



Recent Developments in the Iranian Economy

- **Administrative Restructuring.** Last October, in a surprise and hasty move, President Ahmadinejad accepted the resignation of his deputy at the Plan and Management Organization, the country's development think tank. This had followed an order by the President which removed the authority over the provincial PMO from the national PMO and placed it under the authority of the provincial Governors. Some in his administration and the legal opposition argued that the change was unconstitutional and inappropriate. Ahmadinejad has sought to decentralize the agency, making it more responsible to local governorates. But the change also permits the President, through the Ministry of Interior, to better control the distribution of local spending. He has also set aside personnel inherited from the previous administration in the foreign ministry and the oil ministry. At the same time as the restructuring occurred, two deputy oil ministers resigned.
- **2006 Population Census.** Iran, a country of roughly 70 million people, is currently in the process of collecting figures for its nationwide census, which occurs every ten years. The last census took place in 1996. President Mahmoud Ahmadinejad, who has distanced himself from his predecessors' "two-children policy," has argued that the Iranian economy could sustain a population of 120 million, and that future censuses should take place every five years to account for the country's rapid growth and development.
- **A New Privatization Scheme.** Following a decree by the Leader Ayatollah Ali Khamanei, Mr. Ahmadinejad has also embarked upon a scheme to privatize many large but non-strategic state-owned firms and offer heavily discounted shares to the poor, which he has called "the share of justice." The President is initiating the scheme in an effort to promote small private investments, encourage the development of the private sector, and spread Iran's wealth more fairly. Ahmadinejad condemns his predecessors' attempts at privatization as sluggish and unfair, saying that less than \$3.3 billion was privatized in the last 15 years. It is believed that the Leader has ordered further privatization to prepare Iran for possible membership in the World Trade Organization.
- **A New SIM Card Mobile Network.** As part of these efforts to spur private sector growth, Iran has launched a new mobile phone network, with SIM cards provided by the country's first private operator, Irancell. The new company, in joint venture with South African Mobile Telephones Network, will offer Iranian customers 2.3 cell phones with SIM cards by March 2007 at half the price (\$163) of the country's current network operator, which is state-owned. This is the second mobile network in the country. Prospect for even more business in this area is most lucrative.
- **Developments in Oil and Gas Sector.** Iran's economy is still primarily dependent upon oil and gas, which accounts for over 85% of its export earnings. As the world's fourth



largest oil producer, it can sustain the production of 4.2 million barrels per day (bpd), but its actual output is closer to 3.875 bpd. Together with Iraq, it controls nearly 20% of the global oil reserves (Iran's share is about 9%), and is home to some of the world's biggest undeveloped fields. Its gas reserves, second only to the Russia, remains largely undeveloped.

Iran's income from exports of crude oil and petroleum byproducts topped \$36 billion in the first eight months of its calendar year (which begins in March 21), marking an increase of 15 percent. Due to high oil prices, Iran's foreign currency reserves held in foreign banks have risen to about \$60 billion. At the same time, Iran's foreign debt and obligations has risen to \$90 billion dollars. The country's Fourth Development Plan (March 2005-March 2010) allows the Government to make commitment for another \$30 billion for the oil projects (\$10 billion as finance, \$7 billion as technical and engineering services, and \$13 billion as foreign investment).

Despite the enormous amount of money earned through the high oil prices, Mr. Ahmadinejad has asked parliament for a supplementary budget as his Government is expected to run out of money in the last three months of the current year. Surprisingly, the Iranian Government has also withdrawn \$12.2 billion from its strategic Oil Stabilization Fund, which serves as a buffer to protect the economy in case of price fluctuations in the cost of oil. Ahmadinejad has come under increasing criticism for his spending habits, which includes distributing un-budgeted cash to provinces where he travels.

The price of oil is unlikely to decrease any time soon. OPEC has moved to cut an additional 500,000 bpd following a 10-week, 25 per cent price slump, on top of an earlier output cut of 1.2 million bpd. This slump has been attributed to an excess of 100 million barrels. By mid-December, these cuts had succeeded in eliminating half of the excess oil on the market. As a result, OPEC recently agreed to delay the 500,000 bpd cut until February 1st, following the end of winter in the northern hemisphere. Import-dependent countries fear that the cost of oil could rise due to refining constraints and questions over the stability of the supply from countries such as Iraq, Nigeria, Iran, and Russia. The cost of oil has fallen from a mid-July peak of \$78.40 but is still three times the price at the start of 2002. Analysts attribute the rise in the price of oil to increasing Asian demand.

