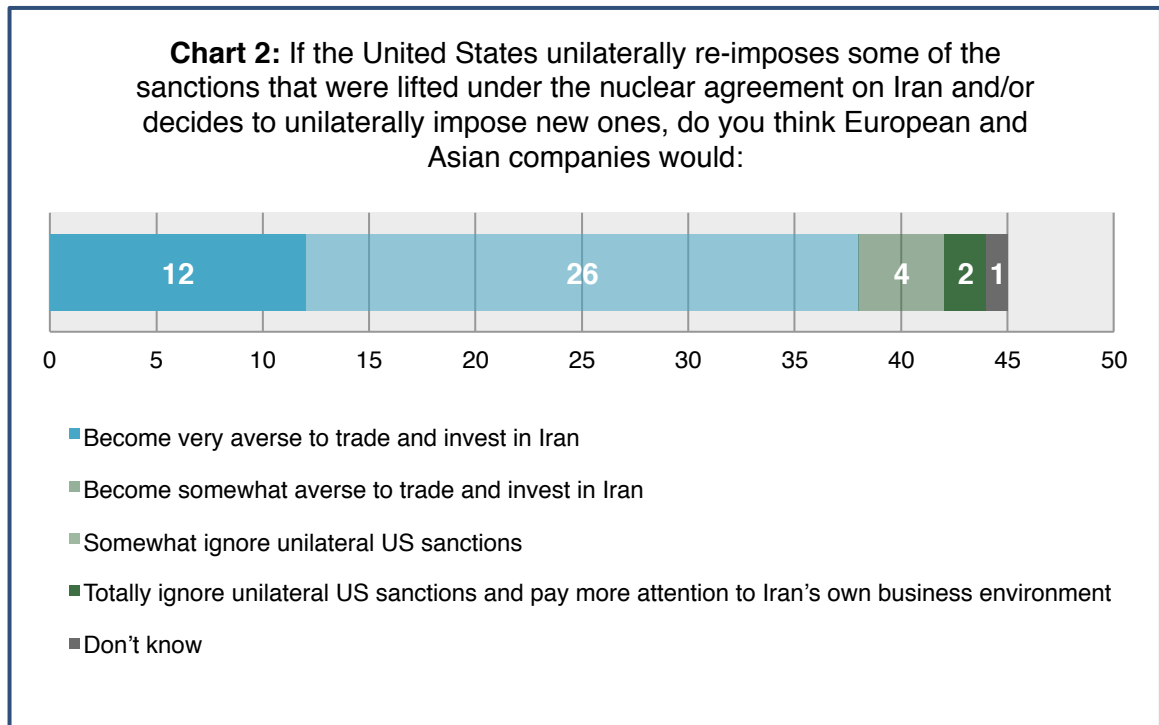
Rouhani's victory was a validation that the nuclear deal, the need for foreign investment, and the expectation of economic growth are inextricably linked in the view of Iranian policymakers and the Iranian public. Iran is an upper-middle income country with considerable domestic financial resources and in most natural-resource rich countries investment needs are largely met using government expenditure, and not just external finance. But the Rouhani government has been restrained in its fiscal policy as it focuses on rebalancing Iran's monetary policy. The Rouhani budget can be described as an austerity budget, which seeks to increase the tax base, limit welfare transfers, and control government expenditures.

Investment levels in the Rouhani government budget have remained essentially constant and low for fear of interfering with concurrent efforts to bring inflation under control. The

¹⁴ Bozorgmehr, Najmeh. "Election exposes Iran's deep divisions." *Financial Times*, 15 May 2017, www.ft.com/content/40a7a75c-2ffb-11e7-9555-23ef563ecf9a.

budget unveiled in December 2017 outlines a 13 percent decrease in the investment budget in real terms for the coming Iranian calendar year.¹⁵ As the budget lacks the development spending that can spur job creation, Iran’s economic planners are perhaps unusually dependent on external finance to bring liquidity to the market and drive growth. This is by design. It is the long held belief of Masoud Nili, Rouhani’s chief economic advisor, that the role of the state in the economy should be limited to facilitating “a functioning market and greater interaction with the outside world.”¹⁶ Rouhani’s budget aims to achieve the former. The nuclear deal was intended to achieve the later.

The dependence on external finance operates across three levels. At the first level, the nuclear deal, and the attendant lifting of sanctions, initiated significant changes in the macroeconomic circumstances in Iran and initiated an urgent demand for financing. At the second level, multinational companies have sought to meet this demand as the new investors and operators of infrastructure projects and commercial ventures in Iran. At the third level, these new projects and ventures promise tangible economic benefits to the Iranian people, principally through job creation and the provision of new goods and services. Consequently, the fear of a “zombie deal” is perhaps only outmatched by fears that without adequate foreign investment, the Iranian economy will once again slide into its own zombie state.



