

Why Iran may need to open quickly if Iran is to open up at all

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Summary

The political framework agreed by Iran and the P5+1 on 2 April is a major milestone towards a comprehensive nuclear deal that could stop a military conflict in the Middle East and open up Iran's large consumer market and energy sector to outside investment. The negotiators still have much work to do before a final deal is reached and the reaction in national capitals, as well as the conflicting interpretations over what has already been agreed, shows that success is not guaranteed yet, even if both sides have a great deal invested in a successful outcome. The biggest gap between the US and Iran is over the pace of sanctions relief and how this is linked to the steps Iran must take. The best way to bridge this gap is by agreeing to implement both over a short time frame. This means that if a deal is to be done and Iran is to open up, it may need to be done quickly, with substantial progress by the end of the year. Iran will remain a difficult place to do business, but there are considerable opportunities for businesses that are well prepared.

Iran and the P5+1 (comprising the US, UK, France, Germany, Russia and China) agreed to a political framework for a comprehensive nuclear deal on 2 April. The agreement, which is in the form of "parameters" for a final deal that must still be reached, came after over a year of talks and many missed deadlines. During this time both of the main protagonists - Iran and the US - have had to focus as much on fighting off opposition in their respective capitals as they have on finding terms that are acceptable. Several more weeks of negotiation on the details are still needed if both sides are to sign a comprehensive deal by the self-imposed deadline of 30 June.

The agreement that was reached on 2 April is curious. We know there was an agreement. But we don't know much about what was actually agreed, other than what is contained in the competing statements released subsequently by the different parties. These are contradictory in some important respects. In many ways this is no surprise as this is a milestone in a negotiation process that is ongoing, with both sides positioning themselves for maximum advantage. However, it serves to illustrate how far apart the two sides remain. It may also tell us something about the type of deal we will eventually see if there is to be a deal at all.

What's at stake?

There are three main reasons why an Iran deal matters and which explain why it is the number one foreign policy priority for President Obama as he sees out his term in office. The first is regional security. The alternative to a deal is at best a continuing standoff, but at worst either a military conflict in the Middle East or a regional nuclear arms race. Both the Israelis and the Saudis, for very different reasons, are in direct geopolitical competition with the Iranians and are already indirectly engaged in intermittent conflict with them through proxies. Absent a deal, that could get a lot worse.

The second reason, not unrelated to the first, is the impact on global oil and gas supplies. Iran has the fourth largest oil reserves in the world, and the second largest gas reserves, but exports well below its potential due to both sanctions and years of economic mismanagement. While war in the region would disrupt global supplies, a deal would, over time, push down prices and in particular create competition for Russia in supplying gas to Europe. The oil price gyrated wildly on 2 April as news of the agreement was digested, with Brent crude at one point falling 4% before recovering.

The third reason is the opportunities presented by Iran as a consumer market. Iran's 79 million inhabitants are relatively well off, with a large and well-educated middle class. Iran is the largest market that remains closed to European and US firms due to geopolitical tensions and the impact of sanctions. If Iran opens up then, as Table 1 shows, the opportunity will be comparable in scale to

	GDP (PPP) in 2013, US\$ billions	GDP (PPP) ranking in 2013	Estimated population in 2015, millions	Ease of Doing Business ranking in 2014
Saudi Arabia	1,547	14	32	49
Turkey	1,425	17	77	55
Iran	1,207	18	79	130
Nigeria	973	20	184	170
Argentina	928	23	42	124
Egypt	910	25	85	112
Pakistan	838	26	188	128
Malaysia	694	28	31	18
South Africa	663	29	53	43
Philippines	643	30	102	95

Table 1: Selected country comparisons of economic data and populations
Source: World Bank, United Nations

the Turkish market. Though we expect US firms to hold back in the event of a deal, both because of non-nuclear sanctions and a continuing wariness of engaging with Iran, this would be too good to miss for many European and other international firms, even if Iran remains an extremely difficult place to do business.

How did we get here?

Iran and the P5+1 have been in on-off negotiations over Iran's nuclear programme since 2006. These negotiations produced their first major breakthrough in November 2013 when a more pragmatic and conciliatory White House and a more open Iranian President Hassan Rouhani, newly elected on a platform of fixing the faltering economy, agreed an interim deal, known as the Joint Plan of Action. This allowed modest sanctions relief, including the export of some Iranian oil, in return for a freeze on key aspects of Iran's nuclear programme. Just as importantly, it set out a process and a timeline to reach a comprehensive agreement. The first deadline for that agreement in July last year was missed, but both sides, including US Secretary of State John Kerry, thought that sufficient progress had been made to continue the negotiations.

