FOCUS ON IRAN

GEORGIA AND IRAN: OPPORTUNITIES FOR “FINDING KEYS TO THE DOORS”

Tbilisi, Georgia

April 2016
GEORGIA AND THE NEIGHBORS is an analytic periodical covering economic, financial, and business trends in Georgia’s neighboring countries and in the major trade partners. The aim of the brief is to scrutinize the potential implications of the key political and economic developments taking place within the region or in the world. Georgia’s policy and business community are the primary audience of the brief. The analyses and projections made by the Georgia and the Neighbors are based on the extensive research and consultations in Georgia and in the countries in focus. It is being compiled by the EPRC’s in-house experts and the outsourced consultants.
### Global Competitiveness Index

<table>
<thead>
<tr>
<th>Rank</th>
<th>Country</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Switzerland</td>
<td>5.7592335</td>
</tr>
<tr>
<td>2</td>
<td>Singapore</td>
<td>5.6766692</td>
</tr>
<tr>
<td>3</td>
<td>United States</td>
<td>5.6129673</td>
</tr>
<tr>
<td>4</td>
<td>Germany</td>
<td>5.5285691</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>60</td>
<td>Macedonia, FYR</td>
<td>4.2810519</td>
</tr>
<tr>
<td>61</td>
<td>Colombia</td>
<td>4.2782079</td>
</tr>
<tr>
<td>62</td>
<td>Oman</td>
<td>4.2472135</td>
</tr>
<tr>
<td>63</td>
<td>Hungary</td>
<td>4.2455023</td>
</tr>
<tr>
<td>64</td>
<td>Jordan</td>
<td>4.2334002</td>
</tr>
<tr>
<td>65</td>
<td>Cyprus</td>
<td>4.2297352</td>
</tr>
<tr>
<td>66</td>
<td>Georgia</td>
<td>4.2220696</td>
</tr>
<tr>
<td>67</td>
<td>Slovak Republic</td>
<td>4.2200303</td>
</tr>
<tr>
<td>68</td>
<td>Sri Lanka</td>
<td>4.2143836</td>
</tr>
<tr>
<td>69</td>
<td>Peru</td>
<td>4.2101585</td>
</tr>
<tr>
<td>70</td>
<td>Montenegro</td>
<td>4.2017293</td>
</tr>
<tr>
<td>71</td>
<td>Botswana</td>
<td>4.1902851</td>
</tr>
<tr>
<td>72</td>
<td>Morocco</td>
<td>4.1649488</td>
</tr>
<tr>
<td>73</td>
<td>Uruguay</td>
<td>4.0885481</td>
</tr>
<tr>
<td>74</td>
<td>Iran, Islamic Rep.</td>
<td>4.0852677</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>139</td>
<td>Chad</td>
<td>2.9646368</td>
</tr>
<tr>
<td>140</td>
<td>Guinea</td>
<td>2.8411147</td>
</tr>
</tbody>
</table>

### Global Innovation Index

<table>
<thead>
<tr>
<th>Rank</th>
<th>Country</th>
<th>Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Switzerland</td>
<td>68.3</td>
</tr>
<tr>
<td>2</td>
<td>United Kingdom</td>
<td>62.4</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>70</td>
<td>Brazil</td>
<td>34.9</td>
</tr>
<tr>
<td>71</td>
<td>Peru</td>
<td>34.9</td>
</tr>
<tr>
<td>72</td>
<td>Argentina</td>
<td>34.3</td>
</tr>
<tr>
<td>73</td>
<td>Georgia</td>
<td>33.8</td>
</tr>
<tr>
<td>74</td>
<td>Lebanon</td>
<td>33.8</td>
</tr>
<tr>
<td>75</td>
<td>Jordan</td>
<td>33.8</td>
</tr>
<tr>
<td>76</td>
<td>Tunisia</td>
<td>33.5</td>
</tr>
<tr>
<td>77</td>
<td>Kuwait</td>
<td>33.2</td>
</tr>
<tr>
<td>100</td>
<td>Egypt</td>
<td>28.9</td>
</tr>
<tr>
<td>101</td>
<td>Guatemala</td>
<td>28.8</td>
</tr>
<tr>
<td>102</td>
<td>Burkina Faso</td>
<td>28.7</td>
</tr>
<tr>
<td>103</td>
<td>Cabo Verde</td>
<td>28.6</td>
</tr>
<tr>
<td>104</td>
<td>Bolivia, Plurinational State of</td>
<td>28.6</td>
</tr>
<tr>
<td>105</td>
<td>Mali</td>
<td>28.4</td>
</tr>
<tr>
<td>106</td>
<td>Iran, Islamic Republic of</td>
<td>28.4</td>
</tr>
<tr>
<td>107</td>
<td>Namibia</td>
<td>28.1</td>
</tr>
<tr>
<td>108</td>
<td>Ghana</td>
<td>28</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>140</td>
<td>Togo</td>
<td>18.4</td>
</tr>
<tr>
<td>141</td>
<td>Sudan</td>
<td>15</td>
</tr>
</tbody>
</table>
FOCUS ON IRAN

GEORGIA AND IRAN: OPPORTUNITIES FOR “FINDING KEYS TO THE DOORS”
CONTENTS

Iran and its importance ...................................................................................................................8
Georgia as a focal point ..................................................................................................................9
Iran Today ...........................................................................................................................................9
Iran sanctions ...................................................................................................................................16
Sanctions lifted – opportunities ...................................................................................................19
Iranian-Georgian Economic Ties .................................................................................................21
Potential cooperation – security, energy sector and beyond .......................................................24
Political relations .............................................................................................................................24
Security implications ......................................................................................................................25
Economic potential .............................................................................................................................26
          Transportation .......................................................................................................................26
          Business Relations ...............................................................................................................28
Conclusions ......................................................................................................................................30
Policy recommendations ................................................................................................................32

