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In February 2019, the Islamic Republic of Iran celebrated the fortieth anniversary of the Islamic Revolution. At first sight, the country appears to be a well-functioning Middle Eastern state based on a semi-rentier economic structure, where oil revenues account for between 10 and 20 per cent of GDP depending on the year (Table 1).

Iran has recently seen two waves of protests due to socio-economic reasons. At the end of 2017, demonstrations started in the eastern part of the country, Mashhad, and although they spread fast, these remained sporadic events mobilizing only the lowest strata of society. The city of Mashhad is known as a stronghold of the conservatives as is home to the Eighth Imam's (Reza) Shrine, which attracts millions of worshippers each year; therefore, it has the ability to mobilize the poor in this way. The reasons behind the protests were mainly economic backwardness and the decreasing standard of living (unemployment, inflation etc.). The second wave of demonstrations started in June 2018 due to the instability of the Iranian rial. Tehran's Grand Bazaar was shut down for several days due to this dissatisfaction with the economic management of the country.[2]

The protests may have come as a surprise, as following the nuclear deal (signed between the P5+1 and Iran in July 2015) the United States – among other stakeholders – lifted sanctions against Iran. The nuclear deal gave an unprecedented opportunity for the Iran to engage with the global economy: with its implementation in 2016, a wave of sanction relief paved the way for a potentially rapid increase of foreign direct investments (FDIs) and growth in the oil sector. But the high expectations of the public about the potential impact of the lifting of certain sanctions on the standard of living have not been realized. However, the Iranian economy has been facing a serious challenge even without sanctions, one that could have a political impact on regime stability.

On 8 May 2018, the Trump administration withdrew from the Joint Comprehensive Plan of Action (JCPOA), the so-called Iran nuclear deal, announced that it would prevent Iran from exporting even "one drop of oil", and in re-imposed sanctions. A first set of sanctions was re-imposed three months after Trump's announcement, in early August 2018. However, the most serious sanctions, especially those related to oil export and production have been effective since 5 November 2018. According to a recent estimation, Iranian GDP will shrink by 3.7 per cent in 2019, which is partly due to sanctions on the oil sector (World Bank 2018: 30). Under these circumstances, a fundamental question to address is whether the economic problems will have political effects.

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2 "Rouhani Under Fire Amid Second Day of Protests in Iran", in *Al-Monitor*, 25 June 2018, http://almon.co/32lv.

Table 1 | Selected macroeconomic indicators in Iran

	2012	2013	2014	2015	2016	2017	2018
GDP growth/year (%)	-7.5	-0.2	4.6	1.3	13.4	3.8	-1.5
Unemployment rate (%)	12.2	10.4	10.6	11.1	12.4	12.5	12.4
Inflation (%)	25.7	39.3	17.2	13.7	8.7	9.9	n/a
Oil rent (% of GDP)	16.6	20.1	19.5	10.5	13.6	n/a	n/a
Military expenditure (% of GDP)	2.7	2.2	2.2	2.6	2.8	3.1	n/a

Source: World Bank Data: *Iran*, https://data.worldbank.org/country/iran-islamic-rep.

THE IMPACT OF THE NUCLEAR DEAL

Fluctuation in GDP growth figures is partly due to United Nations Security Council (UNSC) sanctions but also to internal economic developments. With the imposition of the oil embargo by various stakeholders (UNSC, EU, individual states), the Iranian economy underwent a serious economic downturn. The sanctions mainly hit oil and gas production and export, the bank system as well as the foreign trade and FDIs in Iran. In 2012, GDP per capita declined by 22.3 per cent, which had a terrible effect on economic expectations (Khajehpour 2013: 24).[3] The Supreme Leader described Iran's struggle as amounting to a "resistance economy", arguing that the economy would flourish despite the sanctions. It is a fact that the UNSC, US and EU sanctions had a diverting effect on Iranian foreign trade. In 2017, Iran's major economic partners included China, the United Arab Emirates, Turkey, South Korea and India. The Asian emerging countries have significant demands for Iranian oil; however, they have failed to completely replace the European buyers, which has led to a sharp decrease in total oil export and revenues.