From an Iranian standpoint, “implementation” of the nuclear deal is to be tested against this simple syllogism. Right now, implementation is failing this test. While the sanctions

¹⁵ Salehi-Esfahani, Djavad. “Poverty and living standards in Iran after the nuclear deal.” *Tyranny of Numbers*, 3 Jan. 2018, djavadsalehi.com/2018/01/03/poverty-and-living-standards-of-iranians-since-the-nuclear-deal/.

¹⁶ Harris, Kevan. *A Social Revolution: Politics and the Welfare State in Iran*. Univ of California Press, 2017. (185)

relief afforded by the nuclear deal has spurred economic interest in Iran and a flurry of major contracts have been signed, relatively little investment has flowed to the country, meaning that the economic benefits have yet to reach the Iranian people.

Importantly, this report focuses on external finance, rather than trade. Trade has rebounded since the signing of the nuclear deal. Trade with the European Union rose nearly 160 percent year-on-year in the first nine months of 2017 with a total value of EUR 14.8 billion.¹⁷ Nonetheless, the transitory nature of trade equates to a smaller impact on economic growth in Iran over the long-term and a limited contribution to Iran's reintegration into the global economy in the fuller political sense—trading partners are easy to substitute, investors are not. Moreover, for Iran to boost its exports beyond pre-sanctions highs, new capital improvements will be needed. External finance is therefore a precondition for maximized trade flows.

The imperative to support external finance or investment is echoed in the commercial ambitions of the companies now seeking to enhance their commercial engagements in Iran. When asked to detail the scope of their company's ambition for the Iranian market, an equal proportion of executives surveyed for this report indicated a scope consistent with direct investment as with trade. Not only does this result point to the attractiveness of Iran as an investment destination, but it also reflects the political pressure and incentives being used by Iranian government stakeholders and commercial partners to encourage investment.

Iranian calls for foreign financing and investment began even before the nuclear deal was agreed. For several years, Iranian government officials have bandied about multi-billion dollar targets. Petroleum Minister Bijan Zanganeh has called for USD 60 billion of external finance for the oil industry by March 2018 as part of a wider USD 200 billion redevelopment plan.¹⁸ Deputy Minister of Industry Mehdi Karbasian has targeted USD 50 billion for the mining sector by 2022.¹⁹ Masoud Khansari, President of the Tehran Chamber of Commerce, a private sector body, has stated that USD 50 billion dollars is needed to boost the manufacturing sector.²⁰ Transport Minister Abbas Akhoundi has called for USD 28 billion of investment in Iran's railways.²¹

But just a tiny fraction of this financing has materialized. As the Rouhani administration unveiled its new budget in October of 2017, Deputy Minister Mohammad Khazaee, whose office oversees the provision of investment licenses to foreign financiers, disclosed that the country had received USD 20 billion in external finance commitments,

¹⁷ "Iran-EU Trade Rises", *Financial Tribune*, 2 December 2017.

<https://financialtribune.com/articles/domestic-economy/77082/iran-eu-trade-rises>

¹⁸ Dehghanpisheh, Babak. "Foreign funds for Iran's oil sector a top priority." *Reuters*, 20 Aug. 2017, uk.reuters.com/article/us-iran-oil-zanganeh/foreign-funds-for-irans-oil-sector-a-top-priority-oil-minister-idUKKCN1B00T0

¹⁹ Burton, Melanie. "Iran seeks \$50 billion in mining investment for five-Year plan - deputy minister." *Reuters*, 31 Oct. 2017, in.reuters.com/article/australia-mining-iran/iran-seeks-50-billion-in-mining-investment-for-five-year-plan-deputy-minister-idINKBN1D13LH.

²⁰ Karimova, Aynur. "Iran needs \$50B FDI to improve industry." *AzerNews*, 27 Apr. 2016, www.azernews.az/region/95829.html.

²¹ "Joining the dots: Iran's New Trains." *The Economist*, 2 Apr. 2016, www.economist.com/news/middle-east-and-africa/21695765-some-treats-ahead-railway-enthusiasts-iranu2019s-new-continent-spanning.

including foreign direct investment (FDI) commitments valued at USD 12 billion, since the lifting of international sanctions in January of 2016.²² Crucially, this figure represents the contractual commitments for which licenses had been granted, not the amount that has actually been deployed in the country. By one official estimate, that figure is just USD 8 billion.²³

Iran is seeking foreign investment for two primary purposes. First, the country needs large-scale improvements to fixed capital, particularly in energy and transport infrastructure. Key post-sanctions investment contracts include deals to upgrade Iran's oil and gas production, upgrade airports and seaports, install high speed rail networks, and upgrade the civilian aircraft fleet. Notably, most of these contracts are made between multinational companies and Iranian state-owned enterprises, which continue to dominate what are considered strategic industries. Such investments will boost government revenues by increasing the volume of natural resources available for export as well as the flow of trade on which customs duties can be levied. Indirectly, the investments will also help reduce the costs of goods and services and create jobs.

