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Understanding Iran Under Sanctions: Oil and the National Budget

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Abstract

The efficacy or inefficacy of international sanctions has been a long-standing concern of observers of the Islamic Republic of Iran. Mainstream analyses have tended to address this question by attempting to gauge the resilience of the Iranian leadership in the face of economic hardship. This mode of analysis tends to present Iran's predicament as a 'zero-sum game' in which the Islamic Republic will either give in to pressure from the USA and its allies, or continue to absorb this pressure. What this mode of analysis tends to obscure is *how* sanctions are being absorbed by Iran's political elite in a continuous and dynamic fashion. This article will attempt to shed more light on this question by addressing the way in which diminished oil revenues have occasioned a shift in attitudes toward sanctions, as observed through the public statements of decision makers and the domestic media. This shift has been especially important in discussions surrounding the Iranian government budget for the forthcoming year (2013/14). As discussions of how best to reformulate government finances have progressed, Iran's Oil Ministry has emerged as an important voice. With the political backing of the Iran Revolutionary Guards Corps (IRGC), the Ministry has lent its voice to calls for changes in the relationship between oil and the government budget.



Introduction

Whether in order to further our scholarly understanding, to forecast economic outcomes, or to inform international policy, observation of the hydrocarbon sector of the Islamic Republic of Iran demands an appreciation of how deeply the industry is embedded in the country's economic and political spheres. Iran's designation as a 'petroleum state' can be understood in two important and interlinked senses. First, Iran is an oil producer and a participant in global energy markets. Second, Iran's economy is heavily reliant on oil and gas as its primary source of foreign currency earnings as well as for implicit subsidies on both domestic energy consumption and industrial production. International sanctions have a direct impact on Iran in both of these realms. International pressure on the oil majors and financial institutions has restricted foreign involvement in Iran's hydrocarbon sector to a minimum. This has put a particularly severe strain on the country's ability to maintain the production levels of mature wells desperately in need of enhanced oil recovery (EOR) techniques, to develop the offshore supergiant South Pars natural gas field, and to build a refining industry able to serve the domestic need for refined products – let alone produce a surplus for export. More recently, an EU import ban and US pressure on major Asian oil consumers have been successful in reducing Iran's overall level of export receipts, severely reducing the primary revenue stream of the government.

This drop in revenues has been the catalyst for a new openness in the discourse within the Iranian political elite regarding the effects of sanctions on the economy. The assertion that Iran is completely impervious to any ill effects has, over the course of a few short months, given way to an open acknowledgement of unprecedented difficulties that necessitate immediate action, particularly with regard to the role of the government in the Iranian economy. This shift in the political centre ground, on such an important national issue, has become the primary thrust in the debate to frame government spending plans for the next Iranian fiscal year (beginning in March 2013) especially in relation to the size of the government budget (and by association, the size of the government itself) and to the immediate and future role of oil revenues in the public purse. Viewed from the perspective of the oil sector, debates on the forthcoming budget legislation form the nexus in which the spending demands of the government meet and interact with the



investment needs of the industry. Iran's annual budget determines the distribution of oil revenues to the government, which in turn determines the extent to which it is able to draw on oil income to feed other areas of the economy. Since the oil sector is itself a 'nationalized' industry the budget is also the document that determines the amount of its income available for reinvestment.

As elites jostle to configure fiscal policy that will accommodate a continued tightening of export income over the coming years, Iran's oil industry has found a new voice with which to influence this debate. The voice now heard in the advocacy of oil industry concerns is that of a newly empowered Oil Ministry, having the Iran Revolutionary Guards Corps (IRGC) lending backbone to what, for most of its history, has been a hollow and compromised institution. The Ministry, under the stewardship of the country's most powerful security organization with its growing economic interests, has emerged with a strong claim for a privileged position. It is the intention of this comment to outline the main trends that have emerged in the political and media discourse in relation to this shift in public orientation towards international sanctions. By drawing out these trends a picture will emerge, indicating likely paths that the Islamic Republic may steer in order to avoid crisis – a picture that standard analyses of Iran's position fail to grasp due to a myopic focus on hard data such as macroeconomic indicators and other symptoms of economic hardship. Particular attention will be given to the position of the oil sector, as new dynamics in relation to sanctions have brought oil sector concerns increasingly to the foreground in the current debate.

