

Viewpoints
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The Nuclear Issue: Why is Iran Negotiating?

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After several months of uncertainty, the Iranian government finally agreed to meet again with the P5+1 group in Almaty, Kazakhstan on February 26 for negotiations over its nuclear program. Iran's economy is suffering the effects of the severe sanctions imposed by the West, but the government is not yet prepared to change course on the nuclear issue. Iran needs to be certain of a positive outcome from the negotiations before it commits itself to meeting the West's concerns over its nuclear intentions.

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The Impact of the Iranian Economy on Political Decisions

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Experts agree that 2012 was the worst year in Iran’s economic development since the end of the Iran-Iraq War in 1988. External sanctions have certainly contributed to the poor performance of the Iranian economy, but there were also other key factors, i.e. the consequences of subsidy reforms, weak populist policies of the Ahmadinejad administration, and corruption and mismanagement.

However, while the economy as a whole is suffering, different segments within Iran have varying perceptions of the crisis and different degrees of vulnerability. The question remains whether poor economic realities will lead to different political dynamics in Iran’s national security and foreign policy decisions. In this short paper, I will examine this question.

Key Economic Indicators

The table below summarizes key indicators and points to a number of critical trends that are harmful for the Iranian economy. These trends are:

<i>Indicators</i>	<i>1390* (21 March 2011 to 20 March 2012)</i>	<i>1391* (21 March 2012 to 20 March 2013)</i>	<i>1392* (21 March 2013 to 20 March 2014)</i>
GDP growth (real in rial)	4.0%	2.1%	3.4%
GDP (nominal in USD at median exchange rate)	\$344.9 bn	\$255.7 bn	\$199.6 bn
GDP per capita (in USD)	\$4,589	\$3,366	\$2,596
GDP per capita (USD) growth (decline)	-18.6%	-26.7%	-22.9%
Inflation Official (unofficial)	21.5% (26.9%)	23.9% (35.8%)	23.3% (29.9%)
Oil and gas exports	\$81.7 bn	\$60.5 bn	\$65.8 bn
Non-petroleum exports (including services)	\$31.9 bn	\$25.9 bn	\$25.9 bn
Imports	\$71.0 bn	\$53.1 bn	\$54.9 bn
Trade Surplus	\$34.5 bn	\$33.3 bn	\$36.8 bn
Unemployment Official (unofficial)	12.3% (19.0%)	14.1% (20.6%)	13.7% (20.2%)
Gross official reserves (in billion USD)	109.7	100.0	90.0
In months of imports of goods and services	12.5	22.6	19.6

*Main source: Iran Economics Magazine, January 2013 (Eghtessad-e Iran), *Projected*

- **Falling per capita GDP:** Even though the economy is growing nominally, it is contracting enormously when one converts the economic performance to US dollars (USD) at an average exchange rate. As can be seen, the per capita GDP in USD has declined two years in a row and will further decline in the next Iranian year;
- **Inflation** remains high (in the range of 20 to 30 percent), which is eating into the purchasing power of average Iranian families;
- **Unemployment** continues to remain high, and there is no prospect of a relaxation in the employment market, especially as sanctions and subsidy reforms will continue to undermine the sustainability of many companies in Iran.

Official Responses to the Crisis

In a bid to contain the negative impact of the current trends, various authorities have introduced measures to temper the economic pain felt by society. These include:

- Against protest by the government, the *Majles*, the Iranian Parliament, has postponed the implementation of the second phase of the subsidy reforms;
- The government has introduced stricter measures to contain imports so that the per capita import bill in Iran has declined by about 40 percent in 2012 compared to 2011. This means that, in principal, the quality of imported items is declining, which has direct consequences on the well-being of the Iranian society;
- There are various ideas (from food rations to an extraordinary New Year cash payment) on how to help the lower-income classes overcome the current difficulties. Clearly, the multi-tiered exchange rate system allows the government to look after the main regime supporters (lower-income classes), hence reducing the political cost of economic deterioration;
- There has also been a growing recognition of the fact that a liberalized economic structure and a more prominent role for the private sector could help ease some of the current pains (e.g., unemployment). Therefore, a number of rules and regulations have been introduced. These include the empowerment of the private sector in the export of petrochemicals, crude oil, and petroleum products as well as new customs regulations to promote domestic production.