For these projects, external finance typically takes the form of debt, although equity can also be awarded in return for investment. Lines of credit have been extended for projects in Iran by banks in Europe and East Asia. The largest credit lines have been arranged through China's state-owned CITIC investment group (USD 10 billion), Korea's Export-Import Bank (USD 9.4 billion), and Japan's Nippon Export and Investment Insurance and Japan Bank for International Cooperation (jointly USD 10 billion).²⁴ In Europe, smaller credit lines have been opened by Austria's Oberbank (USD 1.2 billion) and Denmark's Danske Bank (USD 600 million).²⁵ Both Oberbank and Danske Bank are among the handful of European banks which have proven willing to handle Iran-related transactions due to a rare combination of limited exposure to the U.S. financial system and a large number of major clients with a significant portfolio of business in Iran. More recently, Italy is poised to extend a line of credit to Iran worth USD 6 billion.²⁶

The second type of external finance is FDI, in which a foreign company or financial firm invests in the assets of an Iranian business or commercial interest. While FDI typically does not include investments by foreign companies or individuals in equities, this distinction is often elided. Iran has a diversified and developed economy. Across every sector and every size of company, there is a clear desire on the part of Iranian businesses to find new commercial partnerships with international companies, whether for trade or investment opportunities. Whereas state enterprise remains dominant in

²² "Khazaei: Foreign investment approved since the beginning of the 11th government amounts to more than \$ 21 billion." *IRNA*, 12 Oct. 2017, www.irna.ir/fa/News/82693993.

²³ "۸ میلیارد دلار سرمایه خارجی در سال ۹۶ جذب شد" ("8 billion FDI was absorbed in 2017/18"), *Mehr News*, 14 December 2017. <http://bit.ly/2m6nCVH>

²⁴ Nasser, Ladane. "Iran's Leaders Are Bolstered by Billions in Loans From the East." *Bloomberg*, 20 Sept. 2017, www.bloomberg.com/news/articles/2017-09-20/iran-loaned-billions-as-asian-powers-reject-trump-world-view.

²⁵ Schwartz-Goerlich, Alexandra. "Oberbank set to finance Austrian projects in Iran with new deal." *Reuters*, 7 Sept. 2017, www.reuters.com/article/oberbank-iran/oberbank-set-to-finance-austrian-projects-in-iran-with-new-deal-idUSL8N1LN3WK.

²⁶ Vagnoni, Giselda. "Italy and Iran to sign 5.0 billion euro investment agreement: Treasury source." *Reuters*, 10 Jan. 2018, <https://www.reuters.com/article/us-italy-iran-investments/italy-and-iran-to-sign-5-0-billion-euro-investment-agreement-treasury-source-idUSKBN1EZ0Q1?il=0>

infrastructure development, in terms of general commercial activity, Iran's private sector has established a leading position in many sectors, including banking and consumer-focused sectors such as fast moving consumer goods, pharmaceuticals, information and communication technology, and hospitality and retail. Today, the majority of Iranians believe that the private sector—working in tandem with multinational companies—is best positioned to advance Iran's economy.²⁷

But in order to serve this role by creating jobs and bringing new goods and services to market, Iran's private sector companies need financing to fund expansion and innovation. This investment usually comes in the form of equity financing, in which the financier becomes a shareholder of the Iranian entity. Equity investments have been made by international firms at all levels of Iran's economy, including significant venture capital investments that are supporting entrepreneurs in Iran's startup ecosystem, merger and acquisition activity by multinational companies who are now pursuing direct ownership of their Iranian operations, and nascent investment in Iran's listed equities by international investors.

While early cases have been established for foreign investment within enterprise contexts, the number of transactions that have been executed remains relatively small. Add to this the fact that the larger infrastructure investments discussed above work on multi-year timeframes, and it becomes clear that while a modicum of FDI has been promised to Iran, a very small fraction has actually materialized.

