DOI: 10.31857/S086919080007061-4

IRAN'S FOREIGN ECONOMIC RELATIONS IN THE REGION

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Abstract: *The article surveys the statute and key drivers behind Iran's foreign economic activity with the region's countries: Middle and Near East, Central Asia, the Caucasus, South and Southeast Asia. The authors provide an analysis of the dynamics and structure of Iran's foreign trading activity with the key counterparties based on the statistical data of international and national organizations. The article's key focus is the current status and the outlook for Iran's economic relationship with Eurasian countries via the bilateral relations and its membership in regional organizations. The authors assess the impact of new US sanctions introduced by the D. Trump administration against Iran on the Iran's foreign economic policy. The underlying trends of Iran's oil export, the country's largest source of hard currency income and reserves, as well as triggers affecting the supply of Iranian crude oil to the global markets are reviewed in the article. Over a few years, due to constant strengthening western sanctions regime against Iran's nuclear program, China has turned into a largest importer of Iranian oil and Iranian non-oil exports, accounting for over 26% in Iran's foreign trade nowadays. The issues Iran has faced in the light of a new round of US sanctions of May 2018 may possibly affect both the positions of countries-importers of Iranian oil and overall the investment potential of the large Iranian market. The authors undertake an attempt to evaluate the influence of new US sanctions on Iran's investment cash flows. Authors further suggest that the financial vehicle to support the trade with Iran, initiated by Europe in order to fulfill the signed in Vienna in 2015 Joint Comprehensive Plan of Action (JCPOA), might be ineffective. The authors highlight the reactivated sanctions trigger the revival of Asia's economic relationships with Iran which may create upside risks for tension increase in the region.*

Keywords: Iran, foreign trade, sanctions, exports, oil, imports, investments.

For citation: Mamedova N. M., Obukhova A. N. Iran's Foreign Economic Relations in the Region. *Vostok (Oriens)*. 2019. No. 5. Pp. 106–113. DOI: 10.31857/S086919080007061-4

Islamic Republic of Iran's foreign economic activity evolution is affected to a large extent by changes in domestic political climate, political relations' momentum with other countries, the shifts in global policy and macroeconomy. The sanctions regime has proved to be one of the key drivers affecting Iran's foreign trade turnaround (or lack of it) in the Eurasian space. Sanctions' sequences have mostly affected the vital export commodity of Iran – the oil sales abroad.

OIL EXPORTS AND U.S. 'OIL SANCTIONS'

Twenty years ago, in 1997/98, the Western Europe contributed more than half of the Iranian oil exports, while the combined share of Asian oil importers (except for CIS countries) picked up to 46%. At the time, US energy sanctions of 1997 were yet to be fully in place. The share of European countries dropped to nearly 34% on the Asian countries' share expansion to almost 51% already by 2000 notwithstanding a new line named 'others' in the Iranian export oil statistics accounting for Turkey as part of Eurasian countries. Starting from 2017 European companies resumed oil purchases and their share recovered to about 40% in 2017/18 while the share of Asian countries grew to 60%. China, India, South Korea, Japan and Turkey have remained key Iranian oil importers nowadays. Owing to sanctions resumed by the United States in May 2018, many European and Asian companies in Europe and Asia again had to face a dilemma: Iranian oil imports or sanction-avoidance maneuvers. Furthermore, in August 2018, the United States banned the sale of US dollars cash to Iran, gold and other precious metals trade, transactions with Iranian rials, etc. The most sensitive ban for Iran proved to be the one on the purchase of Iranian oil, the main source of country's hard currency income. In November 2018, the US gave out exemptions from sanctions to eight jurisdictions (Greece, Italy, China, Taiwan, Turkey, South Korea, India and Japan) that agreed to greatly reduce amounts of Iranian oil imports within the next six months, while the two European countries were to cut Iranian crude purchases to zero over the next few weeks. Shortly thereafter, the Turkish *Tupras* announced the oil purchase reduction for its refinery, although it is unclear so far how large the reduction would be. India is among the eight countries that were allowed to continue Iranian oil importing, but import volumes are already declining. Back in 2012–2015, during the previous round of US sanctions, India continued to buy oil in Iran, though significantly reduced the volumes. There is much to depend on the EU's efforts to establish the compensation mechanisms for the entities hit by sanctions, similarly on the payment instruments the countries may prefer to use. Early in November 2018, India signed a MoU with Iran, according to which Indian rupee payments would be accepted for Iranian oil (instead of US dollars), while Indian refineries would transfer funds for oil to the account of the *National Iranian Oil Company* (*NIOC*) via one of the largest Indian banks – *UCO Bank*. The Iranian side would use half of these proceeds as payments for the Indian export goods. Over the past two years Iran has become one of the main fuel suppliers for India thus the Indian government was one of the most active (among other states) standing up for the temporary release of anti-Iranian sanctions. China will surely remain the largest buyer of Iranian oil and gas condensate. Until September 2018, China imported more than 600 thousand barrels per day on average while the US permitted China to purchase from Iran just up to 360 thousand barrels per day. These limitations are not applicable for the joint Iranian-Chinese projects in Iran, where Chinese companies have a share of their own production. Following the resumed sanctions, the *Total* ended its participation at South Pars, and the Chinese *CNPC* replaced the French giant as an operator of Phase 11. (The contract had already presumed the exit option: in case the *Total* leaves, the *CNPC* would take it over.) Japan and South Korea reduced their purchases of liquid condensate as well.