While there are initiatives to improve economic conditions, none of them are designed around a softening of the Iranian tone in nuclear negotiations. One reason may be that both the government as well as informal power centers are, in fact, benefitting from the current crisis.

Indeed, Iranian officials can easily hide behind the sanctions and justify their own shortcomings, which are plenty. Furthermore, the status quo allows ambiguity and opaqueness in financial and commercial dealings, paving the way for corruption. From a political perspective, the pursuant crisis related to external pressure justifies a clampdown on all types of dissent and protest.

Outlook

As the above indicators suggest, the Iranian economy has suffered, but regime insiders know that only a part of these problems is related to external pressure. Therefore, a softening of the Iranian position in nuclear negotiations will not resolve the key issues. At the same time, the continuation of a “crisis mode” is quite beneficial for a number of interest groups in Iran. Hence, one should not expect any softening of the Iranian position as a result of economic pressure. The reasons are diverse, but it is important to understand that key constituencies (i.e., Supreme Leader Ayatollah Ali Khamenei and his close confidants) continue to distrust the West, while other segments (business networks close to the regime) are benefitting from the status quo.

With the regime mainly focused on how it can look after the lower-income classes, the main losers remain the Iranian middle class and the truly private business networks. In other words, the current sanctions are weakening the main proponents of change and reform. The only piece of good news may be that the situation will compel Iranian officials to liberalize the economy. However, such efforts are still heavily overshadowed by factional infighting and the tense political processes within the country.

Consequently, it would be a mistake to believe that continued economic pressure will compel Tehran to change its stance on the nuclear issue. It seems that Tehran’s calculus would only change if there is a new Western approach to the Iranian issue.



Khamenei’s Mounting Pressures

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Negotiations on the Iranian nuclear program are set to re-start in February, but Iran’s previous foot dragging in agreeing to a time and venue for the negotiations has been vexing for U.S. and allied diplomats. Iranian behavior is particularly puzzling given the urgency of resolving the nuclear crisis peacefully and alleviating pressure on an increasingly vulnerable Iranian economy. What is Tehran thinking?

Some analysts have suggested that Tehran is divided internally and cannot make a decision. This is unlikely. Supreme Leader Ayatollah Ali Khamenei has consolidated power since the 2009 presidential election and makes decisions for the entire country. If Khamenei wants negotiations to proceed, then Iran’s negotiators will respond accordingly. Rather, Khamenei is hesitant to engage the P5+1 (the United States, United Kingdom, France, Russia, China, and Germany) due to his ideological distrust of the United States. Specifically, he may view the P5+1 offer for Iran to stop uranium enrichment to 20 percent, ship out its highly enriched uranium, and close down the underground Fordo facility in return for a consideration of

sanctions relief as not only a trap but also a prelude to defeat for himself and his regime. Khamenei may be reluctant to make a deal, but mounting pressures from a broad section of the political elite and Iranian society may ultimately force his hand and even loosen his grip on power.

The gridlock in negotiations between the P5+1 and Iran is a problem of sequencing. The P5+1 wants Iran to make the first move in order to build confidence, while Tehran is anxious for the P5+1 to recognize Iran's right to enrichment and to lift sanctions before Iran takes any action. Tehran may be more willing to ship out its 20 percent enriched uranium than to give up its Fordo nuclear facility entirely. Fordo is viewed by Tehran as one of its greatest sources of leverage, especially because it is buried deep beneath a mountain and is less vulnerable to Israeli and possibly U.S. air strikes (although the United States has the military means to do much greater damage to Fordo).

Nevertheless, there is a much larger issue at stake: the historical and ideological rivalry between the United States and the Iranian regime. For the Islamic Republic, the nuclear program is a strategic card in its ongoing battle with America. And although the United States may claim it has no agenda other than solving the nuclear crisis, there is a great deal of hostility toward the Islamic Republic among influential American political constituencies. This is not surprising, given the Iranian regime's history of supporting terrorism, its hostility toward Israel, and its widespread human rights abuses. Among the Iranian elite, there is deep resentment toward the United States for its support of the Shah and of Saddam Hussein during the Iran-Iraq War. Hence, the nuclear crisis is not just about Iran's pursuit of a potential nuclear weapon capability. Rather, it is a bitter struggle over the future of Iranian, Israeli, and U.S. power in the Middle East.