Iran since the oil export ban

In July 2012, the European Union imposed a ban on the transport, purchase, and import of Iranian crude oil and petroleum products. Together with US sanctions and unilateral pressure on Iran's Asian oil consumers, these measures were designed to be the toughest action yet seen in the campaign of shifting Iran's position with regards to its ongoing nuclear enrichment programme. Before the Western sanctions came into effect, Iran had been exporting around 2.2 million b/d of crude, of which Europe accounted for some 600,000 b/d and Asia 1.6 million b/d. According to the IEA, Iran's total oil exports had already dropped to 1.74 million b/d in June 2012, and declined further to only 1 million b/d by July. In addition to the loss of European purchasers, by August 2012, crude exports to Iran's top five non-European buyers (China, India,



Japan, South Korea, and Turkey) were down by nearly half from the start of the year. Though Iranian crude has since become increasingly difficult to track, industry estimates put Iran's current exports at around 900,000 b/d,¹ representing a decline of more than 50 per cent compared with last year. Analysts have estimated that Iran is losing \$3.8 billion in monthly revenues as a result.² Oil export worries have spilled over into a crisis of confidence in Iran's currency, the rial, which by some estimates lost around 40 per cent of its value against the dollar in September alone.³ Currency devaluation has also fed increases in prices. The most recent statistics from Iran's central bank show inflation to be running at 26 per cent, although many believe the real rate could be as high as 50 per cent⁴ or even 70 per cent.⁵ Iran's poor economic health is also reflected in alarming rates of unemployment with the proportion of those out of work in the agricultural sector standing at 20.3 per cent, in manufacturing 32.4 per cent, and in the service sector as much as 47.3 per cent.⁶ In its semi-annual World Economic Outlook, the IMF has forecast that Iran's GDP would shrink 0.9 per cent this year after a growth of 2 per cent in 2011.⁷

None of these indicators augurs well for Iran's short- to medium-term economic prospects, and yet, knowing all of this, Western observers have failed to reach a consensus regarding Iran's economic future. In a recent report, the Economist Intelligence Unit asks if Iran is 'Cracking under pressure?'.⁸ But after a cascade of statistics and projections, amounting to what would appear to be a perfect storm of economic hardships, the report ends as it begins, in uncertainty; 'the Islamic Republic does not appear to be on the verge of collapse' it concludes. On the subject of Iran's latest devaluation-fuelled inflation spike, Johns Hopkins economist Steve Hanke could offer little more, proposing that Iran faced either a 'horrible end' or a 'horror without end'.⁹ The glut of information has left other Iran watchers unwilling to forecast the future at all. Cliff Kupchan, a former State Department official now heading the Iran section at Eurasia Group, has stated that it is 'impossible' to estimate when Iran's economy will be disabled because so many complex factors are involved, 'The numbers available to me don't allow a prediction', he told the Los Angeles Times.¹⁰ As Jahangir Amuzegar concludes in a recent report assessing progress on Iran's subsidy reform programme 'cause and effect on major economic indicators' is 'difficult if not impossible' to determine'.¹¹



The truth is that no amount of raw data can tell us what effects the sanctions are having on Iran, as long as the question of Iran's economic future is viewed from within a logic defined by Western demands. Just as sanctions are presented as a means of inducing the capitulation of Iran's political leaders on the issue of the nuclear programme, analysts have been locked into the narrow requirements of answering the question of if and when this will happen. Much is lost in this mode of analysis. Statistical metrics are offered as a proxy for the intensity of the economic pressure faced by Iran's leadership, as observers strive to understand where (if at all) the current point in time is situated along the path towards an eventual reversal of Iran's stance. Insofar as Iran is yet to 'collapse' it is assumed to possess a limited, but as yet unknown and unconceptualized, capacity for resilience in an equation mediated by economic pain. Iran is fated to hold its ground against economic pressures by means of some unidentified source of strength. Once this mysterious resource runs dry, Iran will 'crack'. Some analysts purport to be able to fill this gap in our understanding with appeals to brute facts of difference. 'Ideologue regimes like Iran', writes the economist Hassan Hakimian, have a 'high pain threshold'. Even if Iran were to receive an 'economic shock', it would take six months for this to translate into a shift in the Iranian position says Mark Dubowitz, a spokesman for a group advocating tougher sanctions, offering for an explanation: 'these guys are hard core revolutionaries'.¹²