© Economic Policy Research Center (EPRC)
IRAN AND ITS IMPORTANCE

From the geopolitical point of view, Islamic Republic of Iran is obviously an extremely important focal point for the region. Its geographic location is more suitable for the hub role than that of its main rival in the Islamic world and another resource-rich autocracy – Saudi Arabia. Being the only country between the Caspian Sea and Persian Gulf, Iran’s Zagros Mountains serve as a land bridge, connecting Azerbaijan and Central Asian countries with the Indian Ocean – thus providing serious economic potential as a transport corridor, should the government of Iran choose to serve as such. It should be mentioned that internally, Iran is a self-contained entity. It is relatively poor, but it has superbly defensible borders and a disciplined central government with an excellent intelligence and internal security apparatus.¹ However, since 1979 Iran’s relations with the US have deteriorated to border on open hostility and as such the presence of US forces both to the east and the west of Iran – in Iraq and Afghanistan – creates significant uneasiness, not as much as concerning the possible invasion but rather concerning the US fomenting ethnic dissent within Iran through these positions.²

Nevertheless, Iran represents a significant economic potential for the US which was a second major trading partner of the Iran in 1978; U.S. goods—mainly arms, industrial equipment and technology—accounted for 16 percent of Iranian imports.³ This means that given the chance the US private sector will definitely flow into Iran – particularly since as a market, Iran is a huge opportunity, being a third-largest country by population, with the significant share of consumer base being young, and the older middle-class population still remembering the US consumer goods from pre-1979 period.⁴

Unlike US, which has significantly reduced its vested interests in Iran since 1979, European countries prior to EU itself imposing sanctions, had been actively investing in Iranian economy, with over 20 European countries, particularly Germany, the Netherlands and Spain investing almost $11 bln in 253 different projects in Iran in 1992-2008.⁵ Evidently, lifting of EU sanctions will reignite the European interest in Iran, providing an additional boost for Iranian economy. Iran has become particularly important for European companies since

---

¹ https://www.stratfor.com/analysis/geopolitics-iran-holding-center-mountain-fortress
² Ibid.
³ http://iranprimer.usip.org/blog/2012/apr/10/us-iran-trade-still-thrives-0
the weakened demand in China and problems in many other emerging markets EU businesses need a new and preferably large market for their activities.

GEORGIA AS A FOCAL POINT

Despite being quite small compared to the economic powers, Georgia has an advantageous geopolitical location being situated on the crossroads between East and West and offering a potential route from Iran to the West (via Azerbaijan). Georgia already has three major pipelines running through its territory (Baku-Tbilisi-Ceyhan and Baku-Supsa oil pipelines and Baku-Tbilisi-Erzurum gas pipeline) and with some other pipelines having been considered (Azerbaijan–Georgia–Romania Interconnector, transporting gas from Azerbaijan to Central Europe; White Stream, transporting gas from Caspian region to Romania and Ukraine; Southern Gas Corridor connecting Azerbaijan and Italy, via Turkey and Greece) can clearly become a part of any pipeline carrying Iran’s fuels to the Europe. Besides, Georgia provides the shortest way from Iran to Black Sea and hence to Eastern and Central Europe and could offer at least a viable alternative to the transportation corridors passing from Iran through Turkey. Although, with the removal of sanctions Iran can provide a competition to Georgian corridor, offering landlocked Central Asian countries an alternative access to ocean via Bandar Abbas and Strait of Hormuz. Nevertheless, Georgia certainly has a comparative locational advantage and must be able to use it now that Iran can offer more of its goods and services to the world.

IRAN TODAY

Islamic Republic of Iran is one of the largest countries in the world, being 18th by the PPP GDP and 29th by nominal GDP at current exchange rates. According to Goldman Sachs Asset Management chairman, Jim O’Neill, Iran is one of the Next-11, emerging markets coming after BRIC countries and having high potential of becoming among world’s largest economies in the 21st century.6 Goldman Sachs’s N-11 has beaten 93 percent of US-based emerging market equity funds in 2012 and given the gradual removal of sanctions against Iran (of which more will be said later), the potential of N-11 is even larger.

Similarly to Georgia’s two other neighbors, Russia and Azerbaijan, Iran is rich with energy resources, possessing 4th largest proved crude oil reserves in the world (after Venezuela, Saudi Arabia and Canada), and

---

largest proved natural gas reserves (18.2% of the whole world natural gas reserves). Unsurprisingly, Iran economy is dominated by oil and gas production, although, unlike some other oil-rich countries, Iran’s industry is quite diversified and Tehran Stock Exchange has been one of the fastest growing in the first half of the decade. Despite its index being somewhat below the historical maximum reached in 2013, it is still quite high and offers significant grounds for optimism. It should be noted that the share of oil rents in GDP has significantly decreased since late 2000s, from almost 40% in 2008 to less than 23% in 2014. This doesn’t mean per se that dependence on mineral resources has gone away, however the trend is heading in the right direction.

Various services represent largest share in Iran’s economy, with oil and gas and manufacturing coming next. Agriculture sector is relatively unproductive, with 18.3% of the labor force producing 9% of the GDP. Apart from petrochemicals, Iran’s second most active industry is automotive, with Iran Khodro being the largest car manufacture in the Middle East. Another important sector for Iran is construction, both on raw materials and production side. Iran is the fourth largest producer of cement in the world and the largest in the Middle East with a production capacity of 70 million tons of cement per year. Its main cement exports go to Iraq (63% of all export), Turkmenistan (7%) and Azerbaijan (4%). The construction sector is booming, with the steady annual growth of 4.2%, which is expected to double, particularly given the lifting of the sanctions. Most likely, once sanctions are removed, Iran will become the largest construction market in the emerging economies. The effect of lifting the sanctions has already been seen albeit on a smaller scale, when South Korea removed majority of its sanctions in March 2014. Two Korean multinationals Hyundai E&C and Daelim, opened offices in Tehran even before that and today South Korea is the largest international partner of Iran in construction. With Iran attempting to diversify away from oil production and to capture more of the petrochemical value chain the next step for construction sector is chemical facilities and China has stepped in with several large-value construction projects.

