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# German–Iranian Relations after the Nuclear Deal: Geopolitical and Economic Dimensions

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**ABSTRACT** *Germany and Iran, being the most populated countries of Europe and West Asia respectively, have shared a long history on various levels, politically, economically and culturally. Traditionally, Germany has been deemed Iran's closest partner in Europe although its policy towards Iran during the so-called nuclear crisis in the 2000s largely followed Washington's lead due to Germany's joining of the latter's coercive diplomacy. With the start of the nuclear negotiations in 2013, Berlin has then played a positive role during the negotiations that culminated in the July 2015 nuclear deal. In light of these developments, this article will review German–Iranian political and economic relations.*

## The Geopolitical Dimension

### ***Germany's Role during the Nuclear Crisis: Following in Washington's Footsteps***

**W**hile Iran's relations with Western Europe had deteriorated after the 1979 revolution, they nevertheless remained intact, with cooperation continuing in the economic, political, and cultural realms. Importantly, Tehran had traditionally viewed Europe as a counter-balance to U.S. pressures. This view had to be gradually revised during the 2000s, when Iran negotiated with the EU3 (the UK, France and Germany) over its nuclear program. *Firstly*, in the wake of the initial diplomatic breakthroughs leading to the Tehran (October 2003) and Paris (November 2004) Declarations, the Europeans did not fulfil Tehran's expectations in return for the 22-month suspension of its nuclear program (November 2003 – August 2005), which were, namely to lobby the U.S. to dismiss its belligerent posture towards Iran and instead to offer Tehran a security guarantee, and to end the U.S. blockade over Iran's World Trade Organization (WTO) membership. Instead, once Iran resumed its nuclear program, accurately pointing out that the agreement was

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## The ‘Americanization’ of Germany’s Iran policy was driven by the German Chancellery which at that time was closely following Washington’s line on many foreign policy issues

not fulfilled by the other side, the Europeans ratcheted-up the pressure, blaming Iran for having broken the accords, although the latter specified the temporary and confidence-building measure of suspension that should be reciprocated by equally meaningful steps.<sup>1</sup> *Secondly*, the failure in that initial phase of nuclear negotiations between the EU3 and Iran prompted an ‘Amer-

icanization’ of the EU’s diplomatic strategy towards Iran by 2006. The Europeans had now adopted the U.S. position by demanding that Iran fully halt its nuclear program (‘zero enrichment’) as a precondition to further talks. If Iran did not give in, it would face the risk of a U.S. attack. Exactly a year into Ahmadinejad’s presidency, this warning was communicated by Joschka Fischer, then Germany’s Foreign Minister, at a speech delivered at the Center for Strategic Research (CSR) in Tehran. Fischer stressed “not to make the messenger responsible for the message.”<sup>2</sup>

In fact, the ‘Americanization’ of Germany’s Iran policy was driven by the German Chancellery which at that time was closely following Washington’s line on many foreign policy issues. In this period, however, German companies which had enjoyed profitable business relations with Iran prior to the outbreak of the so-called nuclear crisis in 2002 and the ensuing campaign of sanctions against Iran heralded by the U.S. Treasury from 2004 onwards, had often expressed their frustration over Berlin having joined the U.S.-led coercive diplomacy against Tehran. Germany company representatives repeatedly stressed that while they were forced out of the lucrative Iranian market due to U.S. pressure, some U.S. firms were still indirectly involved in Iran. Specifically, German multinational companies like Siemens and Daimler, which have a strong stake in the U.S. market and financial system, cut their trade with Iran having come under pressure from the U.S. Treasury that had issued a warning *à la* George W. Bush Jr. of ‘either you are with us or against us.’ German foreign policy-makers rationalized their turn towards coercive diplomacy as a means of avoiding a scenario comparable to the U.S.-led military intervention in Iraq. As a result, as Saghafi-Ameri and Ahadi have stated:

given the fact that the negotiations between Iran and the [EU3] and then the [P]5+1 countries on Iran’s nuclear programme did not yield the desirable results, the observable tendency in the administration of Mr. Ahmadinejad was reviewing the foreign-policy approach [of the previous two presidencies of seeking détente and a “dialogue among civilizations”—*AFN*] and establishing closer ties with Eastern countries under the title of “Look to the East policy.”<sup>3</sup>

This strategy, however, proved to be futile, given Washington's unilateral power exerted upon those Asian countries with which Tehran sought closer ties.