This represents an analytical dead end. Insofar as the economic prognosis looks bad, Iran will perpetually exist 'on the brink' while confounding us with the fact that it has not yet tumbled over it. To the extent that sanctions are understood narrowly as the instrumental means by which Iran will be compelled to bow to Western demands or be driven to economic collapse, observers are locked into questions of the effectiveness of these means – hence discussions of whether or not sanctions have begun to 'bite'. In attempting to draw a simple connection between international restrictions and the likelihood of economic 'collapse' or political 'capitulation', observers obscure the manner in which the Islamic Republic can respond dynamically to the challenges posed by the cumulative effects of sanctions on its economy.



Adjusting to new realities

Those who pay even cursory attention to the language of Iran's leaders will remember a time when Western sanctions didn't mean a 'damn thing' to the Islamic Republic. Until recently, President Ahmadinejad has consistently denounced sanctions as mere 'torn papers' that could have no impact on Iran's progress.¹³ In November 2008, during the height of the global financial crisis, Ahmadinejad said 'western leaders regret isolating Iran's economy from the rest of the world, since their actions have led to the downfall of their own economies *while Iran's economy remains healthy*'. This defiant tone prevailed into the first half of 2012. When, in January 2012, the head of Iran's Central Bank, Mahmoud Bahmani, compared Iran's economic situation to a period in Islamic history when the Prophet and the Muslim community were isolated and suffering in the desert, Supreme Leader Ayatollah Khamenei responded with unprecedented directness. In a highly publicized put-down that surprised many observers, Iran's highest authority responded by making a similar, though contrary, reference to an occasion when Muslim armies persevered against tough odds and were eventually victorious.¹⁴ This was a clear message intended to cascade down the political hierarchy: there could be no divergence from a doctrine that held sanctions to be wholly incapable of undermining Iran's economic health. Even as late as June 2012, as the ban on Iranian exports looked increasingly unavoidable, Ayatollah Khamenei denounced the West as failing to understand that 'Iran has become immune to their sanctions over the 30 years of living with them'.

However, since July there has been a speedy evolution of rhetoric, and this has ultimately produced a consensus that openly accommodates the fiscal strain of sanctions. After a brief period of open acrimony – during which President Ahmadinejad jostled with opponents over the extent to which sanctions, not his own mismanagement, could be blamed for Iran's economic misfortunes – elite voices have coalesced around a new centre ground upon which an urgent policy debate is now taking place. It has been possible, and indeed necessary, for Iran's leaders to present this necessity as a virtue, specifically in relation to the long-standing promise of detaching the government budget from oil revenues – a project that has been neglected by successive administrations and which has now become a mantra. As the deputy speaker of Iran's



Majles asserted in October, ‘we have always known that we need to cut our dependence on oil ... because of sanctions we can reduce the level of oil money in the 1392 budget to a minimum’.¹⁵ In the words of another lawmaker, sanctions have presented Iran with an ‘enforced opportunity’ to move towards ‘a budget without oil’.¹⁶

Short-term measures

Beginning with immediate measures, the cut in oil revenue was projected to result in an estimated deficit of \$54 billion¹⁷ – a gap representing nearly 12 per cent of total government spending for 2012/13. While the Ahmadinejad administration raised doubts about the Majles’ calculations, presidential officials responsible for budget planning admitted that ‘part of the budget deficit this year has been a result of the drop in oil revenues’, moving quickly to cut current expenditures across a broad range of government departments by 20 per cent dated from the imposition of sanctions in June.¹⁸ Other measures have also been agreed that will allow the government to draw an extra 10 per cent of savings from subsidy reforms to be used to help cover the deficit. In addition, arbitrage profits from the sale of foreign currency – over which the administration now exercises greater control through a dedicated currency bourse established to capture the activity on the unofficial market – will also flow into the current budget.¹⁹

