End of European Sanctions

A New Opportunity for Iran's Development

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** The views presented in this article are solely of the writer and do not represent the view/position of the organization that the author is employed with.*

The Geneva accord has provided a new international relations opportunity and will raise Iran's chance of becoming more firmly rooted on an appropriate development path to improve the real standard of living and welfare of ordinary Iranians. This will happen through a rise in trade volume growth - and subsequent effects on domestic GDP growth and employment generation. The quality of the outcome will, of course, depend on how the Government plans and manages for the opportunity to work through into SME development, employment generation and more optimal use of the countries natural and human resources.

There is currently a real need in Iran to improve on development processes and outcomes. The new agreements will ease sanctions and enable more international trade and financial exchange: a positive step towards the type of *inclusive growth and sustainable development* processes and outcomes that the people of Iran well deserve.

The new international agreements should generally raise trade volume, perhaps significantly, and enable Iran's economy to work and perform closer to its potential socio-economic-resource transformation possibility frontier. For this to happen appropriately, trade policy should be fully linked up with socio-economic-resource (sustainable) development policy - to ensure new opportunity is fully synchronized and utilized to benefit all. A sustainable and synergetic approach would be required.

The impact of increased total trade volume (i.e. both imports and exports) on income growth and ordinary peoples income improvements have been significantly debated by economists. For Iran, an easing of sanctions and financial exchange will prompt a larger volume of total trade which could also significantly raise GDP growth and employment generation – but also more and better investment and technology. It will help realize Iran's potential GDP and reduce the huge unemployment backlog. From an *inclusive growth*[1] *and sustainable development* perspective, however, the success of a trade enhancing GDP growth scenario would depend on meeting of certain minimum conditions, however, including: domestic challenge to SME development; need to improve enabling conditions for quality non-oil exports and quality job creation; more and better investment and technology; and an improved Government fiscal situation. Iran's domestic institutional and working context require more enabling changes, while public goods approaches to planning and regulation still remain necessary – if the trade improvement is to work through to development outcomes.

1 inclusive growth is similar to "economic growth and social justice" but also considers natural resources: it is a material economic growth which at the same time raises (decent) employment, reduces inequality and poverty, and also sustains the future generations natural resource base.

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As mentioned, possible adverse outcomes on inflation, human and natural resource sustainability and employment generation must be foreseen and mitigated from the start, otherwise it may become a lost development opportunity (like many others in the past).

The Current Trade and Income Situation: In 2012, Iran's total trade volume for both import and exports was about $195 billion (information source: Eurostat/IMF). In late 2013 it probably remains nearly the same, given last year's bad economic performance. Most of Iran's trade is currently with BRICS countries (Brazil, Russia, India, China and South Africa) – with a total value of $56 billion (or 28% of Iran's total trade value) - which also saw a huge surplus for Iran. Of these, China alone had $30 billion and India about $16 billion. The Persian Gulf Cooperation Council has a total of $35 billion (17%). Next, Japan and South Korea combined have $23 billion (or 11.6%). With the European Union, Iran is currently trading approximately $17 billion (about 9%).

Of this total figure, Iran's exports are about $105 billion: mostly oil and gas, but also about $40 billion in non-oil exports. The country's imports were $90 billion or so. Most of imports (33%) came from GCC countries. Most of exports went to China (22%). Interestingly, well over half of all imports into Iran are intermediary goods; then follow capital goods, while consumption goods imports make up a relatively smaller proportion in terms of value.

Actual GDP in 2001 was about $400 billion (at exchange rate of $1 per 12,200 Rials). This means $5,260 per capita. Potential real GDP in Iran is much more, however: the difference between potential and actual being due to significant unemployment, industrial under-capacity use and lower than possible investments, apart from any efficiency issues. In fact, one of the reasons for the current stag-flation is that national investment is much less than national savings.

The national *amayesh sarzameen* work on Iran's natural, human and capital resource availabilities, for comparative advantage information purposes, well shows this economic potential. Once all available and able resources are working, and productivity on current natural and capital resources is raised to appropriate efficiency levels, Iran's actual GDP could easily be 33% higher. Perhaps closer to $530 billion (or about $7,000 per capita). The existing opportunity loss of this difference is significant, therefore: about $1,700 per capita.