Then newly elected President Hassan Rouhani delivered an inaugural speech in 2013 arguing that sanctions are not the only problems for the Iranian economy: "I don't want to say that all the economic problems are related to the sanctions. A major part of the problem is related to mismanagement" (Coles 2013). With these words, Rouhani tried to distance himself from former President Ahmadinejad's policies, and called for structural reforms. Rouhani's administration achieved single-digit inflation, a stable exchange rate as well as a solid economic growth during his first presidential term (2013–2017). Nevertheless, job creation has remained an unsuccessful area, even for this more pragmatic president.

Since the implementation of the JCPOA in 2016, the Iranian economy has witnessed robust economic growth, which has mainly been built on the recovery of the oil trade with western countries. The GDP growth rate of 13.4 per cent in 2016 was a twenty-five-year record for the Islamic regime, and this reinforced people's high expectations. However, the rapid recovery of Iranian economic growth was not coupled with the improvement of other socio-economic indicators. For the general public, the lifting of certain sanctions does not have any impact on their daily life (World Bank 2017).

3 The next Iranian fiscal year is 21 March 2019–20 March 2020.

Especially important was the decrease in unemployment, which became a campaign promise in the next presidential elections. Yet the youth unemployment rate increased between 2014 and 2016, from 20.9 to 25.9 per cent. Although the non-oil sector is the largest job provider, the growth rate of this sector was just 3.3 per cent in 2016, while the main driver of the rapid growth was still the oil sector (Habibi 2018: 7).

With the lifting of sanctions European companies such as Airbus, Nestlé, Daimler, Total and Siemens rushed to negotiate trade and investment deals with Iran – resulting in a 30 per cent increase in EU–Iranian trade between 2016 and 2017 (Ewing and Reed 2018). For instance, European aeroplane manufacturing company Airbus signed a deal with Iran to sell one hundred planes to IranAir to renew its ailing fleet. Such steps were important measures in creating new jobs and fostering socio-economic recovery. Consequently, the lifting of sanctions had an overwhelmingly positive impact on the Iranian economy, but it also caused an "empty box syndrome": for the vast majority of the Iranian population, this economic growth had no direct effect on their standard of living.

THE US WITHDRAWAL FROM THE JCPOA

After a round of threats, the Trump administration announced its withdrawal from the JCPOA in May 2018. President Trump sees Iran and its nuclear ambitions as a danger to the security of the United States and its allies. The US Secretary of State, Mike Pompeo called for the negotiation of a complex new agreement, which would better serve the interests of Washington, by addressing all the different threats perceived from Tehran. The United States gave a waiver to eight countries (China, India, South Korea, Japan, Turkey, Taiwan and two European countries – Italy and Greece) allowing them to continue trade with Iran's oil sector for a limited time (six months). Countries not complying with the sanctions will face severe punishment from the United States, limiting any financial and trade cooperation with US companies.

The EU has condemned Trump's decision and announced that it is committed to maintaining the deal, along with China and Russia. Although Ayatollah Khamenei described the Iranian economic model as a "resistance economy", the country is aspiring to secure EU investment and trade (Rózsa and Szigetvári 2019). This endeavour is quite risky for European companies, given that any potential economic punishment by the United States would further endanger EU–US trade ties. Still, the EU has announced a number of legal measures in order to keep Iran committed to the JCPOA. The first is the so-called Blocking Resolution preventing any financial damage to European companies trading with Iran due to the US sanctions. The second is the recent introduction of a special purpose vehicle aimed at transferring money between Iran and EU countries. The E3 (France, UK and Germany) announced the launch of INSTEX (Instrument in Support of Trade Exchanges), which mainly deals with trade between Iran and the EU in the non-sanctioned humanitarian sector (Geranmayeh and Batmanghelidj 2019).

As far as the Iranian economy is concerned, the EU's commitment to maintain trade links with Iran is not enough to preserve the 2016 growth rate. The main problem is the low intensity of trade between EU countries and Iran. While EU–Iran trade reached a value of 20 billion euros in 2017, the World Bank expects a decrease in GDP for 2018 of 1.5 per cent as a direct consequence of sanctions on the oil sector (Geranmayeh 2018). In April 2018, Iranian oil export reached its maximum level after the implementation of the JCPOA, with a value of 2.68 million barrels per day. This is expected to drop below a million barrels per day, soon causing difficulties for the Iranian economy (Vakhshouri 2018).