Early in May, the United States did not extend the permit allowing 8 countries to buy Iranian oil in set volumes. Shipments of the pre-paid oil continue, and the probability for Iranian oil exporting to the Asian market going forward exists, although, for instance, in May 2019, China claimed the suspension of imports of Iranian oil.

Furthermore, on May 8, 2019, the US president approved sanctions on imports of metals from Iran drawn against both Iranian metal plants and importers of Iranian metals from countries of the region and Europe, which assets the US Treasury freezes. For Iran, this step is particularly sensitive, given that metal's products share in country's non-oil exports rose to healthy 9–10% [*Iran Statistical Yearbook*, 2016–2017 (1395), p. 458]. Consequently, last year, the Iran-EU trade turnover shrank 66% YoY.

IRAN'S FOREIGN TRADE GEOGRAPHICAL STRUCTURE

In 2018 the share of EU countries dropped to 17.7% in the Iranian foreign trade structure in favour of Eurasian countries, while thanks to the new US sanctions, the UAE importance for Iranian imports again has scaled. European statistics for the geographical structure of Iran's foreign trade for 2018 as provided in the table below reveals the emerging downward trend in Iranian export (the bulk of which is oil). The *Table 1* indicates that in 2018 the Asian countries were the main Iran's foreign trade partners.

Table 1. Iran's top trading partners: total external trade in goods, 2018

#	Country	Share, %
1	China	26.4
2	European Union (28 countries)	17.7
3	India	14.2
4	UAE	9.4
5	Turkey	7.6
6	South Korea	5.2
7	Japan	3.3
8	Switzerland	1.7
9	Afghanistan	1.6
10	Singapore	1.4

Source: European Commission. European Union, Trade in goods with Iran, 03-06-2019, p. 8.

The Table 1 shows that in 2018 the Asian countries were the main Iran's foreign trade partners.

Table 2. Iran's exports by country group, 2015/16–2016/17, $mn

	2015/16	2016/17	Change YoY, %
Organisation of Islamic Cooperation – OIC	22860	21333	-7.0
Economic Cooperation Organization – ECO	7982	10447	31.0
Cooperation Council for the Arab States of the Gulf – GCC	8265	7484	-9.0
Association of Southeast Asian Nations – ASEAN	1434	2111	47.0
Commonwealth of Independent States – CIS	1986	1989	-
European Union – EU	**1589**	**1496**	**-6.0**

Source: [Galischeva, Mamedova, Masumova, p. 71].

