# Iran: open for business

By James King | Published: 01 September, 2015 | Comment on this article



**The historic deal to end sanctions imposed by various Western powers upon Iran still has hurdles to clear, but already would-be investors are eyeing the country's rich potential.**

The historic nuclear accord reached between Iran and six international powers, the so-called P5+1 (China, France, Russia, the UK and the US, plus Germany), has been variously described as the world's greatest investment opportunity, its gravest security threat and its most profound political achievement in years. Perspective matters here. Yet, underlining all of these assumptions is an understanding that the signing of the Joint Comprehensive Plan of Action (JCPOA), the official name of the accord, on July 14, has the potential to reshape not only the regional order but that of the world.

Fittingly for an arrangement of this magnitude, the global response – both positive and negative – has been visceral. Nervous rulers across the Persian Gulf are looking on with suspicion as trade delegations from continental Europe and Asia beat an excited path to the presidential palace in Tehran. Meanwhile, the US congress remains typically divided, largely drawn along party lines.

**A broad welcome**

Similarly, the reaction inside Iran, though broadly jubilant, has not been lacking in nuance. Enterprises that have found success by carving out a niche in a sanctions-scarred economy are now facing the daunting longer term prospect of international competition. Yet, for Iran's financial institutions, an agreement could not have come sooner.

"The agreement was inevitable because it was righteous; it was necessary; it was good for both parties and the international community as a whole; and it creates a win-win situation," says Mostafa Beheshti Rouy, director of the international department for Bank Pasargad, Iran's largest lender by both Tier 1 capital and assets.

"The Bank Mellat case has changed the European sanctions landscape. Sanctions in the future will be much more targeted and much more precise in their application – Sarosh Zaiwalla"

"The financial services sector in Iran would certainly welcome returning to 'normal' conditions. The past eight years have been particularly tough for the Iranian banking sector. Once again, we should be able to establish our correspondent banking relations and provide the business community with a wide array of banking services," he adds.

**Mutual benefits**

Reaching this agreement after years of mutual suspicions and provocations required the right set of political and economic conditions to be in place, all the way from Tehran to Washington, DC. "Both the US and Iran needed something out of these negotiations because their alternatives were either conflict or containment," says Tyler Cullis, legal fellow with the National Iranian American Council.

"The US is broadly pleased with the agreement. It gets what it needs for the next decade in terms of blocking Iran's pathway to a nuclear weapon. For the Iranians, the deal provides a lot of sanctions relief. In the end, both parties got what they needed, if not necessarily what they wanted," he adds.

Regional political considerations also played a role on the Iranian side. Tehran's long-time tussle with Saudi Arabia and to a lesser extent Turkey, over regional leadership has long had the effect of shaping domestic policy. "Iran wants to be the number one power in the Middle East. The approach taken in the Mahmoud Ahmadinejad presidency years was one of strategic distance to the US in order to mobilise popular sentiment and emerge as a soft power in the region," says Bijan Khajehpour, managing partner with Atieh International, a strategic management consultancy.

"The new government [of Hassan Rouhani] changed the rationale. It realised that if Iran is to become the pre-eminent power it has to become a strong knowledge-based, technological power. The only way this could be achieved was by ending sanctions and improving relations with the West," says Mr Khajehpour.

**Hurdles to clear**

While an agreement has been reached, a number of hurdles to its implementation remain. In particular, a vote in the US Congress, which is expected to take place in mid-September, is likely to see the Republican-dominated legislature align against the agreement. Such an outcome can be vetoed by the president, however, and overturning this veto will require a two-thirds majority from both chambers of Congress. This is a feat that would require the support of an unlikely number of Democrats.

Moreover, Iran is still subject to various technical inspections from the UN International Atomic Energy Agency which is expected to deliver its verdict on the country's compliance in mid-December. Accordingly, the process of lifting sanctions is not likely to be executed until early next year.

Despite these challenges, optimism over the deal's conclusion remains high. "We continue to believe that the Iran deal is *fait accompli* regardless of whether Congress approves it. It requires a veto proof majority, which it is unlikely to get," says Mohammad Darwazah, senior Middle East and Africa analyst with Medley Global Advisors, a New York macro policy intelligence provider.