IV. Internal Barriers to Investment

On one hand, the discrepancy between the targeted and realized levels of investment points to unreasonable expectations. Iran's economy is large and diversified, but remains beset by structural weaknesses that give foreign investors pause. Nili points to six "super-challenges" in the Iranian economy: high unemployment, toxic debt in the banking system, poor tax collection contributing to a budget deficit, exposed pension funds, and an economically costly environmental crisis.²⁸ Iran remains a difficult market to conduct business in and the country has in fact fallen in the World Bank's "Doing Business Rankings" since Implementation Day. Iran's score fell from 57.44 in 2016 to 56.48 in 2018, falling from a rank of 118 to 124.²⁹

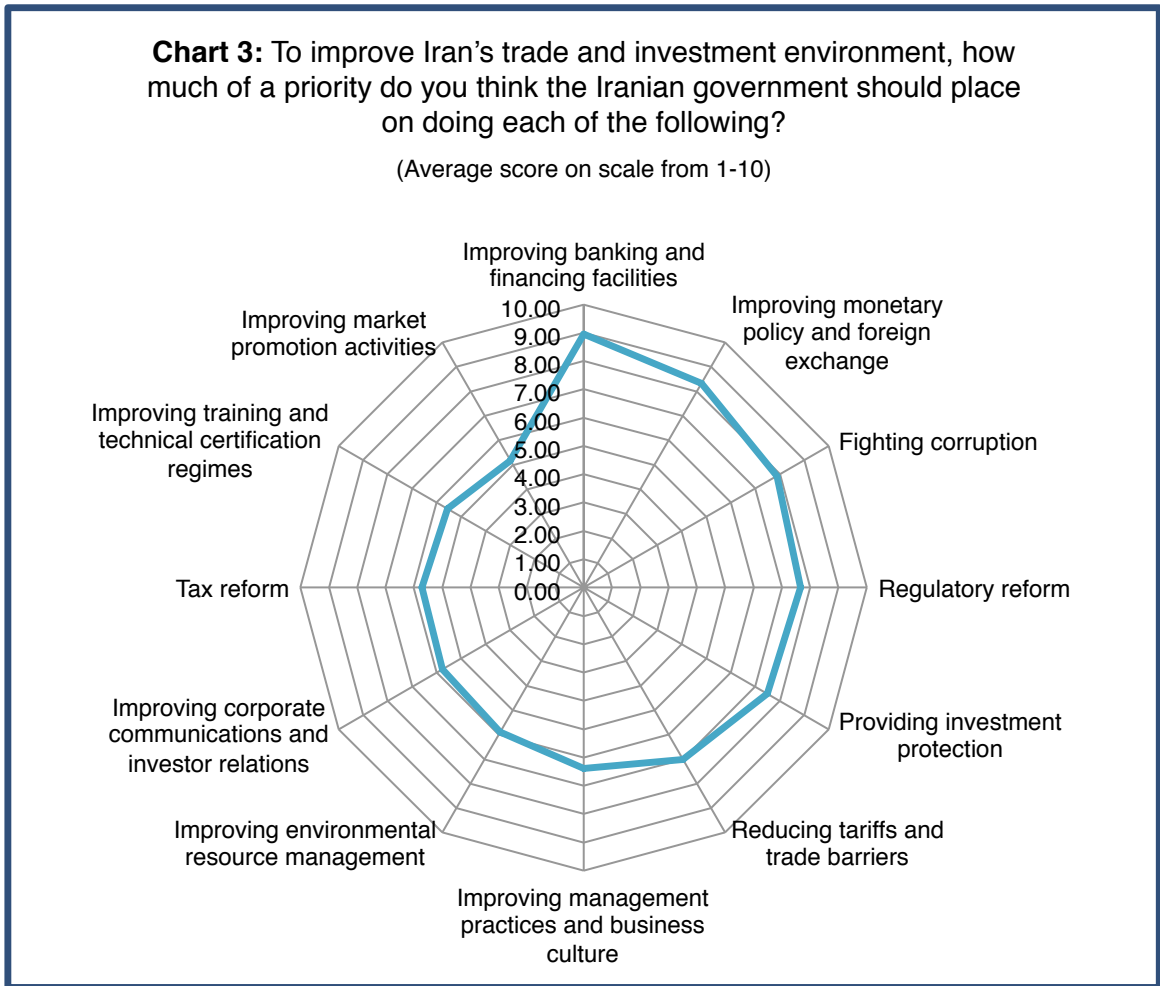
Take the structural macroeconomic issues together with firm-level management issues, and it becomes clear that facilitating investment in the Iranian market is far from an easy proposition for multinational companies and financial institutions. Using a ten-point scale, senior executives highlight Iran's volatile currency (mean 8.33), high-levels of corruption (mean 7.89), and high regulatory barriers (mean 7.66), as urgent areas for improvement

²⁷ "New Survey Examines Iranian Attitudes Towards Foreign Investment, Multinational Companies." *Bourse & Bazaar*, 19 Sept. 2017, www.bourseandbazaar.com/articles/2017/9/17/new-survey-examines-iranian-attitudes-towards-foreign-investment-multinational-companies.

²⁸ "Causes of Super Challenges." *Financial Tribune*, 18 Sept. 2017, financialtribune.com/articles/domestic-economy/72545/causes-of-super-challenges.

