

Iran's New Direction – Opinion piece in Gulf Business, Jan 2014

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We are at a potential cusp, a transformational moment in the Gulf and the Middle East where détente with Iran could radically change the geo-politics and economics of the region. The opportunity should not be missed.

Iran has been headline news for the past few weeks after the P5+1 (shorthand for US) reached a deal whereby Iran agreed to curb some of its nuclear activities in return for a promised \$7 billion in sanctions relief.

In a deal agreed for a six month timeframe and reflecting the current balance of power between the negotiating parties, Iran agreed to halt enrichment of uranium above five per cent purity, neutralise its stockpile of uranium enriched to near 20 per cent purity, stop building its stockpile of 3.5 per cent enriched uranium, forswear “next generation centrifuges”, shut down its plutonium reactor and allow extensive new inspections of its nuclear facilities. Concessions Iran “won” included suspension of international sanctions on Iran’s exports of oil, gold, and cars, which could yield \$1.5 billion in revenue, while unfreezing \$4.2 billion in revenue from oil sales and releasing tuition-assistance payments from the Iranian government to Iranian students enrolled abroad.

Following the announcement, Iran’s official missions hogged the limelight as did the GCC Summit’s leaders applauding Iran’s “new direction”, though its communiqué also voiced concern over Iran’s plans to build more nuclear power plants on the Gulf, saying these “threaten the environmental system

and water security”.

THE ISSUE IS NOT THE NUCLEAR DOSSIER BUT IRAN'S GEO- STRATEGIC ROLE

The current focus of negotiations is on Iran's nuclear capability and sanctions. It will take time and confidence building measures to overcome suspicion, mistrust and three decades of deep freeze in relations. On both sides, hardliners and losers from détente (notably Israel and Saudi) will actively attempt to derail negotiations. However, the opportunity and overture offered by the election of Hassan Rouhani should not be missed. A new path must be chosen.

The ultimate purpose and objective lies not in the nuclear dossier but in defining Iran's future geo-strategic role in the Gulf, Middle East and South East Asia. It is about Iran's active participation in healing long-standing open wounds, including the cancer of the Israeli-Palestinian impasse. Only a Pax Americana-Irania can lead to a stabilisation of Iraq, Afghanistan, and Pakistan and prevent Syria from turning into a failed state with destabilising spillovers into neighbouring countries, notably weak Lebanon and Jordan.

The Iran détente stakes are high. A large dividend from détente would result from reduced military expenditures, of 'swords into ploughshares' across the Middle East. In 2012 Middle Eastern countries accumulated more than \$132 billion in military spending, the highest percentage of GDP in the world (with Saudi leading at 8.9 per cent of GDP, Oman 8.4 per cent and Israel 6.2 per cent).

Freeing up economically sterile military expenditure and re-orienting spending for investment in human capital, infrastructure, R&D, economic and social development projects and regional public goods would have numerous benefits. Leading to much-needed job creation, increasing productivity growth and raising real income for the young generations of a region that has witnessed too much death and destruction. A new path must be chosen.

DÉTENTE WITH IRAN MEANS LOWER OIL PRICES

Globally, détente with Iran would mean a lowering of tensions and risk of disruption of oil supplies through the Straits of Hormuz – substantially cutting the \$10 to \$15 risk premium built into world oil prices – and would also result in increased oil exports from Iraq and Iran, putting further downward pressure on oil prices.

Lower oil prices would contribute positively to the nascent global economic recovery, though the Gulf oil exporters would suffer from a fall in oil export and budget revenues. Similarly, access to international banking and capital markets would be restored for Iran and the sovereign risk premium would decline for all countries, lowering the cost of capital and finance.

There would be two other important medium and longer-term implications.

One, OPEC's governance, strategy and role would need to change to accommodate growing oil production from Iran and Iraq and pressure from shale oil. Two, détente would allow the build-up of pipelines and energy infrastructure from China and Kazakhstan to Iran and Afghanistan to Pakistan and India. Given its geography, Iran would be the lynchpin linking the oil rich Gulf with Asia and China along, the 'New Silk Road'.