As a further measure, infrastructure investment was cut by 30 per cent to reassign funds to cover shortfalls in other areas.²⁰ Government investments had already been in decline before the imposition of sanctions, with reports estimating the drop in funds to government projects at 70 per cent for the first eight months of the Iranian year beginning in March 2012.²¹ Speaking on this subject, Ali Larijani, who had recently criticized the president for blaming avoidable economic problems on sanctions, talked openly in November of a ‘fiscal drought’ that would mean drastic cuts in government funds for municipal infrastructure.²² Though the 1391 budget had earmarked 43,000 billion tomans (\$35 billion) for infrastructure, the head of Iran’s legislative branch stated that in reality no more than 15,000 billion tomans (\$12.2 billion) would materialize. Projects premised on ‘simple government funding’ would no longer be successful, Larijani warned. Recent reports from Iran’s regions reflect varying success in attracting the



interest of private sector investors in infrastructure projects. The overall trend in the foreseeable future will probably be an even more marked withdrawal of the government from involvement in this area, reflecting a downsizing of the role of government in general.

It is certain that sanctions played an indirect and yet significant role in the decision by Iran's Majles in November 2012 to suspend the second phase of the *Targeted Subsidies Reform Act* of January 2010. This placed a moratorium on any price increases by energy carriers, utilities, and basic goods and also blocked any further increases in monthly cash payments – intended to relieve the burden of higher living costs – to millions of Iranians. In reality, as explained by Jahangir Amuzegar,²³ the implementation of subsidy reforms had already come to a halt months before the November Majles vote, despite the enthusiasm of the president to administer a further dose of economic 'shock therapy'. In part due to inflation stoked by the first round of reforms and in part due to a lack of trust in the administration after a series of missteps and violations in implementing the programme, the Majles voted in early 2012 to cut by half government proposals to continue the reforms that were contained in the budget bill for the current Iranian year. In reaction, President Ahmadinejad brought a halt to the programme altogether, though monthly cash payments to households continued. Since the partially completed scheme is not self-financing, these payments constitute a considerable financial burden on the government, while worsening conditions in the wider economy would seem to make any further price increases a political impossibility. Nevertheless, according to the main architect of Ahmadinejad's subsidy reforms, budget proposals for the coming year will contain proposals to continue the programme.²⁴ Senior lawmakers are anticipating that recent spending cuts, followed by a deflationary budget, may bring inflation under control sufficiently for a new round of subsidy cuts to be implemented.²⁵ Others have been more frank, acknowledging that an important concern has been to await the departure of President Ahmadinejad, before further reforms are undertaken under a more compliant administration.²⁶

Sanctions have also shaped debates surrounding Iran's fiscal policy for the immediate future, particularly in relation to the budget for the Iranian year which begins in March 2013. Since 2005, and especially since the political capital of the Ahmadinejad presidency has begun to



wane, discussions have usually centred on demands by the Majles for a greater degree of transparency in the administration's decisions. This year, however, the discussion no longer has the president's performance as its focus, but the necessity of a fiscal arrangement that will reflect new realities. Both officials from the Ahmadinejad administration²⁷ and senior figures within the Majles²⁸ have asserted that the budget for the coming year will be deflationary. However, independent economists stress that this is less a deliberate policy than a necessity 'due to a reduction in the resources of the government'.²⁹ Some attention has been given to the possibility of reforming Iran's loophole-ridden taxation system as a means of countering the drop in oil revenues. Currently, tax revenues accruing to the government amount to only 7–8 per cent of GDP, with an estimated 40 per cent of the economy exempt from tax, and a further 21 per cent accounted for by the informal economy.³⁰ Legislation for the revision of direct taxes is said to be under discussion, with some estimating that such reforms could reduce government reliance on oil revenues by 30 per cent.³¹ However, it is acknowledged that tax administration would take up to three years to reform and thus cannot provide a short-term fix.³² Attempts to raise indirect taxes foundered after opposition from Iran's bazaar class spilled over into urban protest in both 2008 and 2010. Heightened socio-economic pressures at the current time make a resumption of such attempts unlikely.

Oil and the budget

With non-oil receipts unlikely to provide a short-term solution, discussions over the size of Iran's budget will turn on three projected figures: the expected level of oil exports measured in barrels per day; the predicted average oil price; and the exchange rate at which the government will convert oil dollars into rials. In reality, each of these figures will experience variability over the course of the year and as such, these projections serve the purpose of accounting conventions. Their importance to external observers is their role as indicators of Iran's short-term expectations.