The disagreement between the EU and Iran was embedded in a larger geopolitical conflict. In August 2005, negotiations between the two sides broke down after the EU3 offered a package of proposals to Iran, which Tehran harshly rejected. The director of the Atomic Energy Organization of Iran (AEOI) called the proposal a “humiliation of the Iranian people.” Without any substantial offers in return for Europe's demand that Iran fully renounce its enrichment program (prompting an EU diplomat to label the package as “a lot of gift wrapping in a pretty empty box”), the package primarily reflected the EU's geopolitical will to tie Iran to Europe. *Firstly*, the package included the longer-term prospect of Iran becoming an important energy supplier for Europe (especially with a view to Iranian gas), in an attempt to diversify European energy supply in the face of an increasingly dominant Russian supplier. *Secondly*, the EU3 envisaged Iran as a market for its industrial products, holding out on the prospect of a trade agreement with Iran and on political support for Tehran's accession to the WTO –both of which would have facilitated European export of a range of products to Iran. *Thirdly*, while urging Iran to limit its nuclear activities to a minimum, the EU3 pledged to provide Iran with access to fuel rods and nuclear technology, which would have potentially put the Iranian nuclear sector in a situation of permanent dependency. Thus, the EU3's proposal demonstrates that the European states perceived Iran primarily as an energy supplier, as a market for European products, and as a country that should remain technologically dependent on Europe. The Iranian rejection led the Europeans on their part, and above all Germany, to react by fully aligning with the U.S. vis-à-vis Iran.<sup>4</sup> Against this background, in mid-2005, Germany's main foreign policy think-tank took note of “Iran's new distance from the West.”<sup>5</sup>

### ***Germany's Role during the Nuclear Negotiations***

The election of the centrist Hassan Rouhani to the Iranian presidency in the summer of 2013 provided Germany, and the entire West, with an opportunity to change course. The ensuing nuclear negotiations were primarily made possible by two main factors: Indispensably, the U.S. dropped its unrealistic and therefore counterproductive demand for ‘zero enrichment’ in Iran. In addition to that, the White House had become increasingly dissatisfied with its closest regional allies, mainly Israel and Saudi Arabia, which prompted it to consider Iran as a solid actor when it came to stabilizing an unraveling and highly fragile region. Being part of the P5+1 (the five permanent members of the UN Security Council plus Germany) negotiating team, the German Federal Foreign Office helped facilitate the nuclear deal. It continually lobbied for the deal in public as well as behind closed doors and positioned itself against any potential spoilers of the deal, including its close ally Israel. In a tremendous diplomatic

A general view shows representatives of Iran, the United States, China, Russia, Britain, France, Germany and the European Commission attending the EU 5+1 Talks with Iran at the UN headquarters in Vienna on February 18, 2014.

AFP PHOTO / DIETER NAGL



feat, the P5+1 and Iran eventually reached an agreement in July 2015, the Joint Comprehensive Plan of Action (JCPOA).

The JCPOA's provisions are indeed historic. At its core lies the removal of the nuclear-related sanctions (those sanctions imposed during the nuclear crisis by the UN and by the U.S. allies, above all the EU), in exchange for the Iranian agreement to downsize its nuclear program. In December 2015, the International Atomic Energy Agency (IAEA) confirmed that Iran had fulfilled its promise, thus paving the way for 'Implementation Day.' The tremendous extent of this downsizing is surprising, since Tehran had overstepped almost every red line it had set for its nuclear program during the crisis. Even the most skeptical Western nuclear experts working on the Iran dossier have voiced much satisfaction, agreeing that the deal would make it impossible for Iran to build a nuclear bomb without being caught by the strict inspection and safeguards regime. What has to be kept in mind, however, is the agreement's provision that the sanctions can be put back in place should Iran violate the deal – a prospect that is unlikely given that the Iranian elite aims to get rid of the sanctions. Moreover, the JCPOA is still upholding the arms and missile embargo against Iran for the next five and eight years, respectively, thus making sure that the regional imbalance in terms of conventional capabilities between Iran and, above all, the Gulf Cooperation Council countries, will remain in place.