²⁹ "Ease of Doing Business in Iran." *Doing Business 2018*, World Bank, www.doingbusiness.org/~media/WBG/DoingBusiness/Documents/Profiles/Country/IRN.pdf.

should the government wish “to improve Iran’s trade and investment environment.” Importantly, Iranian policymakers are cognizant of their need to pursue reforms in these key areas. In each of the aforementioned areas, the Rouhani administration has introduced or is in the process of introducing new legislation that will help improve the business environment, whether by unifying the official and non-official exchange rates, reducing the red tape for industrial and infrastructure projects, or introducing new penalties for corruption.



Moreover, the government has recommitted itself to privatization. The senior executives surveyed for this report are quite clear that if “all options were equally available” they would prefer to work with private sector companies—49 percent state this preference, compared to just 13 percent who prefer to work with the state sector. This echoes the confidence of the Iranian public in private enterprise. Privatization is taking place in two ways. First, private sector entities are being invited to bid for large contracts, such as in the notable inclusion of Iranian private sector firms among the approved exploration and production partners for foreign firms bidding on Iran’s new energy tenders. Second, in instances where Iranian state companies are pursuing new projects with multinational companies, the Iranians are allowing the creation of new joint ventures, in which the multinational company is often the majority shareholder. These deals, such as state

industrial giant IDRO's joint venture with French automaker Renault, see an Iranian state enterprise as a shareholder within an entity that is majority owned by a private, foreign enterprise.³⁰ In this way, domestic reforms are a response to the demands and expectations of international investors. Should an external barrier to investment render those demands moot, the internal drive for reform will likely subside.

V. The Hesitation of Banks

Above all else, senior executives indicate that “improving banking and financing facilities” should be the highest priority for the Iranian government—on a scale out of ten, survey respondents give a mean score of 8.95. What makes the banking challenges so complicated is that they arise from both internal and external factors.

International bodies, such as the Financial Action Task Force (FATF), an intergovernmental body working to promote the integrity of the international financial system against money laundering and terrorist financing, among other abuses, see substantial weaknesses in the Iranian financial system. The concerns of the FATF and other groups, including American and European financial intelligence agencies, are well founded. Considerable portions of Iran's economy are controlled by state and quasi-state entities, many linked to the Iranian Revolutionary Guard Corps (IRGC), through opaque holdings that do not meet international standards for financial reporting or corporate governance.

Iran remains in a suspended position on the FATF “blacklist” as the government works to implement an action plan to address a lack of transparency in the country's financial system. Several substantial steps have been taken. The Rouhani administration has instructed banks cease to provide banking services with the Iranian Revolution Guard Corps.³¹ In 2016, all publically listed companies, including banks and other financial institutions, began adopting the International Financial Reporting Standards (IFRS) in order to improve transparency.³² Moreover, individual banks have pursued their own efforts to improve standards by providing updated training in compliance to staff and instituting new or upgraded transaction monitoring technologies. But these efforts have proven insufficient to assuage fears about transacting with the Iranian banking system. Beyond factors that are within Iranian control, the continued political uncertainty around the nuclear deal and the possibility of sanctions snapback have amplified the risk profile for each and every Iran-related transaction.

³⁰ Batmanghelidj, Esfandiyar. “New industrial policy poised to transform Iran's political economy.” *Al Monitor*, 4 Sept. 2017, www.al-monitor.com/pulse/originals/2017/09/iran-industry-idro-holding-operation-renault-alstom-deals.html.

³¹ Bozorgmehr, Najmeh. “Iranian banks give Revolutionary Guard the cold shoulder.” *Financial Times*, 18 Sept. 2017, www.ft.com/content/1eb9e41a-7b16-11e6-ae24-f193b105145e.

³² “Jurisdictional Profile: Iran.” *IFRS Application Around the World*, IFRS, 15 Dec. 2016, www.ifrs.org/-/media/feature/around-the-world/jurisdiction-profiles/iran-ifrs-profile.pdf.

VI. Perceiving Risks, Managing Risks

While policymakers have yet to fully account for the role of business leaders as a stakeholder group which can steward the nuclear deal, there is a general awareness among policymakers that the primary barrier to trade and investment in Iran is the perception of risk among companies, and in particular, financial institutions. In this arena, risk can take many forms. It includes legal or compliance risk, pertaining to possible violations of remaining EU and US sanctions on Iran. It can be political or reputational risk, pertaining to the lingering view that investment in Iran may be abetting a rogue state. It can also be operational risk, reflecting the fact that Iran remains a difficult market in which to do businesses, with plenty of endemic challenges that can see projects flounder.