In the budget for the current Iranian year, the level of oil exports was set at 2.2 million b/d. Following the imposition of sanctions, however, actual exports have settled at around half that figure. Budget projections for the coming year reflect this reduction with the figure likely to be



no more than 1 million b/d.³³ This figure will be multiplied by an estimated average price per barrel which is usually set conservatively, allowing for a large margin for error. Surpluses due to higher average oil prices are then paid into Iran's foreign currency reserves, with a portion paid into Iran's sovereign wealth fund, the National Development Fund (NDF).³⁴ A relatively high projected oil price therefore signals more government spending and less replenishment of reserves. Majles figures have signalled a hawkish position, recommending that the 1392 estimated barrel price must reflect prudence rather than permit profligacy.³⁵ However, the estimate will probably be an advance on last year's projection of \$81.50 per barrel, with one senior member of the Majles budget and planning committee estimating that the rate may rise to \$100 per barrel to reflect higher current market prices.³⁶ Others prefer an even higher barrel price of between \$100–110 but with a lower export quantity rate.³⁷

Most uncertain of all is the likely projection for the dollar rate at which oil export revenue is converted to Iranian rials for domestic spending. While projections of export quantities and oil price refer to external factors, Iran's managed exchange rate system makes this last projection a largely arbitrary benchmark. Yet any decision made will effectively determine the spending power of the government. Fluctuations in the dollar rate and subsequent government efforts to stabilize the market have resulted in large spreads between the official exchange rate of 12,260 rials and the much higher unofficial rates, which trade at around double the official rate. In light of recent market instability, the announcement of a conversion rate significantly higher than the current official rate is likely to be interpreted as a devaluation, triggering a severe reaction in the markets. Conversely, setting the rate much lower would probably encourage arbitrage trading. These potential difficulties have been acknowledged publicly by at least one senior member of the Majles budget and planning committee.³⁸ Other members of the committee have even suggested that no rate be announced,³⁹ but given the importance of foreign currency income to the government purse, it is hard to see how any spending plans could be framed in the absence of this figure.



Iran's oil industry: A growing voice

'We must not let sanctions hurt the oil industry' avowed a member of the Majles Industries Committee,⁴⁰ in a statement that broadly reflects consensus in anticipation of debates to frame the coming year's budget. In light of 'limitations on the nation's resources' the oil industry will 'receive special consideration', asserted another senior lawmaker. 'The current restrictions should not be allowed to delay the work of the oil industry', the lawmaker continued, 'we will manage an intelligent transition while providing a foundation for self-sufficiency and profit making'.⁴¹ Sanctions have focused the attention of Iran's political elite on questions of the dual role of the oil sector in the economy. Perception of this role has shifted from the implicit understanding of oil as a pump for the economy, towards a growing recognition of the industry as a locus of demands and interests of its own. This trend has risen in parallel with the accession of the Iran Revolutionary Guards Corps (IRGC) to the stewardship of Iran's Oil Ministry, represented by the appointment of Rostam Ghasemi as oil minister in August 2011. Since then, the ministry has become an increasingly autonomous entity with a greater degree of formal separation of responsibilities from the elected executive.⁴² As sanctions have shaped the debate on Iran's new budget law, advocates of the oil-IRGC compact have lobbied for adjustments in the fiscal give-and-take between oil revenues and the government.

Representation of this perspective in the Majles has been aided by the pro-IRGC make-up of Iran's legislative body following parliamentary elections in March 2012. The influence of the Guards on this election was openly criticized by at least one vocal parliamentarian who claimed that their influence was evident 'from those candidates who were elected and those who were not'.⁴³ One key figure who was brought to prominence by the elections and who has emerged as a central figure in oil sector concerns is former Oil Minister Masoud Mirkazemi who, on being elected to the Majles for the first time, was immediately delivered into the forefront of the debate as head of the Majles Energy Committee (MEC), a select group of lawmakers that discusses issues relating to the oil and gas industry, and leads parliamentary discussions on these matters. Though it was during his ministerial tenure that President Ahmadinejad had the most success in imposing his will on the oil industry, Mirkazemi is more closely associated with the IRGC than