8 http://www.cbi.ir/simplelist/5796.aspx
9 The diagram below does not include imputed bank service charge, which equals -2.7% of GDP
11 http://www.ifpin.info/Iran-NewsArticle-6083#.Vs1bypP6jps
13 Ibid.
The economic development of Iran in the XXI century has been hampered by sanctions with the country virtually unable to shake off double digit inflation for years — a result of disrupted supply chains and high operational costs.\textsuperscript{14} The exchange rate or rial was tightly managed by the Central Bank of Iran until 2013-14, when it was allowed to float, however already in 2011 unofficial black market rates started to diverge from the CBI rates, with the rates on the black market more than twice high than the official ones. In July 2013 the CBI eliminated the peg and multiple exchange system, with the IRR depreciating by more than 70\% compared to its official value a year ago. Nevertheless there still is significant difference in official and black market exchange rates, with the average official exchange rate for 2013/14 being 21,253 IRR/USD and for the black market – 31,839 IRR/USD.\textsuperscript{15} Such divergence indicates that Iranians were (and still do) considering USD as a safe investment, and is translated to inflation, since retailers tie their prices to the market value of the dollar.

\textsuperscript{14} http://www.iar-gwu.org/node/428

\textsuperscript{15} Annual Review 1392 (2013/14) of the Central Bank of Iran, p. 35
At the same time, until 2012 real growth was quite high, remaining positive even in the period of global financial crisis, possibly thanks to sanctions, which had somewhat cut off the financial system of Iran from the rest of the world. In 2012 sanctions imposed by EU finally caught up with the economy and Iran was pushed into a significant recession, lasting two years.
Possibly economic reasons were behind the outcome of 2013 presidential elections, which saw Mahmoud Ahmadinejad replaced by Hassan Rouhani, mostly described as a moderate reformer, nevertheless having strong views regarding both Israel and US. However, his government is definitely more pro-reform than the previous one, with larger emphasis on personal freedom, women’s rights and more open foreign policy. The long-term economic development is one of the priorities of Rouhani’s government, however the Principle 44 of the Iranian Constitution explicitly states that “The state sector includes all the national industries, foreign trade, major mines, banking, insurance, energy sources, dams and large water irrigation networks, radio and television, post, telegraph and telephone, aviation, navigation, roads, railroads, and others which are publicly owned and under the state’s control”, which effectively means that most of the Iranian economy will be state-owned and under central planning system. It should be noted, however, that an amendment of this article made in 2004 allows for 80% of state assets to be privatized and the respective agency, Iran Privatization Organization, has been active since early 2000s, with the peak in privatization proceeds coming in 2010. Nevertheless, the total proceeds from privatization since 2001 have only been $107.3 million, suggesting that Iran

economy is still state-run so far. The economic reform plan, passed by the Majlis in 2010, envisages replacing subsidies on food and energy with targeted social assistance and extensive reforms in banking sector, taxation, customs, employment, social justice, etc. In 2015 the Iranian government issued a sixth five-year development plan, “comprised of three pillars, namely, the development of a resistance economy, progress in science and technology, and the promotion of cultural excellence. On the economic front, the development plan envisages an annual economic growth rate of 8% and considers the implementation of reforms of state-owned enterprises, the financial and banking sector, and the allocation and management of oil revenues among the main priorities of the government during the five-year period.”

The huge role that the Iranian state still plays in the economy somewhat hinders country’s economic development. Largest state companies include National Iran Oil Company (world’s third largest oil company, after Saudi Arabia’s ARAMCO and Russian Gazprom), IMIDRO (Iranian Mines & Mining Industries Development & Renovation), National Petrochemical Company (a subsidiary to the Iranian Petroleum Ministry), Bank Melli Iran, and others. In World Bank’s Doing Business 2016, Iran is 130th out of 189 countries, with only Starting a Business and Enforcing Contracts components’ score being above the median (62nd and 68th respectively). Only Algeria, Djibouti, Iraq, Libya, Syria, West Bank and Gaza fall behind IRAN in Middle East and North Africa region.

At the same time, according to the World Bank Doing Business, the reforms initiated by Iran in the recent years are mostly making it easier to do business. Reforms carried out since 2010 include the following positive changes:

---

22 http://www.doingbusiness.org/reforms/overview/economy/iran
<table>
<thead>
<tr>
<th>DB2015:</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Starting a Business:</strong></td>
<td>The Islamic Republic of Iran made starting a business easier by streamlining the name reservation and company registration procedures.</td>
</tr>
<tr>
<td><strong>Getting Electricity:</strong></td>
<td>The Islamic Republic of Iran made getting electricity easier by eliminating the need for customers to obtain an excavation permit for electricity connection works.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>DB2013:</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Protecting Minority Investors:</strong></td>
<td>The Islamic Republic of Iran strengthened investor protections by requiring greater immediate disclosure of related-party transactions.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>DB2011:</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Starting a Business:</strong></td>
<td>The Islamic Republic of Iran eased business start-up by installing a web portal allowing entrepreneurs to search for and reserve a unique company name.</td>
</tr>
<tr>
<td><strong>Getting Credit:</strong></td>
<td>The establishment of a new private credit bureau improved access to credit information.</td>
</tr>
<tr>
<td><strong>Enforcing Contracts:</strong></td>
<td>The Islamic Republic of Iran made enforcing contracts easier and faster by introducing electronic filing of some documents, text message notification and an electronic case management system.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>DB2010:</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Starting a Business:</strong></td>
<td>The Islamic Republic of Iran simplified business start-up by introducing an electronic registration system.</td>
</tr>
<tr>
<td><strong>Paying Taxes:</strong></td>
<td>The Islamic Republic of Iran made paying taxes easier for companies by converting the sales tax into value added tax.</td>
</tr>
<tr>
<td><strong>Dealing with Construction Permits:</strong></td>
<td>The Islamic Republic of Iran made dealing with construction permits easier by introducing electronic service offices in Tehran; streamlining the process of obtaining location approvals, building permits and building completion certificates; and reducing the time needed to obtain water and electricity connections.</td>
</tr>
<tr>
<td><strong>Trading Across Borders:</strong></td>
<td>The Islamic Republic of Iran reduced the time for exporting and importing through the installation of scanners at the port of Shahid Rajaee and the reorganization of customs clearance offices to separate inspections of special goods (chemicals, petroleum) from those of general goods.</td>
</tr>
</tbody>
</table>
Despite the reforms, Iranian economy was in recession for two years in 2012 and 2013, which was turned around in 2014, with the moderate growth of 3\%.\(^{23}\) The turnaround was helped by the signing of the Joint Plan of Action – a schedule of freezing “key parts of Iranian nuclear program in exchange for temporary relief on some economic sanctions”.\(^{24}\)