Can such obstacles be overcome? Yes, but only to the extent that the goals are limited to a diplomatic solution that is just enough to avert a costly military conflict over the nuclear program. The other issues will not go away as long as the Islamic Republic rules Iran. Regardless, although Khamenei may be reluctant to make a deal, mounting pressure may leave him little choice but to be more flexible.

Although he is Iran's most powerful leader, Khamenei is nevertheless surrounded by rivals and enemies at home. The reformists who so brazenly challenged his regime in 2009 have been effectively pushed out from the corridors of power. But this does not mean they are inactive. The reformists want to contest the June 2013 presidential election, which they claim should be "fair and free." (Khamenei has stated that the words "free election" are code for "sedition.") More moderate conservatives, such as Ayatollah Hashemi Rafsanjani, are also keen to protect their interests and contain, or perhaps even reverse, Khamenei's quest for absolute power. Both reformists and the Rafsanjani camp are anxious about Iran's growing international isolation and its declining economy.

Followers of President Mahmoud Ahmadinejad also view the presidential election with deep concern. Ahmadinejad, who cannot run for the presidency again, has been politically marginalized and worries that his allies will not be able to compete in the election. Recently, the powerful Guardian Council diluted the Interior Ministry's authority to supervise the election. The Guardian Council is largely against Ahmadinejad, whereas the Interior Ministry is

controlled by his allies. The Ahmadinejad camp's total political isolation may embolden it to challenge Khamenei even more publicly – and even criticize his nuclear policy.

More importantly, Khamenei may come under greater pressure from his own conservative camp, especially the Revolutionary Guards. Khamenei's conservative supporters are his most important constituency. He may be able to ignore the reformists, the Rafsanjani conservatives, and the pro-Ahmadinejad elite, but he has to keep the Revolutionary Guards and the merchant class happy. To date, neither appears to have publicly criticized him over Iran's nuclear policy. Khamenei's key foreign policy advisor, former Foreign Minister Ali Akbar Velayati, has resolutely declared that there is "complete agreement on the nuclear program" within the Islamic Republic.

It is true that some hardline Guards and conservatives may be wedded to Khamenei's policy of resistance against the United States, but many also value money, luxury, and power. This group may become more critical of Khamenei as sanctions take their toll. For example, Habibollah Asgaroladi, a key conservative figure and one of Iran's richest men, recently criticized the house arrest of reformist leaders Mir Hossein Mousavi and Mehdi Karroubi. Mousavi, in particular, is considered to have been an effective manager as Iran's former (and last) prime minister, steering the country through its economic crisis during its war with Iraq. Asgaroladi may recognize that Iran needs such guidance once again.

Finally, the Iranian people are becoming restless, as evidenced by recent demonstration in Tehran's bazaar and numerous labor demonstrations throughout the country. The Iranian economy is in much worse shape than the Islamic Republic admits. The effect of sanctions has not been limited to the energy sector; other important export industries such as auto manufacturing, petrochemicals, and even Persian rug making have suffered. There have been reports of many factories shutting down and hundreds of thousands of workers losing their jobs. A Revolutionary Guards officer recently predicted that the next popular uprising will start in the provinces and smaller towns due to declining living conditions. The Iranian people may not be involved in the nuclear negotiations, but they are unlikely to stand idly by and see their once proud, productive, and ancient nation come to total ruin.

Khamenei may very well lose face in future negotiations, but a characteristic of a sensible leader is a willingness to accept some defeats along with the victories. After all, it is the Islamic Republic that is in violation of the Treaty on the Non-Proliferation of Nuclear Weapons, and it must prove to the world that its activities are peaceful in nature. Khamenei's mounting pressures may compel him to be more flexible on the nuclear program. Otherwise, he will face greater sanctions, more internal political opposition, and, possibly, the wrath of his own people.





Showdown for Iranian Talks

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The title of this publication is, “Why is Iran Negotiating?” But the real question is, “why have the Iranians not yet decided to negotiate?” Talks which the United States and other diplomats were confident would be held in January will now take place in February at the earliest.

This is not new. The Iranian nuclear crisis is more than one decade old. It has seen a lot of back and forth in order to get meetings together. And now could not be a tougher time.