However, the main challenges faced by the Iranian economy are not related to sanctions. In 2018, the economy witnessed a wave of turbulence when the government decided to unify the official and unofficial rate of exchange between the Iranian rial and the US dollar. In August 2018, this exchange rate reached an unprecedented high (1 US dollar was worth over 110,000 rial). This single exchange rate had a significant impact on the middle-class standard of living. Due to the higher import prices, inflation reached 24.2 per cent later that same month (World Bank 2018: 12). University students studying abroad thus faced difficulties in funding their studies due to the unavailability of the unofficial exchange rate. The middle class started to invest their savings in gold to maintain their value, but gold prices went up by 150 per cent in 2018 compared with the previous year.

The other issue facing the Iranian economy is regional inequalities. The demonstrations of 2018 partly took place in the economically marginalized western part of the country, namely Khuzestan province. Khuzestan is home to various minorities, including a significant Arab community, where socio-economic difficulties have triggered protests against the authorities. Other provinces suffering from regional inequalities are Sistan and Baluchistan, where Baluchi nationalism resulted in the emergence of an armed movement against the government (Perletta 2018: 3). These sorts of economic difficulties should not be seen as direct impacts of the sanctions, but they point to the need for structural reforms in the Iranian economy. Local demonstrations are also often correlated with environmental issues, including water management-related questions.

CONCLUSIONS

Western analysts often raise the question of the political consequences of economic turbulence in Iran. The demonstrations of 2018 did not aim at overthrowing the regime, and they remained within the framework of the Islamic Republic, which means that we cannot discern any stakeholders emerging with legitimate power who are able to challenge the system. Protests have taken place in eighty-five cities across the country, but the numbers of people gathering were in the hundreds rather than the thousands. Yet this does not mean that the Iranian political system is without problems. The renewal of US sanctions will only intensify the challenges the Iranian economy faces, which might lead to further public unrest – especially in those areas that already suffer from socio-economic difficulties. The social contract between government and citizens needs to be redefined (Tabatabai 2019: 14). With accelerating inflation in 2019, the middle class's purchasing power will erode significantly, not to mention that of the lower classes of society. The decision made by the Trump administration to withdraw from the JCPOA could have an effect on the political legitimacy of reformist groups which had strongly supported Rouhani's foreign policy goals, which aimed at agreeing with the international community on the nuclear issue. Even if the Islamic Republic's political system is not directly endangered by the re-imposition of sanctions, their impact on the economy will most probably heighten unrest and could lead to political crisis in the coming years.

As far as the EU's policy towards Iran is concerned, Brussels should realize its limited economic role in maintaining the JCPOA. The dilemma of the JCPOA remains a rift in EU–US relations. The EU should convince European investors and companies of its ability to maintain existing trade channels with its Iranian counterparts. If the Europeans have no capacity or political weight to engage with Iranians more fully in the economic sphere, then Asian partners, namely China and India, will replace them, as in the pre-JCPOA period. China in particular, with the One Belt One Road Initiative, has the willingness and the capacity to build a monopolistic relation with Iran, although with its investment in the Chabahar port facility, India has tried to balance the strategic Chinese–Pakistani partnership based on the China Pakistan Economic Corridor. With these developments in sight, China and India can rapidly fill the vacuum in Iran at the expense of the EU.

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MENARA

Middle East and North Africa Regional Architecture: Mapping geopolitical shifts, regional order and domestic transformations (MENARA) is a research project that aims to shed light on domestic dynamics and bottom-up perspectives in the Middle East and North Africa amid increasingly volatile and uncertain times.

MENARA maps the driving variables and forces behind these dynamics and poses a single all-encompassing research question: Will the geopolitical future of the region be marked by either centrifugal or centripetal dynamics or a combination of both? In answering this question, the project is articulated around three levels of analysis (domestic, regional and global) and outlines future scenarios for 2025 and 2050. Its final objective is to provide EU Member States policy makers with valuable insights.

MENARA is carried out by a consortium of leading research institutions in the field of international relations, identity and religion politics, history, political sociology, demography, energy, economy, military and environmental studies.

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