the current administration, having headed the IRGC think tank, the Center for Fundamental Studies.⁴⁴ Speculation also connected Mirkazemi with a role at the IRGC's engineering arm Khatam ol-Anbia following his resignation as oil minister, although this was denied by the company immediately after reports were published.⁴⁵ The March 2012 parliamentary elections brought with them almost wholesale changes in the membership of the committee that Mirkazemi now heads and which has played a leading role in the debate on the characteristics of next year's budget. The appointment of several outgoing members of the Committee to senior posts in subsidiaries of the National Iranian Oil Company (NIOC) and as advisers to the oil minister may also have helped to cement current and prospective links between the bodies.⁴⁶ Significantly, in at least one meeting between Ministry officials and MPs from the Majles Energy Commission, held to discuss new methods of oil sector investment funding, 'representatives of contracting firms' were also been present, a likely reference to Khatam ol-Anbia, the engineering arm of the IRGC which has, in recent years, grown in stature as an upstream player. A ministry official emerging from the meeting described it as the beginning of a 'new chapter' in relations between the Majles and the Oil Ministry.⁴⁷

Lobbying for a greater share

October 2012 saw this 'new chapter' begin in earnest, when the MEC began to relay Oil Ministry arguments for an increase in the proportion of oil revenues flowing directly back into the oil sector. In the words of one MEC member, 'the oil industry is in need of support and we will try to meet those needs in the 1392 budget'.⁴⁸ As part of the same report, published on the official Oil Ministry news website, Mirkazemi offered a scattershot of supporting material to emphasize on which fronts the debate on the oil industry's entitlements would be fought. With the overall decline in oil receipts 'the 14.5 per cent share allocated to the oil industry will naturally decline' he said, reflecting an implicit claim to the priority of oil investment over current expenditure as a demand on oil income. Mirkazemi also referred to the massive subsidy on gasoline production, provided by NIOC in its supply of crude to domestic refineries at a knock-down rate of \$7 per barrel. 'This must be solved if it is not to cause problems for the oil



industry' he said. Acknowledgement of the high cost of external sources of project financing, and of payments for buyback contracts, were also included among the MEC list of complaints.

In recent years, annual budget laws have compounded these issues with amendments and omissions, effectively denying NIOC a fixed share of revenues gained from crude sales to domestic refineries.⁴⁹ One of the most important of these changes has been the recalculation of the 14.5 per cent share of revenues from the sale of crude assigned to NIOC as a proportion of export sales rather than the more general category of crude production as a whole. The Ahmadinejad administration has also continued to exploit grey areas in Iran's loosely institutionalized fiscal regime by continuing to spend according to plans that overestimated actual returns to the government from oil sales,⁵⁰ a practice that has necessitated budget deficits, withdrawals from foreign currency reserves, and tapping into domestic revenue streams of the oil industry – in particular, those of the National Iranian Oil Refining and Distribution Company (NIORDC). In a scheme which remained opaque even to Iran's own national auditors, the government has effectively bankrolled its distribution of cash payments to a majority of Iranians by reserving for itself a large part of the differential between the highly discounted rate at which NIORDC sells crude to refineries and the final pump price of gasoline⁵¹ which now stands at 33 or 57 cents per litre (depending the level of subsidy), having risen from under 10 cents per litre when subsidy reforms began in 2007. Most recently, a report was presented to the Majles revealing that the Ahmadinejad administration had, in the fiscal year 2010/11, illegally redirected \$12 billion of oil money to cover current spending shortfalls, while a near identical shortfall was found in the foreign currency reserve.⁵² Sanctions on Iranian oil have helped the Oil Ministry to cast these issues as part of the rhetorical push to cut the reliance of the national budget on oil income, while concurrently pushing for a larger proportion of revenues returning to the industry for reinvestment. A number of statements from oil officials and parliamentary figures indicate that a consensus has formed around proposals for an advance on the 14.5 per cent share of export revenues currently available to the Oil Ministry, to a proposed 25 per cent.⁵³ This larger proportion would help offset the reduction in investment due to the export ban, but would have little to no impact on the long-term investment shortfall.