**Investment enthusiasm**

Though the sanctions regime is still technically in place, it is quickly fraying at the seams. In recent months, trade delegations led by senior government ministers from Germany, Italy, France and Serbia have all arrived in Iran to gain early leverage in the race to develop commercial ties. Meanwhile, the Austrian president, Heinz Fischer, is expected to be the first Western head of state to visit the country later in the year.

Efforts on the part of continental European countries have been matched by their Asian counterparts. A Chinese trade delegation visited Iran's southern port city of Bandar Abbas in July, a visit that was followed by a high-level Japanese delegation to the country in August.

"Over the past three months, numerous trade and business delegations have travelled to Iran from Europe and Asia. Both the international and domestic business communities are preparing themselves for the lifting of sanctions. The Iranian consumer market is close to 80 million people, while our abundant natural resources and exceptional geo-political location collectively make for a compelling investment case," says Mr Beheshti Rouy.

**Winners and losers**

These events highlight a key difference between the EU and US. As a result of the JCPOA, the EU is expected to return to being Iran's number one trade partner. Though the full process of sanctions relief will occur over a number of years, most of the commercial- and business-related prohibitions for European entities could potentially be removed quickly. From the US side, the agreement will for the most part apply to sanctions covering nuclear-related activities. As such, Washington's trade embargo will remain in place.

This means that big winners and losers are already emerging from the sanctions agreement. Of the losers, the US corporate community is the largest. Despite some loosening of restrictions on the civil aviation sector, few individuals or entities will be able to deal with Iran on a commercial basis. In fact, the distinction between the outlook for Europe and the US is so evident that certain provisions were apparently introduced to the final agreement to ease the process of European investments into Iran.

"There is a provision in the agreement that permits foreign subsidiaries of US companies to engage with Iran. My suspicion is that this was a demand from the European side, since they probably had concerns over the potential of a US private equity firm, for example, having large-scale passive investments in an EU company, thereby transforming the EU company into a US-owned or US-controlled entity for purposes of US law," says Mr Cullis.

Nevertheless, the scramble for Iran has already begun. The country's vast market potential is well known; it holds the world's second largest reserves of natural gas and its fourth largest reserves of crude oil. Moreover, it has developed extensive automobile, petrochemical, pharmaceutical and shipping sectors, among others, which are ripe for investment. Iran's young and well-educated population is an additional investment draw.

As such, the coming years are expected to shape the regional and global economic order significantly. "One of the main impacts of the deal will be on world oil prices. We anticipate that it will take about nine to 12 months for Iran to begin exporting an additional 1 million barrels of oil per day. Our conclusion is that this will bring down the price of oil by about 14%, or $10 per barrel. The implications of this are clear; it will hit other global exporters," says Shanta Devarajan, the World Bank's chief economist for the Middle East and north Africa region.

**Opportunities abound**

For obvious reasons, Iran's hydrocarbons sector is seen as the country's biggest investment opportunity. And while years of joint EU-US sanctions have left most of the big Western oil firms out of the loop, their Asian counterparts have been quick to fill the void. Despite this situation seemingly placing the traditional oil majors at a disadvantage, there remains some scope for optimism.

"If you look at the longer term investments required in the advanced sectors of Iran's economy, the government is much more selective about who it will do business with. In the past few years, where Western companies have been absent, the Chinese, Indians and Russians tried to fill the gap. Some of them, especially the Chinese, undermined their long-term interests providing lower quality products to Iran at high prices because they thought they had no Western competition," says Mr Khajehpour.

This perspective has been backed up by ongoing discussion among Iran and major Western oil firms. According to Mr Darwazah of Medley Global Advisors, the most concrete negotiations to date have occurred between the government of Iran and Shell, Eni and Total.

**Financial gain**

Beyond Iran's dominant industries, it is the country's financial sector which has the most to gain from the agreement. Under the sanctions regime, Iranian banks have been frozen out of the global financial system. This environment, coupled with serious mismanagement, particularly during the years of the Ahmadinejad administration, has undermined the entire sector. According to data from Atieh International, total government debt owed to the country's banks stood at $250bn by the time Mr Ahmadinejad left office. While the new administration has settled some of these debts, a large figure remains outstanding.