**IRAN SANCTIONS**

Since the last Shah of Iran, Mohammad Reza Pahlavi had been overthrown in 1979 by the followers of Ayatollah Ruhollah Khomeini, the relations between Iran and the West (mainly the United States) have been strained at best, with the US imposing first sanctions against Iran in the wake of the Iran Hostage Crisis of 1979, freezing all property of the Iranian government by the Executive Order 12170.\(^{25}\) The ban on most US-Iran trade followed shortly.\(^{26}\) Sanctions were increased during the Iran-Iraq war and in 1995 in two separate orders President Clinton prohibited at first US trade in Iran oil industry\(^{27}\) and then any US trade with Iran.\(^{28}\) Additional sanctions were imposed by US in mid-2000s, when it was revealed that Iran was implementing undeclared nuclear activities.\(^{29}\)

The questions over Iran’s nuclear program\(^{30}\) made the international community concerned as well, with the UN and EU joining the anti-Iran sanctions. Overall, the following sanctions have been imposed on Iran over time\(^{31}\):

\(^{23}\) As given by the World Bank; IMF World Economic Outlook for October 2015 shows a different figure of 4.3% (https://www.imf.org/external/pubs/ft/weo/2015/02/weodata/weorept.aspx?pr.x=19&pr.y=2013&ey=2020&scsm=1&ssd=1&sort=country&ds=.&br=1&c=429&s=NGDP_RPCH&grp=0&a)


\(^{25}\) https://en.wikisource.org/wiki/Executive_Order_12170

\(^{26}\) http://www.reuters.com/article/us-iran-nuclear-sanctions-factbox-sb-idUSTRE59C22020091013

\(^{27}\) https://en.wikisource.org/wiki/Executive_Order_12957

\(^{28}\) https://en.wikisource.org/wiki/Executive_Order_12959

\(^{29}\) http://www.armscontrolwonk.com/archive/600517/exiles-and-iran-intel/

\(^{30}\) Nuclear program was the main cause of sanctions against Iran, however a number of sanctions imposed by the EU was linked to human rights and some other sanctions imposed by the US were linked to terrorism. These sanctions have not been lifted.

\(^{31}\) Completely taken from http://news.yahoo.com/overview-international-sanctions-against-iran-214805012.html
<table>
<thead>
<tr>
<th>Country/Organization</th>
<th>Sanction</th>
</tr>
</thead>
</table>
| **UN (43 individuals and 78 entities affected)** | - Resolution 1737 (December 2006) imposes economic and commercial sanctions against 10 entities linked to Tehran's nuclear and ballistic programmes. Their assets and those of 12 individuals are frozen.  
- Resolution 1747 (March 2007) freezes the assets of 13 new entities linked to the nuclear programme or the Iranian Revolutionary Guards. There is also an embargo on Iranian arms purchases and restrictions on loans to Iran.  
- Resolution 1803 (March 2008) imposes a foreign assets freeze and travel ban on key players in the nuclear programme and forbids the supply of dual-use items (civilian and military) to Iran.  
- Resolution 1929 (June 2010) places new restrictions on Iranian investments and bans sales to Iran of battle tanks and combat aircraft. |
| **US (around 100 entities affected)** | - November 1979: Washington begins to ban businesses and individual Americans from trading with Iran except with Treasury Department approval in response to the hostage taking at the US embassy in Tehran.  
- June 1995: The US implements a broad economic embargo against Iran.  
- November 2008: Washington forbids US banks to take part in fund transfers involving Iran.  
- July 2010: A law targets the supply of petrol to Iran, which is highly dependent on refined products, and foreign firms that invest in the Iranian energy sector.  
- November 2011: Washington reinforces sanctions on goods, services and technologies for Iran’s petrochemical sector. In December, assets of foreign financial institutions that trade with the Iranian Central Bank in the petrol sector are frozen.  
- July 2012: The US imposes new economic sanctions on Iran’s oil export sector and on two banks accused of dealings with Tehran.  
- June 2013: Washington unveils sanctions on the rial currency and the auto sector. |
| **EU (92 Iranians and 466 companies or groups, including the Iranian central bank affected)** | - July 2010: The EU bans technical assistance or the transfer of oil technologies to Iran. It also bans the activity of some Iranian banks and adds names to the United Nations list of individuals banned from travelling.  
- In May, then December 2011 it freezes the assets of 243 Iranian entities and around 40 more individuals, who are banned from receiving visas.  
- January 2012: The EU approves a ban on Iranian oil imports and freezes assets of the Iranian Central Bank.  
- October 2012: New sanctions target EU dealings with Iranian banks, shipping and gas imports.  
- December 2012: The EU extends its blacklist. |
Sanctions have had both direct and indirect impact on Iranian economy. First and foremost the sanctions imposed by the US in 2012 hit where it hurt most – the oil industry. While China – largest consumer of Iranian oil – remained relatively immune to the US pressure and continued buying Iranian oil, some other countries, like South Africa, Greece or Japan, have suspended or significantly reduced their consumption of Iranian oil.\(^{32,33}\) Indian companies also relented to US pressure, with the Indian oil imports from Iran falling almost twice.\(^{34}\) This not only hurt Iran, but also allowed its main religious and economic rival – Saudi Arabia – to step in to make up the deficit.

However, impact of sanctions on Iranian economy extended far beyond oil. The pressure exerted by the US created significant difficulties for some firms and even countries to conduct business with Iran. Once EU joined the sanctions, many Iranian banks were blocked from doing business with the rest of the world, since the Belgium-based SWIFT, a company facilitating most international money transfers, had to comply with the EU sanctions.\(^{35}\) The financial sanctions were not limited only to SWIFT - in late 2010 Reserve Bank of India instructed its lenders to stop processing current-account transactions with Iran using the Asian Clearing Union, originally set up by the United Nations in 1974 to help facilitate trade in South Asia and headquartered in Tehran.\(^{36}\) Since 2009 Iran tried to persuade Indian companies to use ACU precisely in order to circumvent sanctions on financial dealings, however US pressure had finally had its effect.\(^{37}\)

Historically the sanctions imposed on an entire country usually have a dire effect on its citizens – e.g. according to UNICEF, due to sanctions imposed on Iraq, per capita income there dropped from $3510 in 1989 to $450 in 1996\(^ {38}\) – a staggering 87% decrease. Iran is far more self-sufficient country than Iraq (or Cuba), however it is unquestionable that the sanctions had a significant negative effect on Iran’s citizens’ well-being.


