

## Iran: A Troubled Economy on the Verge of New Sanctions

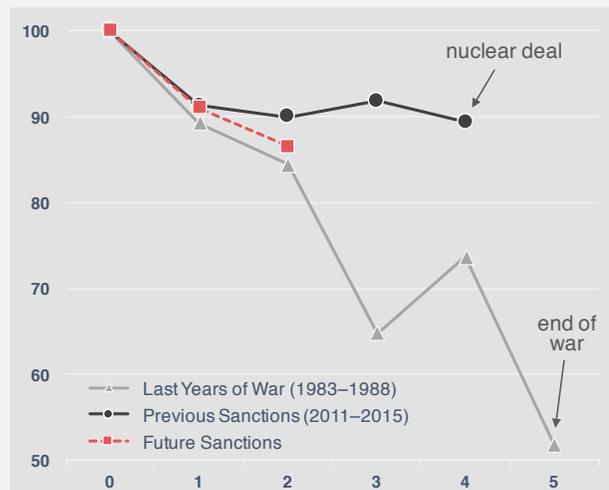
Pooya Azadi, Stanford Iran 2040 Project

After decades of insufficient and non-inclusive economic growth, the signs of stress in the Iranian economy are multiplying. Of the twenty-six million people in the labor market, upwards of three million, mostly young and highly educated, are unemployed. Severe water scarcity has become the new norm—suggesting that the output from the agriculture sector will shrink, and hence the food security of the country's large and growing population can no longer be taken for granted. Crude oil production has already reached its pre-sanction levels and significant production growth in the short to mid-run seems unlikely.

On the financial front, bouts of instability—which have reached a historically unprecedented level—are making the underpinnings of the economy increasingly fragile. The financial sector is heading for a “*Wile E Coyote*” moment where the overall stability of the banking system and the value of currency can both plunge quite suddenly. High positive real interest rates (i.e., nominal interest rate minus inflation) have dampened investment for a prolonged period, while—considering the sluggish realities of the real sector—private savings will be channeled to the currency market (hence depreciating the rial and accelerating capital flight) should the interest rate be reduced. Furthermore, having enormous amounts of non-performing loans, the banking system has essentially turned into a country-wide Ponzi scheme with a growing imbalance in their balance sheets. Another looming challenge facing the economy is the pension funds that, despite a favorable population age composition, are already becoming insolvent. Pension crisis not only erodes the economic well-being of vulnerable pensioners but also leads to an even smaller fiscal space for the much-needed capital expenditure.

For decades, the government of Iran has responded to these and other challenges with irresponsible and unsustainable policies, which—although sometimes successfully postponed the pain—never addressed the underlying problems properly. As such, it is expected that departure of the economy from its present disequilibrium towards a new equilibrium point will be associated with devastating austerity.

Recently, there has been widespread speculation that the United States is considering embarking on new sanctions against Iran. The extent to which these new sanctions could impact the economy is hard to predict



**Fig 1.** Real GDP per capita vs. years into the crises (1983, 2011, and 2017 = 100).

due to uncertainties around their various aspects. However, it is beneficial to have an estimate, even in rough terms, on what could be on the horizon for the economy if new sanctions are imposed. Assuming that the scope and aggressiveness of the future sanctions will be similar to those of the sanctions implemented in 2011 and by taking into account the shares of different sectors in the economy, it is expected that the real GDP per capita of Iranians will decline by approximately 13% in a mere two years (dashed line in **Fig. 1**). This would mean that the average income level in real terms will decrease from 15.7 to 13.7 million toman.

To put this in context, ex-post data of the evolution of Iran's GDP per capita during the previous sanctions (2011–2015) and the years of the Iran-Iraq war following 1983 when the economy was deteriorating at a fast pace are also shown in **Fig. 1** (solid lines). Massive buildup of government debt, lower economic resilience, loss of social capital, deepening of both centralized and decentralized forms of corruption, capital flight, lower oil prices, and severe drought and water shortage are among the underlying reasons why the new sanctions regime can have a more pronounced impact on the economy compared to its predecessor. It is also worth noting that the estimated values shown in **Fig. 1** are based on the assumption that no catastrophic financial crisis will occur during the time period considered. If a financial crisis occurs, however, an economic collapse—which was improbable if not unthinkable until recently—could become the reality of Iran in the not-too-distant future.