It is in this context that the views of the MEC in recent discussions surrounding government accounts must be seen. During debates that eventually resulted in the suspension of the second phase of the government's subsidy reform plan, Mirkazemi and his supporters positioned themselves strongly as fiscal hawks, raising the spectre of budget deficits if the government was not allowed to continue to implement price increases.⁵⁴ After confirmation that the second stage of reforms would not go ahead, Mirkazemi expressed fears that the strain of maintaining cash compensation payments without further price reform would bring about dire consequences for investment in oil and gas projects, as the government would continue to lean on the oil industry for spending excesses.⁵⁵ In short, as the Oil Ministry and its supporters in parliament have grown independent from the administration, they have embodied calls for fiscal prudence, tying the investment interests of the oil industry to the calculations that determine the overall size of the budget. 'The government must calculate its budget realistically,' Mirkazemi observed, 'otherwise, like last year, there will be a budget deficit equal in proportion to unrealistic projections'.⁵⁶ 'We must reduce the dependence on oil in the budget to a minimum', Mirkazemi said, 'so there is no need to sell excessive amounts of oil ... sanctions will help us make a decision on this issue sooner'.⁵⁷ The Oil Ministry is thus pressing budget planners to prevent the coming year's projected price per barrel from rising to a level that may risk eventual deficits. From the perspective of the Ministry, international oil markets are oversupplied, with prices held artificially low as a result. Promoting this perception lends strength to arguments for greater reinvestment and to reduce the emphasis on expanding overall production in the short term.

Victory for the Oil Ministry in the current debate will not be enough to solve the problem of investment shortfalls in critical areas such as expanding refinery capacity and developing shared fields. However, these discussions offer some indication of possible longer-term trends. One indication is the Ministry's request for special consideration for revenues from oil fields financed by external capital. As part of continuing efforts to unlock the potential of domestic sources of investment, much attention has been given to the role of bank-led consortiums in the operation, and even potential ownership, of oil fields. Iran's relatively undeveloped shared fields, in particular, present attractive greenfield investment opportunities for the private sector. However, under current fiscal arrangements, banks have been reluctant to commit to the necessary large



investments. Backed by popular arguments highlighting the danger of more rapid shared field development by Iran's neighbours, the Oil Ministry is currently pressing for reforms that would allow a greater proportion of revenues from these fields to flow directly back to the projects themselves.⁵⁸ These revenues would be available to finance buyback repayments or other external financing costs, thus strengthening the incentives for further bank-led and private sector investment. Such changes would be a natural progression, following the granting of unchallenged rights to offer no-bid contracts for shared fields to the Oil Ministry in March 2012.⁵⁹ This possible trend, developing in parallel with a reduction in the size of the budget, suggests a gradual de-governmentalization of certain areas of Iran's oil industry revenue and investment flow. A similar shift is probable in the refining industry, where investment requirements will fuel arguments for a more commercially oriented relationship between NIOC and domestic refiners. These concerns will be pressed by pro-oil voices in discussions on the resumption of subsidy reforms that are likely to emerge after the end of the Ahmadinejad administration.

Conclusion

Six months after the imposition of sanctions on Iran's oil exports, the question of how economic pressure might force change in Iran's political position remains unanswered. However, attention to the public discourse among the leadership of the Islamic Republic reveals a shift away from a rigid insistence on the inefficacy of sanctions, to an open discussion of how finally to wean Iran's government from its addiction to oil money. Calls to establish Iran's economy on a sound non-oil foundation have been heard for many years, but it is sanctions and the necessity to reduce Iran's vulnerability that have brought them – front and centre – into mainstream political debate. Asserting itself as a stakeholder in this debate has been Iran's Oil Ministry, which has been adding its voice to calls for curbs in government spending while advocating greater attention to the demands of the oil sector for reinvestment in the industry. The Oil Ministry and its supporters will do everything in their power to prevent the government from offloading the pain of sanctions onto the shoulders of the oil industry in return for short-term political gains. They will also lend their weight to arguments for the gradual detachment of the oil industry from



government demands over the longer term. While it is certainly unrealistic to believe that Iran can cut its reliance on oil suddenly or decisively, it is nevertheless true that sanctions have helped to create an atmosphere in which both the political will and the capability for far-reaching change appear to be solidifying. In response to diminished oil revenues, Iran's leaders have adopted a new urgency in discussions concerning the role of oil in the government budget for the coming year, and beyond. As Iran enters a new phase in its adaptation to economic difficulties, it will not be sufficient for observers merely to watch proxy measures of economic hardship for signs of collapse or resilience. A better understanding of Iran under sanctions will require closer attention to the manner in which the political elite interprets and responds to sanctions, both in debate and in policymaking.

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