\(^{33}\) [http://www.wsj.com/articles/SB10001424052702304636404577295104273175364](http://www.wsj.com/articles/SB10001424052702304636404577295104273175364)


\(^{36}\) [http://www.wsj.com/articles/SB10001424052970203513204576046893652486616](http://www.wsj.com/articles/SB10001424052970203513204576046893652486616)

\(^{37}\) Iran did find another loophole, by dealing in gold, rather than in USD or EUR, with the Turkish Halkbank, a move that wasn’t banned by the US until mid-2013, by which time both Turkey and India paid for Iranian energy around $10 bln in gold - [http://www.telegraph.co.uk/news/worldnews/europe/turkey/10540423/Turkeys-politicians-gold-dealer-and-the-pop-star.html](http://www.telegraph.co.uk/news/worldnews/europe/turkey/10540423/Turkeys-politicians-gold-dealer-and-the-pop-star.html)

\(^{38}\) [http://www.unicef.org/evaldatabase/index_29697.html](http://www.unicef.org/evaldatabase/index_29697.html)
SANCTIONS LIFTED – OPPORTUNITIES

On January 17th 2016 international sanctions related to Iran’s nuclear program were lifted, after the International Atomic Energy Agency, the UN nuclear watchdog, announced the previous night that Iran had complied with its side of the July 2015 accord.39 The EU nuclear-related sanctions were removed completely, whereas US removed part of their sanctions, including a ban on commodities trade for non-US citizens, ban on non-US companies to do business with Iran, a particularly harmful ban on non-US citizens providing insurance/re-insurance of crude oil, gas and petrochemical products to or from Iran, as well as sanctions prohibiting companies to invest in the energy sector in Iran, or buying crude, oil products or petrochemicals from Iran.40 Certain US sanctions, still remain in force, including US trade embargo and effective prohibition of any US dollar transactions (since those would have to transit through US banks). 41

This will be a huge boost for various sectors of the economy: lifting energy sanctions would mean possible increase from oil exports by $10bn; around $30bn of frozen assets (according to the CBI) would be brought back to country; IMF predicts 5% GDP growth increase in 2016-17 from almost zero currently; according to Iran’s first Vice-President Eshaq Jahangiri, sanctions have added 15% to the cost of trading with Iran and lifting them will save the country some $15bn yearly in cheaper trade.42

According to Hamidreza Araqi, managing director of the National Iranian Gas Company, following the removal of international sanctions, Iran’s gas industry will prosper and establish a firm foothold in international markets.43 Europe, eager to diversify away from politically motivated Gazprom, will embrace the opportunity of a new significant source of natural gas. E.g. Czech Republic is keen to import gas from Iran, according to Iranian Petroleum Minister Bijan Namdar Zangeneh who met Czech Republic’s Minister of Industry and Trade Jan Mladek in Tehran,44 whereas EU officials already plan the “technical assessment mission” to Iran, in order to explore the energy ties following the lifting of interna-

40 http://blogs.platts.com/2016/01/19/iran-post-sanctions-oil-plans-market-impact/
41 Ibid.
tional sanctions. According to Arias Canete, European Climate and Energy Commissioner, potential areas for cooperation include all areas of energy -- nuclear, oil, gas, renewable energy and energy efficiency.  

Iran has already made first post-sanction sale of oil to Europe, when National Iranian Oil Company reached a long-term agreement with Greece’s largest refinery, Hellenic Petroleum, on January 23rd, 2016.  

Besides going back to the being a major international actor on the oil market, Iran will regain access to significant sums that had been frozen due to the sanctions. “Based on economic analysis of Iran’s oil exports and trade flows and an aggregate of International Monetary Fund and U.S. government estimates, the report determines that the Iranian government has $90-$120 billion in foreign assets. As part of the JCPOA, Iran will gain access to these previously frozen funds.” Authors of the cited report also believe that removal of sanctions will cause the economic growth in 2016/17 to accelerate to 4-5% with imports and oil exports growing at a faster pace.  

Other sectors that would benefit from lifting of sanctions include automotive industry and pharmaceuticals that had been major exports before the sanctions were tightened.  

The incomes generated by post-sanction trade and regaining of assets will be important for Iran in improving the living standards at home, particularly since the oil prices have sunk to a decade-low levels. The public expects better socio-economic conditions so Iran government will need to focus on investments in domestic economy and infrastructure projects.  

---

45 http://uk.reuters.com/article/iran-nuclear-eu-idUKI8Nl5109W  
46 http://www.wsj.com/articles/greeces-hellenic-petroleum-to-buy-iranian-oil-1453554806  
49 http://uk.reuters.com/article/uk-iran-nuclear-funding-analysis-idUKKBN0OA0Z920150525
IRANIAN-GEORGIAN ECONOMIC TIES

The relations between Georgia and Iran can be traced to the 5-6th centuries BC, when the Achaemenid Empire, extending from Indian borders to eastern parts of Modern Greece, subordinated the kingdom of Colchis. Since then the two countries have mostly been if not at war, then at least in hostile relations, until the occupation of Georgia by Russia. However, after the independence Georgia has had extensive diplomatic and economic relations with Iran, starting in 1992 and today the tumultuous past can be all but forgotten.