Possible Development Scenarios – Trade Effects on GDP and Employment: The difference in actual and potential GDP mentioned above is significant. As is well known, Iran's 5th Five-year Development Plan intends to achieve *economic growth and social justice* - so as to alleviate this. The expected rise in trade volume growth will also support the Plan's intent to achieve this outcome. Once improvements in international relations work through into trade, the likelihood of an increased

growth rate in international trade volume rises: the question is how much would just the rise in trade volume contribute to improvements in socio-economic development?

The following table sets out possible future scenarios, prompted by a 15% rise in trade volume annually (explained more below). GDP could then possibly rise yearly by two to three percentage points; while employment creation could be generated for up three or four hundred thousand jobs yearly. This is especially so if SME's become active in this process and start adopting improved technologies and investing more. *(Table1)*

First of all, if Iran did actually witness a yearly 15% annual growth rate in total trade volume, then the current volume of $190 billion could double to $392 billion within six years (by 2019). If so, and given current conditions, BRICS trade could more than double to well above $130 billion within six years. The EU could also gain significantly, and perhaps more than the rest: gaining more than treble in six years to over $50 billion yearly.

But how would such a rise in total material trade volume affect Iran's standard of living? Firstly, the impact of the extra $200 billion or so trade volume on Iran's GDP, over a six year period, could be probably calculated in such a manner to yield an additional (year-on-year average) of $13 billion value added on GDP per annum. That is a feasible figure. Such a double increase in trade volume may, therefore, provide up to 3% of the annual GDP growth. A significant amount. That would then potentially contribute to creation of additional 400,000 or so jobs yearly (at current estimates of GDP growth elasticities on employment growth).

One could expect also an additional annual national consumption of about $8 billion and national saving of $5 billion – from the extra yearly $13 billion generated. If all the $5 billion is invested then additional multipliers will work through creating indirect jobs and incomes – probably about $10 billion more in GDP income the following year. The GDP income multiplier of higher levels of capital inflows (of about $10 billion per annum) would itself be about $20 billion yearly. The total probable new investment effect of trade opening would, therefore, be about $30 billion in new GDP income annually.

New investments, especially in SME's, and the crucial role of new public goods projects targeted at employment creation in both SME's and less productive regions and groupings, are required to complement the trade opening if sustainability is to be ensured.

All in all, the trade opening would probably lead to about $43 billion annually on GDP: directly ($13 billion) and indirectly ($30 billion). If so, then Iran's GDP growth could rise well above the current long term average of 4% – and the improved trade conditions on their own could contribute to just under half of the job creation that Iran's yearly one million new job seekers require. The five million unemployment backlog, however, would have to be resolved through other means.

Some Domestic Challenges: For such

Table 1 - Six Year Scenario (Optimistic - Based on Annual 15% Trade Growth)

	2014	2015	2016	2017	2018	2019
Population - mill	76	77	78	79	80	81
Total Trade - $ bill	195	224	258	297	341	392
GDP - $ bill	400	408	424	450	477	505
GDP growth rate - %	2	4	6	6	6	6
GDP/cap - $ (approx)	5,260	5,300	5,440	5,700	6,000	6,250
Income Distribution - Gini	0.4	0.4	0.37	0.37	0.35	0.35
Unemployment - mill	5	4.5	4	3.5	3	2.5
Trade Contribution to GDP Growth %	-	3	3	3	3	3

Source: calculations based on conventional sustainability assumptions a scenario to succeed, however, it is crucial that employment generation, income growth, investment quality and selection (and accompanying technology choice) as well as income distribution be seen as an integrated whole and used as the basis for any trade policy.