The US Congress, hard-liners in Iran, and many US allies in the Middle East, including Israel and Saudi Arabia, remain deeply sceptical about the compromises that are required to reach a comprehensive agreement. Opposition from within the US Congress is one reason why the White House wanted to agree a political framework now before negotiating a comprehensive agreement by the end of June. Republicans in Congress, led by Senator Bob Corker, with the support of some Democrats have been pushing for Congress to have the final say on any deal, which the Obama administration fears could jeopardise the negotiations. The White House is working hard to prevent the Iran hawks from gaining a veto-proof, two-thirds majority in the Senate or at least to alter the final bill so that it is more palatable. But the announcement must also satisfy audiences in Tehran and other capitals, as well as in Washington, which explains why all sides have been putting their own spin on it since. What, then, can we conclude from this about the prospects for reaching a comprehensive agreement by 30 June?

Spinning the deal

The agreement on the political framework was announced in a press conference by Iran's lead negotiator, Foreign Minister Javad Zarif, and

the EU High Representative Federica Mogherini, who is the official head of the P5+1 negotiators. It was accompanied by a carefully negotiated joint statement just 500 words long and sparse on detail. This states Iran's enrichment capacity will be limited to a single site, but not by how much. It explains, in very general terms, what will happen to Iran's other nuclear sites and how Iran's compliance with a deal will be monitored. It also describes the quid pro quo for Iran - the termination of nuclear-related sanctions enforced by the EU and the US and the revocation of nuclear-related resolutions previously passed by the UN Security Council. Significantly the text says these steps will be simultaneous with IAEA verification of Iranian implementation of its key nuclear commitments.

Both Iran and the US have been quick to spin the deal to their respective domestic audiences in their own particular ways, which are inevitably somewhat contradictory. In Tehran the news of the agreement was greeted with celebrations in the streets. President Rouhani said 2 April would "remain in the historic memory of the Iranian nation" and the agreement was a "first step towards productive interactions with the world." Zarif took a more cautious line, saying "we're still some time away from reaching where we want to be."

In Washington there were no celebrations in the streets. Instead the US State Department issued its own fact sheet setting out what it says has been agreed. This provides much more detail than the negotiated statement, notably spelling out Iranian commitments on enrichment limits and specific timelines, but without adding much on the sequencing of the removal of sanctions. This was well received by many commentators in the US, but provoked a backlash in Tehran, where the Supreme Leader Ali Khamenei, who is the ultimate decision taker in Iran, accused the US of setting out a version of the political framework that was "contrary to what was agreed". He was characteristically equivocal in his support for a deal saying he was "never optimistic about negotiating with America". But perhaps most significant of all, in words echoed by President Rouhani, he said that if a deal is to be done then sanctions "should be lifted completely, on the very day of a deal".

The need for speed

This is likely to be the core issue in the remaining negotiations. Neither side trusts the other. The US wants sanctions to remain in place until "the IAEA has verified that Iran has taken all of its key nuclear-related steps." Iran wants sanctions relief

on the day a deal is done - ie, on 1 July. These positions are hard to bridge or to finesse. A close reading of the statement released by Zarif and Mogherini allows for both interpretations. It says sanctions will be terminated "simultaneously with the IAEA-verified implementation by Iran of its key nuclear commitments." The US interprets this as implying all commitments must be verifiably implemented first; the Iranians only that they must be adhering to an agreed timetable for their implementation. Some parts of the deal will be hard to implement quickly: for example if, as the US suggests, the core of the Arak reactor must be destroyed and removed from the country. But the real issue is political rather than technical. The only way to reconcile the two positions is to ensure that implementation of both sides of the agreement is as rapid as possible.

This may turn out to be the most significant conclusion to draw from the 2 April political agreement on the parameters of a comprehensive deal: Iran may need to open quickly if Iran is to open up at all. If a comprehensive agreement is reached by 30 June then we should expect there to be substantial progress on implementation and sanctions relief by the end of the year. By then we may not be at the end of the road in terms of implementation and some sanctions are likely to remain in place, but we will need to be close to the end of the road for political reasons. For the White House this will have the added attraction of ensuring they are a long way down the path of implementation before the presidential primary season is in full swing. The US will also retain the assurance that the sanctions apparatus will remain in place and sanctions can be reintroduced if necessary, should there be backsliding by Iran. For Iran this will ensure that some of the benefits from the agreement will become apparent before parliamentary elections take place in February next year.

For business interested in the Iranian oil sector or the Iranian consumer market exploring opportunities in Iran will remain difficult while there is residual uncertainty about sanctions and because the business environment there is so challenging. The potential benefits to those positioned to take advantage if Iran does open up may, however, make it worthwhile.

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