Out of 47 bilateral treaties and agreements signed by the two countries most important are related to the cooperation in energy and transport as well as to the trade and economic relations. Iran was one of the many countries that had enjoyed visa-free entry to Georgia until mid-2013, when the government of Georgia revoked such entry and effectively denied entry to citizens of the country with the 6th largest number of visitors to Georgia (after Turkey, Azerbaijan, Armenia, Russia, and Ukraine), resulting in the number of Iran visitors dropping almost 72% in 2015 compared to 2012.50

Iran hasn’t been so far a particularly important trade partner for Georgia. In 2015 Iran was the twelfth largest export destination, representing 1.62% of Georgian exports, and twelfth largest importer in Georgia as well, with 1.19% of Georgian imports coming from Iran. These figures are slightly larger than average share of Iran in Georgian trade (0.89% of imports and 0.99% of exports in 1995-2015).

Despite these lowly figures, Iran is a significant export destination for sawn wood (HS code 4407), with 46.8% of all exports in 2015, and 23.3% since 2006. Another, possibly potentially significant export category is re-export of motor cars and vehicles, 5.5% of which in 2015 went to Iran. Given the problems in exporting vehicles to traditional re-export destinations like Armenia, Azerbaijan and Kazakhstan, Georgia could use the lifting of sanctions as an opportunity for this sector. Other notable exports include ferroalloys, iron and steel bars and rods, sheep and goats and new rubber tires, however apart from the latter (8.16% of total in 2006-2015) the share of these exports in total is negligible.

Although the overall share of Iranian imports in Georgian trade is quite low, it is dominated by products for which Iran seems to be the major source – 57.8% of petroleum coke, 57% of float glass, 51% of grapes and 33% of sacks and bags in 2006-2015 have been imported from Iran, meaning that Iran can be considered a major trading partner if for a very specific set of imports.

50 http://gnta.ge/ge/%E1%83%A1%E1%83%90%E1%83%A2%E1%83%90%E1%83%98%E1%83%A1%E1%83%A2%E1%83%98%E1%83%99%E1%83%90/
As for FDI, investment from Iran has been virtually nonexistent, with the share of Iranian FDI in total investment in 2006-2015 less than 0.1% (about $9.2 mln in value). Over last two years Iran mainly invested in processing industry ($2.039 mln) and real estate ($1.900 mln), with investment flowing in other direction in agriculture and fishing ($3.104 mln USD). It should be noted that FDI from Iran started picking up in 2012-2013, only to drop dramatically in 2014-15, perhaps due to inexplicable decision of Georgian government to introduce visa regime with Iran and limit the period the Iranian citizens could stay in Georgia for.\(^{51}\)

---

\(^{51}\) Remittances from Iran are hardly worth mentioning at all, with the total turnover (sum of inflows and outflows) being $347,700 since 2010.
As mentioned above, Iran has enjoyed visa-free access with Georgia prior to 2013 and the stricter visa regulations were immediately reflected in the drastic decrease of visitors. Similar to FDI, number of Iranian tourists peaked in 2013 and the upward trend was clearly visible. While the share of Iranian tourists was not high, given the lifting of sanctions this upward trend could have been retained and amplified with the removal of sanctions visitors from Iran might have constituted another important source of capital inflow.
POTENTIAL COOPERATION — SECURITY, ENERGY SECTOR AND BEYOND

The biggest opportunity for Georgia is “and beyond”, therefore conceptual title of Georgia’s Iran policy could be framed as “Gateway to Europe”. Materialization of this potential requires complex and sophisticated approach. First of all increasing political engagement for widening the space for issue oriented cooperation agenda. Secondly, minimization, removal or accommodating the major conflicting factors in foreign and security policies related with US-Georgia strategic partnership, Georgia’s NATO aspirations and Georgia-Israel Relations. Additionally, the fact that among six major regional countries (Georgia, Azerbaijan, Armenia, Iran, Turkey and Russia) only Iran has diplomatic relations with all the others indicates the complexity of the issue and along the challenges provides significant economic opportunities for Georgia.

POLITICAL RELATIONS

Current political agenda of Georgia-Iran relations is relatively limited and is supported by ad-hoc / occasional visits and consultations. Materialization of the strategic goal of the Georgia-Iran partnership requires widening of the political agenda. Goal of the widening of the political relations should be two fold: finding common interest and minimizing conflicting issues – i.e. walking a fine line\(^{52}\) in balancing relations with its traditional partners and allies.

At the first stage it would be important to establish more extensive communication channels for better understanding the positions of the sides. It would be impossible to materialize “Gateway to Europe” policy without high-level political engagement and widening the field for political relations.

Multi layer engagement would allow paving wider avenue for the primary focus of cooperation in economic field, particularly for the long-term economic cooperation goals of strategic nature – communications, infrastructure and investments. Important element of political relations would be cultural, educational and people-to-people relations.

Healthy and mutually beneficial political relations would largely depend on skillful diplomatic efforts to narrow the gap on its security implication.

\(^{52}\) http://edition.cnn.com/2012/06/15/world/europe/georgia-iran-west-relations/index.html
SECURITY IMPLICATIONS

Security agenda of bilateral relations with Iran should be focusing on contributing to the regional security. Due to extreme complexity and sensitivity of several aspects of the issue (particularly accommodating sovereign defense and security policy choices) should be contained on the margins of the security agenda.

While issues of supporting sovereignty and territorial integrity as well as countering terrorism and energy security have potential of positive cooperation, relations with US, Russia and NATO will for some period remain as the issues of controversy.

The Iranian leadership has constantly voiced its concern to Tbilisi regarding Georgia’s close security partnership with the United States, claiming that strengthening NATO’s position in the region is not the best way to maintain regional stability. Recognizing the limitations on its ability to influence Georgia, however, Tehran has increasingly adopted a pragmatic policy toward Tbilisi better suited to its limited political resources53.

Notwithstanding the lifted sanctions, several major security and geopolitical factors would complicate policy making: US considers Iran as the foremost state sponsor of terrorism—continues to exert its influence in regional crises in the Middle East through the Islamic Revolutionary Guard Corps—Qods Force (IRGC-QF), its terrorist partner Lebanese Hizballah, and proxy groups. It also provides military and economic aid to its allies in the region. Iran and Hizballah remain a continuing terror threat to US interests and partners worldwide.

For the last two centuries Russia has never been far from the center of Iranian politics; often as a colonial foe, sometimes as a convenient ally against a common enemy54.