When asked what is the “primary obstacle facing your market rollout in Iran,” 32 percent of survey respondents indicate sanctions compliance, a kind of legal risk, while 20 percent point to “managing political and reputational risk.” By comparison, 21 percent point to “access to financing.” It is telling that commercial or operational issues such as finding a local partner or structuring a local entity are far less frequently identified as major barriers. In effect, it is not the management of endogenous risks that pose a challenge for multinationals working in Iran. Many of these companies presently boast the necessary experience as well as access to local and international advisors in order to mitigate these risks. Barriers arise when companies need to manage the exogenous risks, such as snapback, and the perception of those risks by outside parties—principally parties who see possible legal, political, or reputational consequences to their facilitation of commercial activities in Iran.

This fact is perhaps best illustrated by the continued frustrations around Iran’s still limited access to the international banking system. The inaccessibility of banking and financial services is often misunderstood. It is not first and foremost a problem of a lack of financing. To draw on a commonly used metaphor, it is not the diameter of the “financial plumbing” that explains the insufficient flow of money to and from Iran. Iran is still at an early stage in its post-sanctions recovery and the small number of bankable investment opportunities requires a proportionally small amount of external finance. The real issue is that the pipes that should be connecting Iran to the international financial system are deliberately disconnected or blocked, rendering even routine financial transactions for day-to-day business costly and complicated. The reason for these disconnections or blockages is the concern among banks that the movement of financial resources to Iran through their “plumbing” could expose them to legal and reputation risks, especially at a time when the Trump administration has indicated its general opposition to the nuclear deal.

As described by the chief executive of a European investment company, “Larger banks have made it very clear that they will only serve major multinational companies on Iran transactions—they are acquiescing to their biggest clients.” Everyone else “has to work with the handful of smaller financial institutions comfortable facilitating payments to Iran.” The executive relays that making his company’s initial investment in an Iranian private sector company was “by far the most difficult thing I have done in my career.”

Importantly, the challenge was not finding the investors to support the venture. “There is certainly plenty of capital, the question is how you capture it and deploy it.” Structuring a suitable vehicle to invest in Iran is costly, as are the eventual transactions given the significant levels of due diligence required. Tellingly, “the bank was more sensitive to the identity of the investors than to the nature of the investments in Iran. There was a clear need to ensure no U.S. persons are involved.” Put succinctly, “the capacity problem is actually a compliance problem.”³³

Executives are ambiguous as to whether European governments are doing enough to “support post-sanctions trade and investment with Iran,” with 62 percent noting that these governments are “probably” or “definitely” not doing enough. The assessment of the United States is starker—94 percent believe the United States is “probably” or “definitely” not doing enough to fulfill its commitments. No respondent gave a positive assessment of American efforts.

Looking across the full spectrum of commercial actors, policymakers concerned about the slowdown in compliant trade and investment with Iran ought to adopt two strategic aims. First, it is necessary to improve capacities for the *management* of risk. Such a strategy is best suited to supporting the companies seeking to trade and invest with Iran. For example, two oil companies may perceive the same magnitude of risk in Iran, but the company with better tools for the management of that risk is the one that will more likely to pursue market opportunities at the present time.

The second strategic aim focuses on the *perception* of risk and is suited to those entities that facilitate or enable trade and investment with Iran. Consider banks, whose standardized services of limited scope mean that there broadly exists an equal level of risk management capacity among institutions. Companies seeking to do business in Iran have encountered resistance from banks to the idea of establishing unique protocols for Iran trade and investment, given the costs of such measures and the fact that enabling transactions for Iran is not inherently more attractive than doing so for any other market worldwide. As such, most financial institutions have broadly equal means and aptitude to manage Iran-related risks. Therefore, banks that perceive less specific risk (around a given deal) or systemic risk (among Iran transactions at large) are more likely to render services, enabling investments to take place. In this instance, perception is more important than the capacity to manage.

European governments have engaged in official visits and trade delegations in order to signal that companies will enjoy political support for any Iran business activities, and have provided briefings on sanctions and related trade issues. Even the Obama administration engaged in outreach to businesses to educate executives on the status of US sanctions following Implementation Day.³⁴ The importance of this support should not be discounted. Nearly half of executives surveyed report speaking to the non-Iranian government officials, including Tehran-based ambassadors, at least once every two

³³ Bourse & Bazaar Phone Interview: “Investment Company Executive- Stockholm,” January 2017

³⁴ Brunnstrom, David. “Kerry seeks to soothe European bank nerves over Iran trade.” *Reuters*, 12 May 2016, www.reuters.com/article/us-iran-banks-kerry/kerry-seeks-to-soothe-european-bank-nerves-over-iran-trade-idUSKCN0Y300J.

months, with 15 percent of respondents speaking to officials at least once every two to three weeks.

This meaningful dialogue between policymakers and business leaders is fundamental to the economic implementation of the nuclear deal. But the existing dialogue is largely disjointed, taking place within bilateral rather than multilateral frameworks and depending largely on the initiative of individual executives. By contrast, technical implementation of the nuclear deal has succeeded because of a clear program, well-defined mechanisms, and a means for verification at each milestone. The same qualities must be brought to bear in the new implementation of the sanctions related commitments under the JCPOA.