Eurasian countries are key Iran's trading partners. China is the largest buyer of both Iranian oil and other non-oil Iranian goods. As per table above, China's weight in Iran's total trade turnover exceeded 20% in 2018. The table below provides data on top-15 Iranian non-oil countries-exporters with a combined share totaling 88%. Country-wise, Iran's non-oil exports structure remains heavily skewed towards the Middle East and Asia (Italy's share is less than 1%) as presented in *Table 3.*

Table 3. Iran's non-oil export partners, 2018, $mn

Country	Export, $mn	Weight in Iranian non-oil export, %	Country's ranking in Iran's export
China	9665	19.1	1
Iraq	9110	18.0	2
Syria	7170	14.1	3
Turkey	5868	11.6	4
Afghanistan	3266	6.4	5
India	2360	4.7	6
South Korea	2117	4.2	7

Country	Export, $mn	Weight in Iranian non-oil export, %	Country's ranking in Iran's export
Pakistan	1275	2.5	8
Indonesia	833	1.6	9
Thailand	798	1.6	10

Source: Trade Promotion Organization of Iran. Iran's Trade Statistics in Brief (2018), p. 3.

The shipments growth to Syria draws a special attention given its share gain in Iranian non-oil export. The later might be further attributed either to the supply of extra food and military equipment, or to the launch of the construction of a power plant by Iran with an estimated investment value of $460 mn. [UPDATE 2-Iran reaches 400 mn euro deal with Syria to build a power plant, 02.10.2018]. (Tehran and Damascus agreed to establish an investment bank and a joint chamber of commerce). [Iran, Syria to set up joint bank in Damascus, 30.01.2019].

China remains Iran's largest oil customer. The other key export destinations of Iran include the United Arab Emirates, South Korea, Turkey, Germany and India. In order to lower the impact from US sanctions, Turkey and Iran, concluded an agreement to pay the bilateral trade transactions in national currencies through the Turkish bank Ziraat and the Iranian bank Melli [Bank Melli Iran provides Special Facilities for trading groups, 16.05.2018]. As a result from the reset sanctions, two-thirds of Iran's imports went through the UAE, out of which most of it contained goods of European and US origin. The top-10 Iran's import partners' combined share approached nearly 80% as shown in *Table 4.*

Table 4. Iran's top import partners, 2016/17–2017/18

#	Country	Import, $mn	Share in total import, 2017/18, %	Share in total import, 2016/17, %
1	China	13 216	24.3	23.0
2	UAE	10 067	18.5	57.0
3	South Korea	3 717	6.8	7.0
4	Turkey	3 193	5.9	13.0
5	Germany	3 083	5.7	22.0
6	India	2 255	4.2	15.0
7	Switzerland	2 158	4.0	82.0
8	France	1 766	3.3	85.0
9	Netherlands	1 439	2.7	82.0
10	Italy	1 428	2.6	16.0

Source: Trade Promotion Organization of Iran. Iran's Trade Statistics in Brief (2018), p. 5.

The Emirates account for a significant share in Iranian imports. Being a major transit country in the Middle East for Western companies, the UAE will further benefit from the recently imposed sanctions against Iran (as it was prior 2015). Data on Iran's imports destinations by groups of countries released for 2016/17 and 2017/18 are presented in *Table 5* below.

Table 5. Iran's imports' structure by groups of countries, 2016/17–2017/18, $mn

Name	2016/17	2017/18	Growth, YoY, %
Organization of Islamic Cooperation – OIC	7 122	11 094	156.0

Economic Cooperation Organization – ECO	3 514	3 917	111.0
Cooperation Council for the Arab States of the Gulf – GCC	5 830	8 017	138.0
Association of Southeast Asian Nations – ASEAN	1 557	2 041	131.0
Commonwealth of Independent States – CIS	2662	1 055	-60.0
European Union – EU	8 289	10 999	133.0

Source: [Galischeva, Mamedova, Masumova, 2019, p. 76].

The decline in trade turnover has been evident solely in regard to the CIS countries, that was largely resulted from the drop in trade volumes with Kazakhstan and Russia. The key underlying drivers were the low prices for the metal imported from Kazakhstan and Russia, and grain imports reduction by Iran from these countries. This cut is unlikely to be sustainable: it is a way more profitable for Iran to import wheat than to spend funds on irrigation in dry years, while the frequency of droughts increased. The economic relationship between CIS countries and Iran might be adversely impacted going forward due to the US sanctions tightening furthermore against Iran. The loosening economic ties (because of US sanctions imposed on Iran) became evident in Uzbekistan, where more than 100 Iranian companies operate in the following key fields of economic cooperation: transport, textile, agricultural and petroleum industries. Uzbekistan has a great potential as an economic partner for Iran and after the signing of the JCPOA and the international sanctions lift in January 2016, Iranian-Uzbek relations got a new momentum. In June 2017, Uzbekistan and Iran have agreed to jointly work on investment climate improvement. Nonetheless, the work on the financial contracts and investments "road map" is put on hold with Uzbekistan being in a sit-and-wait mode resulting from the new American sanctions.