Following the agreement on a Joint Communiqué in the P5+1 talks Russia immediately agreed on an oil for goods swap with Tehran. Russian President Vladimir Putin also signed a decree ending a self-imposed ban on delivering the S-300 anti-missile rocket system to Iran, thereby removing a major irritant between the two after Moscow cancelled a corresponding contract in 2010 under pressure from the West55.

Besides the access to the EU market, Iran is interested in access to the Russian market.

54 A. Milani, Russia and Iran: An Anti-Western Alliance? Stanford University, December 2007, pp 328.
55 Russia opens way to missile deliveries to Iran, starts oil-for-goods swap, Reuters, 13 April, 2013.
While economically this could be beneficial it contradicts Georgia’s national security interests. The Russian-Iranian partnership and Iran’s attempts to expand Shiite influence in the region are also security concerns for Turkey. Supreme Leader Khamenei continues to view the United States as a major threat to Iran.\textsuperscript{56}

With the abovementioned several of many complicated security implications, to make the Iran policy consistent with the Georgian national interests (including its security) is only possible by tightly correlating it with Georgia’s major foreign and security policy priorities, namely EU/NATO integration and Strategic Partnership with the US.

**ECONOMIC POTENTIAL**

**TRANSPORTATION**

Post-sanction Georgian-Iranian economic relations will most likely cover several different directions. First of all, given the re-emergence of Iran as a significant energy exporter, Georgia could exploit this new opportunity to further diversify its gas import – an issue which became even more important now, in the light of Georgia-Gazprom negotiations. Since the price of natural gas is declining even faster than that of oil (almost three-times drop since early 2014\textsuperscript{57}), Georgia could benefit from the competition among Caspian basin natural gas providers to find a best deal for itself and assert its position as an important part of East-West energy corridor. If the negotiations with Gazprom are indeed a result of need for diversification, opening up Iran supply will definitely provide more diversification with additional benefit of not being dependent on Russian energy giant, known for being used by Kremlin for geopolitical purposes.

In December 2015 representatives of Armenia, Georgia, Iran and Russia met in order to discuss energy cooperation issues and discussed a number of regional projects.\textsuperscript{58} These included the possible electricity import from Georgia and Armenia to Iran, given that Georgia has a surplus of energy in the spring and summer, while the situation is reversed in Iran.\textsuperscript{59,60} At the same time the option of Iranian gas import to Black Sea via Armenia and Georgia was

\textsuperscript{56} http://docs.house.gov/meetings/IG/IG00/20160225/104550/HHRG-114-IG00-Wstate-ClapperJ-20160225.pdf
\textsuperscript{60} Potential inclusion of Iran in the regional grid of electricity interconnectors would allow Georgia and Iran to trade freely with produced electricity with each other and more importantly with the neighboring countries both in the neighboring region and Europe.
emphasized in the conversation between Rouhani and Armenian President, Serzh Sargsyan in February 2016,\(^61\) whereas earlier in January, National Iranian Gas Exports Company Managing Director Alireza Kameli indicated that there had been negotiations between Georgia and Iran on sending Iranian gas through Armenia to Georgia.\(^62\) While Russia will definitely try to strong-arm Armenia to prevent Iranian development in this direction,\(^63\) it still is a viable option and a course which should be taken.

Georgia could also provide a cheap way for Iranian oil to reach Europe. Iran has essentially four options for transporting oil to Europe: (i) tankers via Persian Gulf and Suez; via Georgia and Black Sea crossing (ii) Armenia and (iii) Azerbaijan; and (iv) via Turkey. Despite Iranian relations with Turkey and Azerbaijan warming up after significant periods of disagreement (both Recep Erdogan and Ilham Aliyev have recently visited Iran), these two options seem less likely at the moment, particularly the Turkish direction, given the vague relations of Turkey and Daesh, Iran’s enemy. As for the Persian Gulf option, Iran possesses largest tanker company in the Middle East and transportation of pledged million barrels daily will not be particularly difficult, however Georgia should offer a pipeline option; Iran might need some persuasion, however it is a perfectly realistic possibility.

However, Georgia should not limit itself only to being an oil transportation corridor – our geopolitical location has long been considered as a comparative advantage and Georgia can easily become a logistical and transportation hub. There already is an agreement between Georgia and Iran on passenger and cargo automobile transportation, signed in 1993,\(^64\) so persuading Iran to import and export goods via Georgia will be an important step in Iranian-Georgia economic relations. Particularly once Tbilisi-Poti road is completely renovated it will serve as an important transport artery.

At the same time a serious consideration is being given to the construction of Iran-Armenia railway, which will provide an alternative to current Iran-Azerbaijan railway and provide a link between Iran and Black Sea, via Georgia. There is a threat, discussed in our previous issue of “Georgia and Neighbors”, which Russia will try to force through an Abkhazia-Armenia railway, however a strong position of Georgian government in this respect coupled with the obvious gains for both Iran and

\(^{61}\) [http://www.eurasianet.org/node/77266](http://www.eurasianet.org/node/77266)
\(^{62}\) Ibid.
\(^{63}\) Which might be particularly easy, given that Gazprom owns 100% of gas distribution network in Armenia
Armenia, should prevail in directing the Georgian part of the so-called North-South Transport Corridor.

**BUSINESS RELATIONS**

The potential economic gains from Georgia-Iran post-sanction relations should not concentrate solely on various transportation options. Despite the fact that at the moment the Iranian investment in Georgia is negligible in value, the number of Iranian business registered in Georgia increased from around 100 in 2010 to more than 1500 two years later.\(^{65}\) The removal of sanctions could mean Georgia, somewhat constrained before by its close relations with and dependence on the US, becoming more open for Iranian capital, whereas Iran in its turn might find profitable to invest in Georgian economy. If the transportation of goods will indeed pick up, Iran might become interested in building warehouses in Georgia, investing in ports and in industrial zones. This will certainly be simplified now that the visa limitations for Iran citizens have been lifted again. Another important benefit coming from growth of Iranian investment, particularly in the light of recent currency volatility in the region, will be increased flow of foreign currency, which will help stabilizing Lari.