VII. Recommendations

The text of Annex II of the Joint Comprehensive Plan of Action clearly outlines “sanctions related commitments” for the parties to the agreement, and subsequently details the “activities” that were to be allowed following the lifting of sanctions. But the mere fact that activities are now allowed has not meant that those activities have been taking place. The nuclear deal established no formal mechanism or plan to ensure that sanctions relief commitments actually manifest the outcomes that were clearly so important to the Iranian negotiators, whose early sense of the deal’s economic importance was acute. To this end, Annex II of the agreement deserves its own new plan of implementation, building-on but not beholden to the work of the JCPOA Joint Commission.

There are three key elements to such a plan. First, the economic implementation of the JCPOA needs its own coordinating body. The Joint Commission itself is poorly suited to conduct this coordination given the divergent views of the United States, Russia, and China on matters of sanctions and economic implementation. However, the European Union and its European External Action Service (EEAS), which has taken the mantle of leadership on the nuclear deal since the change in American administrations, would be well positioned to convene such a body.

While the EEAS itself lacks the economic expertise to broadly devise and implement such a plan, it has the authority to work across European Union agencies and member-state governments to convene specific working groups to discuss sanctions related issues. It is possible to imagine a new multi-agency commission for economic implementation, formed in accordance with European commitments under the JCPOA, to organize its own working groups to bring policymakers and business leaders together for periodic, multilateral, and technical discussions on issues pertaining to the reintegration of Iran in the global economy. The creation of such a commission would strengthen European leadership on the implementation of the JCPOA, bolstering the nuclear deal by addressing the current gap in implementation surrounding Annex II.

These working groups would seek to foster cooperation between Iranian and international stakeholders on a range of issues. In the area of monetary policy and economic reform, Iran would be able to seek international input for its self-driven efforts to normalize foreign exchange, manage inflation, recapitalize struggling banks, and

support privatization and job creation in the economy. In consideration of compliance and regulations, a working group would enable stakeholders to ensure that the various processes underway, such as the FATF Action Plan and the adoption of IFRS standards, have a common venue for discussion to ensure a more cohesive plan for reform, alongside contingency planning for the possibility of events such as snapback. In the effort to more effectively facilitate post-sanctions trade and investment, issues surrounding Iran's access to international credit, the recalibration of tariffs and customs rules, and the creation of stronger investment protections could be addressed holistically. Finally, in order to support operational excellence on the part of international and Iranian companies, initiatives focused on technology adoption, corporate governance, human resource development, and corporate social responsibility deserve their own focused dialogue.

Yet, dialogue alone is insufficient. The second element for such an implementation plan is to ensure that the collective dialogue supports the achievement of clear targets. Currently, the success of renewed economic engagement between Iran and the international community is difficult to measure beyond basic economic statistics. But statistics fail to capture the extent to which progress is being made in the thornier, more subjective areas such as improved financial transparency. Creating new benchmarks, metrics, and milestones, agreed within a multilateral framework and incorporated into a cohesive implementation plan, will prove valuable in helping to address issues of risk perception.

Third, any plan for implementation must encourage action at the company level. There is some sense among the business community that government officials, particularly in Europe, ought to be more vocal in advocating for renewed commercial ties with Iran. But this is an awkward position for governments to take, and their ability to generally indicate political support for trade and investment is insufficient to address the perception of risk or the management of risk at the company level. As such, the implementation plan ought to include initiatives that enable companies, particularly Iranian companies, to improve their risk management capacity in ways that convincingly reduce risk perceptions.