Iran's share of the OPEC cut is 176,000 bpd, to a quota of 4.11 million bpd. In October, Iran informed its customers that it would be cutting supply from November onwards. OPEC will next meet to discuss lowering its production ceiling in Abuja, Nigeria. In an unrelated development, Iran also had to reduce its gas exports to Turkey this January (2007), despite its contact with that country.



The reason given is gas shortage in Iran during a very cold winter. The Government has been forced to cut gas delivery to many cities, causing serious problems for many provinces which depend on gas heat.

In another shocking development, it was officially reported that despite its high level of production, Iran may cease to be an energy exporter within the next two decades if it fails to resolve its energy problems. The claim was made by Alireza Attar, the Iranian Deputy Foreign Minister for Economic Affairs, who recently spoke at a panel during the two-day World Economic Forum in Istanbul. Iran cites its growing energy needs as a reason for its controversial nuclear program, and it plans to build 20 nuclear power plants to generate 20,000 megawatts of nuclear energy capacity. The future of this vision is very much in doubt given the current state of crisis over Iran's nuclear enrichment programs.

- **Cultivating New Economic Partners.** In recent years, Iran has embarked upon an aggressive program to cultivate economic partners both in the region and beyond. In December 2006, Iran sent a trade delegation to the Sultanate of Oman as part of a new Omani-Iranian Business Council, which was originally established by a joint agreement between the two countries in June of 2004. The Council moved to abolish customs tariffs between the Musandam Governorate of Oman and the southern Iranian province of Hormozgan. It also jointly established a marine shipping company, in an effort to promote trade exchanges between the two countries and increase exports of Iranian and Omani commodities.

Iran's attempts to cultivate closer ties with its Persian Gulf neighbors have not gone unnoticed by the United States. Recently, it warned the United Arab Emirates against the sale of technology to Iran, suggesting that the Emirates are selling military equipment to Iran that is being used to construct Improvised Explosive Devices (IEDs) for use against American soldiers in Iraq. Dubai is currently Iran's largest trading partner, with over \$10 billion in annual trade. Given that Dubai has very little of its own to sell, an absolute amount of this trade is re-export, primarily originating from the United States, Canada and Europe.

Iran has not limited its overtures to the Persian Gulf region. As part of a new initiative, it has sought \$30 billion from foreign countries to develop its oil resources, principally from China, Japan, and Russia. According to Iran's PetroEnergy Information Network, the country is currently in negotiations to give Sinopec Group, China Petrochemical Corporation, a \$100 billion contract to develop its Yadavaran oil field and secure the rights to oil and gas supplies for a 25 year period. The deal would give China a controlling 51% stake in the oil field and the right to buy 150,000 bpd of Iranian crude oil and 250 million tons of liquefied natural gas (LNG) per year.



Royal Dutch Shell, which has served as a consultant to Sinopec for this deal, is itself seeking a 20% share in the field's development. The field will likely produce 300,000 bpd, which is equivalent to China's current daily imports from Iran. The Chinese National Petroleum Corporation is also seeking to develop the newly discovered natural gas field near the island of Kish in the Persian Gulf, which is said to hold a reserve of more than 30 trillion cubic feet of natural gas. Iran expects the gas project to pump 50 million cubic meters of gas a day once it is developed. Iran holds 15 percent of the world's natural gas reserves but it has been slow to develop these reserves for export.

China is willing to assume incredible risks to meet its growing energy need. Iran, for its part, needs substantial foreign investment in order to keep its aging oil extraction infrastructure operational – investment that has not been forthcoming from the major consumers of oil in Europe and the United States. Yet, China's growing relationship with Iran did not dissuade it from backing the sanctions against the Islamic Republic at the Security Council of the United Nations. Given that Tehran has little alternative, this Chinese act may not adversely affect its relationship with the Iranian government. Thus far, however, the Sinopec Group deal has not been concluded, although China has signed a smaller deal to purchase three million tons of LNG per year for the next 25 years.

Japan is also seeking a business relationship with Iran. Japan is almost entirely dependent upon the Middle East for its oil, and imports about 15% of its total oil consumption from Iran. In 2004, it signed a two billion dollar development deal with Iran, giving it a 75% stake in the development of Iran's Azadegan oil field. In October, it announced that it would only be seeking a 10% share of the oil field, a move that was motivated by concern over the prospect of sanctions against Iran, according to some critics, which would endanger its investments. Previously Japan had been pressured by the United States to completely abandon the deal, but it defied this pressure.