As such, the deal presents Iranian lenders with an opportunity to resume a number of profit-generating activities that they were previously denied. "We expect to resume what we can call 'a normal banking practice' allowing us to offer traditional banking products and services to our clients. The main change will come in the form of trade finance activities. We shall witness a sharp rise in the volume of issued letters of credit and letters of guarantee, among others. We expect the volume of foreign exchange transactions to also significantly rise," says Mr Beheshti Rouy.

The development of Iran's financial services sector also has significant implications for foreign lenders. In recent weeks, the Iranian government made the surprise move to approve the existence of 100% foreign-owned banking subsidiaries in the country. "This is because [the government] knows that outside financing will be required," says Mr Khajehpour.

Moving forward, the expectation is for second- and third-tier European lenders to make the first moves to build stronger ties with Iran. "European financial institutions will find a way to provide banking and trade finance services to major institutional clients who are interested in returning to Iran, but even this will take some time," says Mr Cullis.

**Court battles**

The nexus between Iran's banking sector and international sanctions has also hit the headlines more recently following the success of Bank Mellat, one of the country's leading private lenders, pursuing the UK government for sanctions-related damages. In May this year, the UK's High Court ruled that Bank Mellat's $4bn damages trial should proceed after rejecting the government's attempt to delay the hearing. In effect, the UK courts have agreed that the application of sanctions on the lender was unlawful, citing lack of evidence of the banks' links to proscribed activities.

"The Bank Mellat case has changed the European sanctions landscape. Sanctions in the future will be much more targeted and much more precise in their application. The days of blanket sanctions are over. The imposing state has to be careful to ensure that it has evidence that will stand up in court otherwise it risks paying damages that will come out of the pocket of the taxpayers," says Sarosh Zaiwalla of Zaiwalla & Co, Bank Mellat's representatives.

This case and others have attracted the ire of US enforcement authorities. "The US has blocked the property of Iranian banks. There's no effective way to challenge that under American law. That's why it is frustrating to the US government that Iranian banks have, at times, successfully challenged European sanctions. The US government has spent a lot of time in Europe trying to change this situation," says Mr Cullis.

**Unfreezing assets**

Looking ahead, attention is quickly shifting to the prospects for Iran's sizeable chunk of 'frozen' assets located predominantly in China and India. In China, these assets are mostly held in the Bank of Kunlun, a unit of China's state-owned National Petroleum Corp. Established to handle all oil transactions related to Iran, it is the only Chinese lender to be cut off from the US financial system.

Estimates of the value of these assets vary widely, from as low as $30bn to as high as $150bn. Whatever the true figure, these funds have not technically been frozen and are available for two purposes: bilateral trade with the host country and humanitarian transactions, globally.

Nevertheless, a lack of advanced tradable goods, particularly from China, has left most of this money untouched. Instead, the Iranian government has reportedly been obligating these funds to other parties, as well as China. "Iran has been acting like it has access to these assets, so a lot of this money is obligated. For example, about $20bn is owed to China alone as payment for development projects. On this basis, I don't expect a flush of money to be returning to Iran," says Mr Cullis.

As the slow process of sanctions unravelling occurs, the prospects for Iran's economic growth appear undoubtedly brighter. The World Bank estimates that foreign direct investment will pick up by up to $3bn to $3.5bn per year within a couple of years. The knock-on effect in terms of gross domestic product growth is expected to be significant. While it appears that Iran has overcome the sanctions challenge, its next test will be the effective management of this impending windfall.

"We expect gross domestic product growth to reach 5% or 6% in the next couple of years. This will be a major windfall for the Iranian economy because it has been in such a poor state for the past several years. What is going to be critical is that the Iranian government manages this windfall properly so that growth can be sustained," says Mr Devarajan.

Print Share Comment
Email

## More stories from this section

Cyber attack: Is your bank safe? Comment on this article

Emerging markets look to SWFs for stability Comment on this article

NPL woes continue for European lenders Comment on this article

View from Iran: how the country's economy came to crisis Comment on this article

The ties that bind commodities players Comment on this article

Sanctions leave Iran's banks short on partners and profits Comment on this article