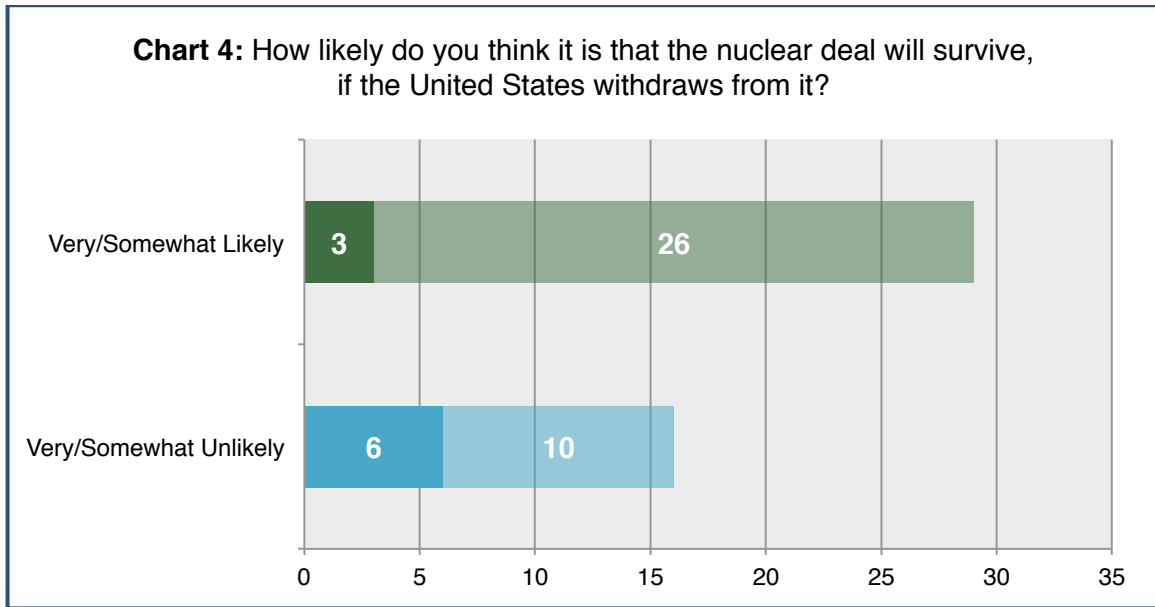
To do so, the implementation plan must include an effort to devise officially sanctioned training or technical assistance programs in which companies can elect to participate. While many such companies are currently receiving such training from the likes of international advisory firms, there is no authoritative recognition of these efforts. The United States and Europe in particular have a history of extending government-sponsored or supported training and technical assistance programs to economies undergoing significant transformations, often with the private sector actually providing the training in question. Such programs were perhaps most notably used to support market liberalization in post-Soviet economies.

A similar set of initiatives would be valuable in the Iranian context. On one hand, companies that pursue such certifications would necessarily be improving their ability to adequately manage risk. On the other hand, the certification itself will prove a compelling signal about the company and the nature of its management. Wide participation in such programs by Iranian companies and their international commercial partners should help meaningfully reduce the perception of the risk in the market, reinforcing the very idea of

Iran’s commitment to reform. Such programs would be especially valuable for the Iranian companies listed in the attachments to Annex II—companies whose former designation as sanctioned entities remains a kind of stigma.

VIII. Conclusion

The experience of the JCPOA to date offers one final lesson when considering a new and expanded effort around implementation. President Trump may yet try to kill the nuclear deal.³⁵ Even if Congress devises a “fix” to the Iran Nuclear Agreement Review Act, the deal will remain vulnerable.



In the face of such uncertainty, the resilience of the business community can support the resilience of the nuclear deal. The most basic quid-pro-quo of the JCPOA—the cessation of nuclear enrichment in return for improved economic prospects—may be defensible even in the event of snapback. Notably, 38 percent of senior executives respond that their company did not “cease trading with Iran in the period between 2006 and 2015.” Through a combination of carve-outs, licenses, and other creative solutions, a significant proportion of companies were able to persist in the Iranian market even during the height of international sanctions. Companies are applying lessons from this period to address present uncertainties. When asked how their companies were able to “overcome potential risks” in order to make “a significant sale or investment in Iran in the past 2 years,” 20 percent of respondents indicate that they included force-majeure clauses in contracts with Iranian partners. The same proportion reports “obtaining a license from U.S. authorities.” Furthermore, 10 percent of respondents pointed to “de-risking from the U.S. market” as the reason for their ability to press forward.

³⁵ Crowley, Michael. “How Trump could kill the Iran nuclear deal in January.” *Politico*, 28 Dec. 2017, www.politico.com/story/2017/12/28/trump-kill-iran-nuclear-deal-260860.

Those parties committed to preserving the nuclear deal ought to build on this resilience. Even if the United States re-imposes secondary sanctions, the European, Russian, and Chinese governments can still seek to deliver on the basic quid-pro-quo of the deal, so long as Iran remains in compliance with its non-proliferation commitments. A substantial 54 percent of senior executives indicated that “assuming Iran remains committed to the nuclear deal,” blocking regulations, which would protect companies from U.S. penalties, would positively affect the “decision to invest in Iran.” But the planning for such a contingencies must start now, and it should be part of a new plan for economic implementation.

Despite all of the uncertainty and the frustration surrounding the future of the nuclear deal, a staggering 91 percent of executives surveyed for this report still believe that their companies can be commercially successful in Iran. Moreover, the majority of respondents—63 percent—believe that the nuclear deal is “somewhat likely” to survive even if the United States withdraws. If engaged with the right plan, business leaders will be able to draw upon this stubborn optimism and valuable pragmatism in order realize a fuller and more durable implementation of the nuclear deal. Policymakers who seek to preserve the JCPOA must ensure that this increasingly rare combination of confidence and capacity is not squandered.

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