Iran’s nuclear program has progressed to a point where people fear the Iranians are on the verge of the so-called “break-out capability.” This would mean that they could, in short order and possibly without being detected, make enough highly-enriched uranium to produce a bomb. Iran has amassed more than 5,000 kilograms of low-enriched uranium (enriched for increasing the amount of the U-235 uranium isotope to five percent) which Tehran says is for making fuel for civilian reactors. But it could also be the raw material, upon further enrichment, for some five atomic bombs.

Meanwhile, Iran has a stockpile of over 130 kilograms of uranium enriched to 20 percent. This uranium is designed to be made into fuel for a research reactor in Tehran that produces isotopes for medical diagnosis. The problem is that this 20 percent enriched uranium is a significant step on the way to making weapons-grade uranium, which is enriched to over 90 percent. Since enrichment is an exponential process, rather than a linear one, 20 percent enriched uranium is some 90 percent of the way to weapons-grade uranium.

Iran is short of having enough 20 percent enriched uranium to make one atom bomb, but it is when it reaches this point that a “break-out capability” is feared.

Israel had predicted that Iran would reach break-out in mid-2013. The fear is that a decade of confrontation over Iran's nuclear progress will finally boil down to a stark binary choice of living with an Iranian atomic bomb or having to bomb the Islamic Republic to stop it from acquiring a bomb.

But 2013 may not be so decisive. For one thing, Iran’s technological progress may not be so fast. Iran is still working at getting its second enrichment site, at Fordo, up to speed. It has been unable to get more advanced centrifuges – which can increase the rate of enrichment – working in production lines at their main enrichment plant in Natanz.

In a new development, Israeli intelligence has reportedly decided that Iran would be unable to produce a nuclear weapon until 2015 at the earliest. One Israeli intelligence officer was quoted saying that the delay is not due to sabotage alone: “There has not been the run towards a nuclear bomb that some people feared. There is a deliberate slowing on their end.”

So, there is space for negotiations. This is because diplomacy, strengthened by sanctions, still looks a lot better than military action. The result may very well be that the crisis will limp on, as it has since secret Iranian nuclear work was first uncovered in August 2002.

Iran is trying to stretch things out both to avoid further sanctions and to give itself more time to pursue its nuclear work. The United States proposed at least two dates in January for talks and indicated it will basically meet Iran anywhere it chooses. But Iran never responded about the first date in the middle of the month and had tentatively signed on to talk January 28-29, with no location set. Said one Western diplomat: "I think their purpose all along was to get as many meetings as they could get in order to talk as little as they can."

The Iranians may be reluctant because they know that the situation when they meet again with the P5+1 will not be much different than it was last time, in Moscow in June 2012. And they do not want to be blamed if talks fail, as looks to be the case if the two sides' positions have not changed. This could lead to even tougher sanctions. The United States and its negotiating partners – the United Kingdom, China, France, Germany, and Russia – have hardened, not softened, a proposal that Iran had already rejected in talks last year. The six major powers still insist that Iran cease 20 percent enrichment before it can get significant sanctions relief, and they have modified this demand to reflect Iran's increasing the number of centrifuges in Fordo.

Iran, however, wants sanctions relief now. This is its main condition for any sort of opening deal. Iran is currently facing sanctions on its central bank and oil sales that appear to be increasingly effective. In 2012, the Iranian currency, the rial, lost half its value. Oil and gas revenues dropped 45 percent in the last nine months of 2012. U.S. officials feel these measures will only become more effective as the months go by and more time is needed.

Iran also wants larger issues to be handled, especially in direct talks with the United States, such as the normalization of relations between the two countries. Iranian officials say repeatedly that the United States is using the nuclear issue for political reasons as it seeks regime change in the Islamic Republic.

This does not sound like a process that is ready to end anytime soon.

A final factor: Iran will be distracted as it heads into March with Iranian New Year's celebrations and then the campaign for Iranian presidential elections in June.

The United States is committed to its dual-track diplomacy and has convinced Israel to follow suit. But it is an open question how Israel will act by mid-year, especially if talks are going nowhere and Iran takes its nuclear work up a notch.



*These papers are based on the authors' presentations at the Wilson Center on January 29, 2013.
The opinions expressed herein are those of the authors and do not reflect those of the Wilson Center.*

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