First, for trade to affect Iran's development path, a crucial requirement is to generate employment. The heavy five million unemployment backlog is especially affecting educated youngsters: while being able to provide decent jobs for one million or so people coming yearly onto the labour market is critical. The aim of full employment of the over 30 million or so potential work force should remain a policy priority that trade must be linked to. Second, raising annual income (GDP – i.e. value added) growth is essential: from the low levels of the past few years to a more sustainable 5% (or 6%). This latter will enhance domestic production capacity to provide the extra new resources required for development – and to ultimately raise Iranians' welfare. It can be undertaken through increased quality, targeted and results based investments in both private and public sectors.

Thirdly, improving on the use of knowledge and technology in the investment process, including external and internal knowledge transferability, so as to help achieve a new reorganization of economic work practices, should be part of this. This ensemble would help raise the performance and productivity of Iran's over 30 million or so potential human capital, and improve on the innovation and information capacity of Iran's significant stock of SME's (*small and medium sized enterprises*). Getting national investment back on to a more optimal proportion with national savings, therefore, remains critical: as aggregate investment has been well below aggregate savings – leading to the kind of adverse growth dynamics we have recently witnessed and the subsequent stag-flation.

Further, trade volume increases, if to be beneficial, cannot be isolated from income distribution. A goal of the 5^{th} Plan is to reduce income inequality from the current official .40 Gini or so to about .35 Gini. This will then enable combined performance and equity in the economy, improve social responsibility and improve purchasing power for the 75 million consumers of the domestic market. It will reduce adverse and negative trade-offs in the system and enable trade and investment to work better. An appropriate equity approach will, therefore, engender a more optimal proportion between national investment and national consumption – supporting sustainability and equity.

Supporting SME Development: However, achieving an overall *inclusive growth* outcome – even one based on SME development – would require that not only Iran's GDP grow at a sustainably higher average rate than its long term average of below 4%, but that both capital and labour productivity (total productivity) also start rising above its very low base. Iran's current productivity structure is inhibiting, however. It is quite well known that well above 95% of businesses in Iran are small (and employ only up to 10 persons) while the remainder employ between 10-50 persons. Further, the private and cooperative sector together have only about 20% of GDP, while they employ about 80% of the labour force. Such overall imbalances in business size and in income-employment relations have generated adverse comparative advantage and economies of scale - affecting real wages and the ability to be productive and to export. Productivity and ability to pay good wages have remained low in Iran. They have also resulted in less than optimal proportion of resource use: especially in use of intermediate goods (which is excessive and wasteful).

To circumvent, and ensure full use of the trade opportunity, this will require a more targeted and combined trade-investment-technology policy: to enable the higher trade volume potential

Table 2 – Structure, Employment and Income Inequality – Approximate scenario figures from late 2000 period (value in 10'000 billion Rials)

	Wages (Cons)	Profit (Saving)	Value Add (GDP)	Gov (tax & subs)	Inter-med Goods	Total Output	Potential Employ million	% of Total Employ	% of Total Value Added	% of Total Wages
Industry	35	56	91	14	70	175	4	13	18	15
Extractive	21	63	84	-	56	140	1	3	17	9
Construction	28	21	49	-	21	70	2	7	10	12
Agriculture	42	14	56	-	14	70	6	20	11	18
Transport	28	28	56	-	14	70	1	3	11	12
Services	63	21	84	-	7	91	13	43	17	27
Utilities	3.5	3.5	7	3.5	3.5	14	0.5	2	1	1
Trade	7	28	35	-	-	35	2	7	7	3
Finance	7	28	35	-	-	35	0.5	2	7	3
Total	234.5	262.5	497	17.5	185.5	700	30	-	-	-
% Total Output	33.5	37.5	71	2.5	26.5	100	-	-	-	-

to work through into SME's investment, raise employment and reduce inequality. New investments, especially in SME's, and the crucial role of new public goods projects targeted at employment creation in both SME's and less productive regions and groupings, are required to complement the trade opening if sustainability is to be ensured. Further, for trade opportunities to really work, income inequality should be reduced: as many working people are low income and cannot properly become part of a virtuous economic cycle.

Although Iran has the potential capacity for working at a much higher level of international exchange in goods and services, the sustainability and equity of this is needs careful consideration.