Back in 2013 despite the international sanctions, 1500 Iranian companies were present in Georgia, i.e. the government did not prevent the Iranian business from operating in the Georgian market that time. Thereafter Georgia had started experiencing pressure, and most of the Iranian companies in Georgia were shut down.

Late September 2017, Kazakhstan signed a memorandum with Iranian *Ardabil Petrochemical Co*. worth $205 mn. A cancer center and a refinery plant are planned to be constructed for which the equipment and technology will be needed. Drop in the investment activity (due to new round of sanctions) hampers trade development. By 2016, the government of Hassan Rouhani achieved signing agreements on mutual protection of investments with 7 countries (Russia, Japan, Singapore, Iraq, Slovakia, Luxembourg); the agreements were ready for signing off with other countries [Iran's Trade with Turkey Tops $10 Billion, 02.03.2018]. Investment projects had been supposed to target the traditional energy sector, services and tourism development; the largest ones were related to the water management, electricity, railways. Primarily the projects had assumed participation of Russian and Chinese companies, with western companies' involvement thereafter, while foreign investments would build a momentum for the multilateral trade's turnaround.

WHO RUNS THE FOREIGN TRADE BUSINESSES?

Importantly, that Iranian large enterprises (both oil and non-oil ones) account for 90% of the country's export, although the contribution of small and medium-sized companies (SMEs) recently has started to climb gradually. According to 1H19 data, Iranian oil exports reached $19 bn, whereas Iranian SMEs export totaled $7 bn, including $3 bn worth goods produced by SMEs themselves. 36 Iranian SMEs attracted over $2.3 bn worth FDI in 2017/18, mainly the enterprises working with Eurasia. In November 2018, the Iranian trading house was launched in Kyrgyzstan with 100 Iranian (mainly small) companies being invited. Trading transactions with Iraq (that includes Iraqi Kurdistan) and Syria, are performed by SME, to a large extent, that are very proactive as rely not solely on Iran's state support, but on traditional – family and religion – ties. Under the sanctions regime it is easier for small companies (that are more flexible *per se*) to bypass the restrictions introduced (among others using the Islamic forms of financial settlements) than for the large corporations, particularly the state-owned ones.

Iranian SMEs are active participants in the cross-border trade (including the illegal one) managed by the living in Iran so-called 'separated nations' who enable the development of these types of trade. Illegal trade is reportedly the most active on the borders with Afghanistan, Pakistan and Iraq (in Kurdish areas in northwestern Iran) where a large number of professional traders use hard-to-reach roads for the transportation of goods. Marine routes with the countries of the Persian Gulf are used for illegal trading spurred over the recent years by the sanctions regime introduction and including both consumer and capital goods, gasoline as part of the trading items. Interestingly, the goods are both imported illegally to Iran, and exported from the country given that the prices for certain subsidized items in Iran are a way below the global ones. The illegal trade payments are exercised via 'hawala', a widely used informal type of cash settlements [Galischeva, Mamedova, Masumova, 2019, p. 82–83].