Georgia should also consider Iran as a potential market for its products. 80 mln-strong population is a huge and virtually untapped market and while it might be somewhat wary towards US companies, it will welcome European firms. Georgia could step in as a proxy for American companies, creating joint ventures (with the caveat that we do not have particularly great experience in this field) and providing new technologies and services for Iranian population. At the same time ratification of DFCTA allows Georgia to offer Iranian investors a potential opportunity of preferential trading with the EU (given that the necessary requirements for the rules of origin are met as per the Association Agreement). In parallel to logistical infrastructure Iranian businesses could benefit by establishing joint production facilities in Georgia for various goods for further exporting it to EU. Apart from the direct economic boost, Georgia would greatly benefit by merging big volumes of Iranian resources and European standard technologies and business practices on its territory.

Georgia can also offer a range of its own products – starting with water resources, both drinking and mineral. Also, if the gas/oil pipeline agenda will come forward

---

\(^{65}\) It should be mentioned that Saakashvili government opened up its relations with Iran in 2011.
this will create an opportunity for stimulating the pipe production in Rustavi Metallurgical. More potential directions for cooperation between Georgia and Iran will be revealed after the visit of Georgian Prime-Minister Giorgi Kvirikashvili to Iran.

Banking sector is another potential area of cooperation between the two countries. Despite being small in size, Georgian banking sector is considered one of the best in the region and its resilience was proved by the twin crisis of 2008, when Georgia was not only hit by the global financial crisis, but also (and predominantly) by the war with Russia and Georgian banks overcame this period virtually unscathed. On the other hand Iranian banking system is much larger, however the high level of the non-performing loans indicates that there is a certain room for improvement. Iranian banks have been cut off the world financial system for quite a while and Georgian banking sector could provide a useful outlet.
CONCLUSIONS

Iran issue should become part of the comprehensive agenda in foreign, economic and security policy. Security element of this policy should be substantial and multi-dimensional. This would require holistic, whole-of-the-Government approach with effective coordination mechanism within the Government as well as Georgia’s foreign partners (bilaterally with key strategic partners as well as international organizations).

Particular policy priorities should include promoting extensive economic relations, and minimizing security concerns. Also policy should encompass comprehensive risk assessment and alternative policy options and transition mechanisms for various contingencies in the range from worsening to significant improving the Iran-West relations.

Prior to today the economic relations between Georgia and Iran were not most extensive and neither country was a particularly important economic partner for another. However now that the sanctions have been removed and Iran begins its reintegration into the global economy, Georgia can prove to be a valuable ally, providing transportation corridor, the market for Iranian goods, opportunities for preferential trading with the EU, as well as sell its own products – mineral waters, timber, etc. – to Iran. Georgia can gain both financially and politically from cooperation with Iran. Another source of natural gas, especially when the talk of diversification is so vocal, is going to be very important in shielding Georgia from Gazprom influence. Trade with Iran will provide a large market for our products, but even more importantly, for our services. Re-export of used cars (which has picked up last year) might be a good example of redirecting efforts from countries now in the Eurasian Customs Union to Iran. Georgia can become if not a focal point, at least an important target for Iranian investment and while most of Iranian businesses that came into country might be categorized as small, new and open relations might induce medium-to-large Iranian enterprises to invest in Georgia, providing new jobs and flows of foreign currency.

There are certain weaknesses in Georgia’s position: one should not forget that Georgia is not the only country interested in Iran, and our competitors may be better placed (Armenia, with the caveat that it still needs access to the Black Sea), or richer (Russia, Turkey), so Georgian government and Georgian private sector must actively exploit Iranian direction, through negotiations and active persuasion. At the same time, Georgia must not forget the somewhat strained relations between Azerbaijan and Iran and take into account that flirting with Iran oil/gas resources may not be tak-
en lightly by our main ally in the South Caucasus. Also intensifying relations with Armenia (to exploit road/railway transportation options) may be frowned upon by Turkey.

However, on the whole, Iran represents a great opportunity for Georgia to reinforce its position as a hub on the crossroads of Europe and Asia, and if before today Georgia was considered as a pivotal point of the Silk Road on the East-West direction, it can become a focal point on the Southern-North route as well.
POLICY RECOMMENDATIONS

In order to build comprehensive agenda of the bilateral relations with Iran, to be able to react on potential geopolitical changes in Iran’s relations with the West, capacity to analyze the process should be boosted by:

- Academic and analytical researches of political, economic and security aspects;
- Improving human capacity and knowledge of the issues within the governmental agencies (MFA, MIA, MOD, MŒ etc. as well as, probably, NSC)
- Fine-tuning information exchange and consultation mechanisms with partner countries and international organizations;
- Comprehensive study of Iran’s economic potential and interest in EU market;
- Comprehensive study of the interests of particular EU countries in trading with Iran.

Based on the abovementioned analysis major focus of Georgia-Iran bilateral relations should be economic, financial, trade, investment and transportation issues. Energy policy should be separate issue but not be dominating bilateral relations agenda. Sensitive issues of security should be minimized and/or accommodated and at some extent removed as an impediment for other elements of cooperation agenda.

Several short and long term strategy milestones needs to be considered with clearly lined up priorities:

Short term strategic milestones should include:

- Tourism;
- Small and medium trade;
- Well developed, transparent and secure financial services;
- Small and medium size construction projects;
- Economic/investment opportunity promotion;
- Promoting efficient access to the EU market.

Long term Strategic milestones:

- Attracting Iranian investments in logistical infrastructure construction;
- Promoting joint production in Georgia for the EU market;
- Attracting new technologies and capabilities in Georgia, which in combination with Iranian resources could successfully produce quality goods for export.
- Development of energy infrastructure (including interconnector power lines) within the regional energy framework.
EPRC is a rare think- and do- tank which brings to light the most pressing economic issues confronted by the society, provides cutting-edge analysis, offers evidence-based recommendations, and stimulates public debate and education. EPRC was established in 2002 and from the very beginning has played an active role in linking the civil society and the public sector, providing guidance and advice in various fields of public policy, budget oversight, and monitoring the implementation of the major state and donor-funded programs. Throughout the past decade EPRC has earned a reputation of an objective, reliable, and non-partisan source of information on the issues related to economic, financial, and social policies.
The brief is published with the financial support of the Open Society Foundation’s Think Tank Fund.