Structure and Distribution Realities: According to official data - derived through the national survey conducted to obtain information for the *Law of Targeting Subsidies* – up to fourty percent or so of the population are living below a relative income-poverty line (i.e. a line which is two thirds of median income). The impact of this on daily lives and livelihoods is significant: forcing people to work more time in order to make ends meet; signifying low productivity and efficiency; more energy of all sorts expended when having more than two jobs (both a human capital and CO^2 producing dilemma); probable lack of savings and insufficient expenditure on human capital development requirements; etc. The subsequent pressures on the social protection system is obvious.

The input-output table2 is indicative of the distribution structure. It shows value added and intermediate use in economic sectors: and employment and income inequality possibilities. It provides a picture of the areas in which increased trade volume could show itself and policy targeting be undertaken.

Value added makes up 71% of total output value. Intermediate products make up about 26.5% of total output – and the huge yearly imports of intermediates in Iran is reflective. The relation between savings/profits is more than consumption/wages (respectively 37.5% and 33.5% of the value of total output).

The differences in the distribution of sector employment, value added and wages are also indicators for threat and opportunity in taking advantage of new trade possibilities. For example, large discrepancies exist between agriculture and services: agriculture has only 11% of the total income but 20% of the total employment; while services employs 43% of the total labour force but receives only 17% of total income. The latter is also well reflective of the low-salary position of employees. The highest savings/profits to consumption/wage proportions are in trade and finance, the lowest in agriculture and services. We also know (from yearly household income and expenditure surveys) that many Iranians are working on low incomes (possibly generally up to 35% of the people - based on two thirds of median national income measure): of which about 45% of those are involved in agriculture and construction sectors and about 40% of those are probably unskilled or skilled agricultural labourers.

Trade policy must be sensitive to these structural proportions. Especially on how they may reduce effective demand in the economy and, therefore, GDP growth potential: affecting the utilization of new trade opportunity. For example, the relationship between value added and intermediate goods use indicates the extent of efficiency in material usage. A higher proportion of value added in total output (i.e. proportionate less use of intermediates) would signify a more productive economy, of course. Further, a more sustainable (and more equitable) development path would also require that the consumption/wages proportion (of 33.5%) to increase to ensure effective demand and welfare together. All this – the sector distribution balances and the proportion of low income in the labour force – is crucial for a trade policy understanding (and for achieving 5th Plan goals). An inclusive growth oriented trade policy would aim at changing the structural proportions - to perhaps the following: value added from 71% to about 75% of total output; wages from 33.5% to about 38%. This would imply both efficiency and equity together. It would also mean a new national technology framework that is more productive and more equitable.

Trade Strategy: Given the above, and to utilize potential new trade improvement, would require that trade policy focus on: a) labour productivity increases in SME's; b) help employment generation in deprived groups/sectors/regions; c) link up with better institutional mechanisms for income distribution in both current and new business contexts and investments; d) be part of planning for new targeted investments; e) and perhaps also become integrated into the regional planning level approach undertaken in tandem with the 5th Plan directive to enable District level Governors and planning agencies to become empowered and capable for producing five year development plans.

Accompanying trade volume improvements usually are increased capital inflows, either as FDI or portfolio investment or just expatriate investments, and foreign technology transfer.

Unless such issues are dealt with directly, the extra $200 billion trade potential over the next six years will not be realized in terms of *inclusive growth and sustainable development* outcomes.

Although Iran has the potential capacity for working at a much higher level of international exchange in goods and services, the sustainability and equity of this is needs careful consideration. Clearly, more income and new employment will depend on the nature of the overall quality of new targeted investments undertaken, the institutional context and income distribution conditions. Without a targeted policy approach there can be no *inclusive growth* outcome nor sustainability nor appropriate use of the trade opportunity. To make the most of opportunity, first a public goods approach may be adopted. This provides a normative framework for trade-growth-employment goal setting and targeting. It would require targeting combined trade-investment-technology planning. Trade and investment can't be left alone to markets – otherwise it could get onto a dangerous track (as in sole *structural adjustment* processes).