FREE ECONOMIC ZONES

In attempt to diversify foreign trade, Iran focuses on external economic development via organizing free economic zones (SEZ) and special economic zones (SEZ), part of which prioritize the trade with the region's countries. In particularly, the Chabahar, Bandar-e Anzali, Aras (AFTZ) and Arvand FTZ encourage the cargo transit and trade via the International North–South Transport Corridor (INSTC). The Chabahar FEZ has turned into a key link both for INSTC and for the New Silk Road project, to trade with Pakistan as well as to transit the Chinese and Indian goods to Afghanistan and Central Asian countries. Chabahar port is leased for 49 years by India that had invested much into it, including the transport infrastructure construction connecting the port in the Indian Ocean with neighboring countries. The Bandar-e Anzali, the only free economic zone in Iran, located on the coast of the Caspian Sea, is set up to enhance trade with the Caspian region countries. In the zone the port and railway infrastructure are under construction, transit corridors are being set up, the commodity exchange operational platform is being upgraded. Export-import and transit deliveries of goods to the Caspian countries, Turkey, and countries of Southeast Asia are carried out via the Bandar-e Anzali port. Aras FTZ is set up to promote trade with the Caucasus countries and the Arvand FEZ – with Iraq. Located at the confluence of two rivers, the Shatt al-Arab (Arvandrud) and Karun, near the border with Iraq, with main types of transport infrastructure rolled out (rail, road, sea and air), Arvand FTZ serves as a junction for two international transport corridors – East-West TC and North-South TC. The Maku FTZ contributes to trading operations with Turkey and with the Caucasus countries. The Armenian Meghri FEZ was launched in December 2017 (with the participation of the Prime Minister of Armenia and the Ambassador of Iran to Armenia) and currently promotes trade operations on the Armenian-Iranian border. In May 2018 at the economic forum in Astana, the Eurasian Economic Union (abbreviated by EAEU or EEU) and Iran signed a temporary agreement on a free trade zone. On June 10, 2019, the Majlis of Iran ratified the interim agreement on a free trade zone with the Eurasian Economic Union. A three-year provisional agreement suggests a free trade zone between the EAEU countries and Iran, assuming the regulation of a limited list of trading goods [The Iranian Parliament ratified the interim agreement on an

FTA with the EAEU, 10.06.2019]. The provisional deal paves the way for Iran's permanent membership in the union, which is to be finalized in the next 3 years.

Apart from free economic zones, 16 special economic zones (SEZs) are set up in Iran to attract foreign investment into production and foreign trade spheres. Bilateral contracts dominate in Iran's foreign trade activity. Nonetheless, Iran seeks to actively participate in regional economic organizations. In 1985, Iran initiated the Economic Cooperation Organization (ECO), the successor for the Organization for Regional Cooperation (which Iran, Turkey and Pakistan were the members of). In 1992, Kazakhstan, Kyrgyzstan, Tajikistan, Azerbaijan, Afghanistan, Turkmenistan and Uzbekistan joined ECO. Before the sanctions, ECO members were proactive, while Iran had initiated a number of transport projects. Iran is a *Shanghai Cooperation Organization* (SCO) candidate member, had submitted the application for membership in the WTO (back in 1996).

CONCLUSION

The strong economic ties with neighboring countries may not become a competitive alternative to the western markets' business opportunities no matter what efforts Iran endeavors to unlock its regional trade potential. To develop its open economy model, to stay the world's leading supplier of hydrocarbon, Iran needs a constant access to the global markets, which, in their turns, provide the country with the modern technologies, equipment, industrial production accessories (that take the lion's part of Iran's imports). European countries have worked out an *Instrument in Support of Trade Exchanges* (INSTEX), a new channel for settlements with Iran allowing to bypass US Sanctions and trade with Iran. There has been no material impact from this measure so far, although the development of the new financial mechanism *per se* highlights Europe's stance, the importance of its legal and political support for Iran, and may involve positive implications for the countries in the region and Iran. However, on May 30, 2019 the United States have made claims to Europe regarding new financial channel, which has not even launched yet. Stephen Mnuchin, the US Secretary of Treasury, had forwarded a letter to Peru Fisher, head of the company *Instex SAS*, warning over "serious consequences" the trade with Iran may entail, up to the loss of access to the US financial system and the punishment for cooperation with Iran that can be applied to any country or to individual companies [Foreign direct investment (FDI) in Iran]. The signing off the bilateral agreements with countries on transferring a part of payments in national currencies could be a way out option for Iran. It is essential to emphasize that Iran has a good track-record in this type of transactions despite the very limited scope for such payments when it comes to settlements between Iran and Turkey, India, China. Apparently, having a US and European sanctions' tough experience, Iran may seek to diversify its trading partners geographical mix in favour of Southeast Asia that faces a scaling demand for energy resources.

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