IRAN DÉTENTE MEANS LARGE ECONOMIC BENEFITS

Détente with Iran would not only be a major change in the geopolitics of the Middle East, it would potentially generate large economic benefits to Iran and the Gulf countries.

The combination of strengthened sanctions, which quarantined Iran from the international banking and payment system, with economic mismanagement and populist economic policies under Ahmadinejad led to a downward spiral in economic performance.

Iran, which used to export about two million barrels per day (bpd) before the sanctions, exports around one million bpd, a

halving of its main export commodity.

Iran's GDP contracted by 1.9 per cent in 2012 and the IMF estimates a further drop of 1.5 per cent in 2013. The currency collapsed, with the Rial's unofficial value falling from around 13,000 to the US dollar in September 2011 to roughly 30,000 to the dollar earlier this summer. Not surprisingly, inflation has skyrocketed to between 40 per cent to 70 per cent depending on the source, with the Central Bank of Iran announcing an official rate of 39 per cent for the 12-month period ending in August, and youth unemployment exceeding 24 per cent.

The political cost has been heavy and led to the Rouhani change; a new path was chosen. Iran now has a team of technocrats in the top economic policy cabinet positions, with an objective of macroeconomic stabilisation, committed to market-based reforms and greater international openness that would encourage foreign investment. Indeed, Iran will have to undertake major reforms to improve the investment climate, introduce laws and regulations to ease the cost of doing business while protecting investors and liberalising economic activity, with an expanded role for the private sector.

UAE & GCC WOULD BE MAJOR BENEFICIARIES OF IRAN DÉTENTE

Amongst the GCC nations, the UAE was the main trade partner for Iran, thanks to the emergence of Dubai as a key re-export hub.

Starting in 2000, GCC exports to Iran grew substantially, reaching \$13.4 billion from 2008 to 2009, with the GCC states, particularly the UAE, enjoying a sizeable trade surplus with Iran.

The sanctions caused trade relations within the region to plummet – a good example being Dubai's trade with Iran, which plunged by more than a third to Dhs25 billion in 2012. With sanctions removal and détente, trade is likely to rapidly exceed pre-sanction levels, benefiting both countries.

In 2008, the GCC accepted an offer from Tehran to begin negotiations on a FTA. Negotiations can now be re-opened to strengthen regional and bilateral relations. The GCC countries can benefit from Iran's agricultural and industrial potential, while Iran can benefit from the GCC's services sector, logistics infrastructure and capital for investment. Opening up would lead to a mutually beneficial surge in trade and investment.

A \$1.3 TRILLION INVESTMENT OPPORTUNITY IN IRAQ AND IRAN

As a result of more than two decades of sanctions Iran has not had access to modern technology & investment and achieved lower overall levels of investment.

Iran will need to catch up and raise investment by up to 15 per cent to 20 per cent of GDP (or about \$60 to \$80 billion) for at least ten years. Hence, as a conservative estimate, Iran will be opening investment opportunities of some \$600 to \$800 billion over the coming decade ranging from core infrastructure, agriculture, oil & gas, industry and housing among others.

Iraq's reconstruction will require investment in the order of \$700 billion. Détente with Iran and resulting stabilisation in Iraq would mean infrastructure and reconstruction expenditure of some \$1.3 trillion, a major boon and boost to the region's economies and for the global economy.

A GCC6+1 IS NEEDED: A NEW PATH AND A NEW VISION

Détente with Iran would be a game changer leading to a deep transformation of the geo-strategic, political and economic geography of the Gulf and the Middle East. The stakes are high.

The GCC countries – in this case led by the UAE – should seize the opportunity to reap the economic and financial benefits

from the opening of trade, investment, development and reconstruction opportunities.

The creation of a "GCC6+1" framework could create an official platform for dialogue, consultation and open negotiations on a wide set of issues including security, economic and financial relations.

With the appropriate vision, the Gulf could become a zone of peace, stability and prosperity where the peoples of the region could fructify their vast human, energy, natural and financial resources. The alternative is increased militarisation, tension and mistrust and growing risk of conflict. It is clear which option is beneficial for our region.