The simplistic calculation made above, on the growth rate of trade volume, has many caveats and conditions. The quality of the jobs it manages to create; the type of growth pattern it produces; the extent and type of skills and industries it may destroy in the process of structural change; and modernization of techniques that it will bring with itself are all questions.

One would have to first consider trade volume impact on investment and its related knowledge-cum-technology. Accompanying trade volume improvements usually are increased capital inflows, either as FDI or portfolio investment or just expatriate investments, and foreign technology transfer. These usually significantly affect domestic human capital and its use – and especially the types of employments and skills being generated. Trade and investment can be planned together and targeted towards improving capacity of low income groupings human capital development (health, knowledge, skills that can support trade – e.g. in micro-enterprise contexts); in their regional and income groupings (in areas and low income groups that can generate export trade – e.g. deprived regions such as border areas with good trade potential); in informal and semi-formal lines of work (to raise standards of social responsibility – e.g. rugs and needle work of female workers). Such targeting can only be good for trade if planned well.

Given that well over half of Iran's imports are normally in *intermediary* goods, a value of about $50 billion in 2012, and which are used in industrial processes and re-exporting, the employment impact of more than a doubling of imports trade will be mainly in the industrial, extractive and construction sectors. Imports, therefore, would probably not leave much room for direct employment and income distribution gains. Perhaps the converse – they may destroy domestic traditional industry. However, exports will provide much room for pro-active targeting. Given that some of Iran's non-oil exports are in low value added products sourced in more labour intensive industries the employment generating aspects of a doubling of exports could go possibly towards benefiting the lower income groups.

Although such export sector targeting may be considered as the means to raise employment and improve distribution, it does not necessarily mean it is a sole "export-oriented" policy – rather a domestic SME based growth policy that develops skills that can also be used for exports.

The Government itself has adopted the principle of economic growth and social justice in the 5th Plan. Apart from harder work and effort, and better quality investments, the new trade opportunity will hopefully be utilized to support this process. Price based *structural adjustment* approaches to improving trade and growth have been on the policy table in Iran for well over two decades now. However, from experience, it would seem that an *inclusive growth and sustainable development* strategy – based on targeted investments and capacity development - would be more sustainable in Iran's current socio-economic circumstances. Such new trade strategy will not only help reduce so-called rent seeking and quasi-rent activity in the economic system, but will ensure sustainability and equity. ■

Iran urges Saudi cooperation to enhance security

Foreign Minister Zarif Conducts Four-Nation Arab Tour

Iran's Foreign Minister Mohammad Javad Zarif has called for cooperation between Iran and Saudi Arabia to improve regional security.

Describing Iran and Saudi Arabia as "two great countries in the region," Zarif emphasized that through Tehran-Riyadh cooperation, "We can further guarantee the security and stability of the region."

"We hope that the misunderstandings that have existed will clear and we expand our ties with Saudi Arabia in a good fashion," Zarif added.

The top Iranian diplomat was speaking to reporters (Dec. 2) in Tehran following his return from state visits to Oman, Kuwait and Qatar.

Zarif pointed to the August visit to Iran by Oman's Sultan Qaboos bin Said and added that Iran now expects state visits to Tehran by the emirs of Qatar and Kuwait.

Describing strong ties with regional states as Tehran's foreign policy priority, the Iranian foreign minister added, "My interpretation is that these countries as a whole are very much interested in opening a new chapter in their ties with Iran, which we hope will benefit peace and stability as well as the progress of the people of the region."

Zarif further underlined that he had reached consensus with the officials of Kuwait, Oman and Qatar that "regular political consultations in all areas, bilateral visits and organized talks" should continue between Iran and the said countries even on areas of disagreement such as the crisis in Syria.

"We believe such conflicts of viewpoint should not adversely affect the good neighborly ties of the countries, since we regard southern Persian Gulf and regional countries as especially significant; and this region's security is tied to the welfare and economic progress of its people and nations," said the Iranian foreign minister.

Shortly after his return to Tehran, Zarif stretched his Persian Gulf tour to include the UAE where he met and exchanged views with the Emirati leaders on key regional issues and bilateral ties.