### ***Germany and Iran after the JCPOA***

Prior to the JCPOA it was widely anticipated that the agreement would have a relaxing effect on regional geopolitics as well as on Iran's domestic politics. This

could turn out to be true in the mid- and long-term; in the short-term, however, the opposite dynamic set in: Political repression in Iran intensified under the umbrella of rapprochement with the West, while the already rampant anti-Iranian resentment of important political actors in the region (above all Saudi Arabia) only increased.

Since having reached the agreement in 2015, the German and Iranian foreign ministries have not ceased to stress that the nuclear deal can and should serve as a blueprint for tackling the other crises in the region and even beyond. However, the regional perception of the JCPOA differs strongly from this European assessment. The Iran nuclear deal has aggravated concerns by regional players as to Tehran's increasing geopolitical standing in the region. The traditional U.S. allies in the region in particular are now regarding Iran with even more suspicion. They fear that Washington has chosen Tehran as its new, main regional ally and will therefore grant it a free hand in regional politics. Consequently, a new alignment bringing together Saudi Arabia, Turkey, and Israel, against Iran, has emerged.

In the wake of the nuclear deal, Ankara revitalized its ties with Israel, stressing the latter's need for increased security. More importantly, despite Turkey's previous intent to pursue a policy of equidistance towards Tehran and Riyadh, a pro-Saudi geostrategic tendency has now materialized in Ankara. This shift was reflected by the creation of a high-level Turkish–Saudi Strategic Cooperation Council in early 2016, which rests on the countries' shared assessment of regional conflicts. Its common denominator is arguably the aim of both countries to counter Iran's influence and power, especially when it comes to Syria. However, despite the deteriorating Iranian–Turkish relationship (mainly due to the fact that they support different sides in the war in Syria), both countries have decoupled regional rivalries from bilateral relations centered on ambitious trade goals as well as shared concern *vis-à-vis* Kurdish empowerment.<sup>6</sup> Not least do they continue to be mutually dependent on each other: Iran relies on Turkey as an energy and trade transit to Europe while Turkey is dependent on Iran's gas.

The main antagonism currently exists between Riyadh and Tehran. At the beginning of this year, the Iranian–Saudi relationship reached its lowest point to date, which poses serious challenges to the region's security. This escalation



**Iran's policies in Iraq and Syria rather than having an inherently sectarian outlook or strategic impetus has been subject to a process of 'sectarianization' fueled by domestic security dilemmas there with weak states and ongoing civil conflicts**

## A case in point for Germany's misconception of Iran's role in the region was the convening of the Munich Security Conference (MSC) Core Group Meeting in Tehran on October 17, 2015

process between the ruling Shiites and the marginalized Sunnis.<sup>7</sup> As things currently stand, hopes for an improvement of Iranian–Saudi relations remain elusive. Both sides seem uninterested in seriously engaging in a process of détente, which could be facilitated by the West. The situation is exacerbated by the fact that both sides' intelligence services expect the collapse of the other's regime within months.

### *Misconceiving Iran's Regional Policies: Falling into the Trap of Extrapolation*

Since the successful conclusion of the JCPOA, there has been a tendency within German foreign-policy circles to extrapolate Tehran's "constructive engagement" with the West on the nuclear issue onto other foreign policy fields, above all Syria and Iraq, where Iran seeks to maintain hegemony. Yet Iranian foreign policy remains a multifaceted and complex phenomenon that espouses different priorities depending on the area in which it operates.<sup>8</sup>

On the one hand, Iranian behavior towards reaching the nuclear deal has been informed by a foreign-policy school of thought that can be labeled 'Defensive Realism.' Here, Iran pursued the primary goal of establishing good relations with the West based on a win–win rationale in the conduct of foreign policy.<sup>9</sup> This policy of engagement with Western great-powers is directed by the Rouhani administration and the Ministry of Foreign Affairs (MFA) which was granted the authority to deal with the nuclear dossier during the negotiations and which is headed by Iran's former ambassador to the UN, Javad Zarif.

On the other hand, Iran's policies in post-Saddam Hussein Iraq and in post-uprising Syria are informed by another foreign-policy school of thought that can be labeled 'Offensive Realism.' In Iraq, Iran has shown no interest in reversing the sectarian (and highly corrupt) system set up by Washington and sustained by Tehran, which favors the Shia majority over the Sunni minority.<sup>10</sup> It continues to favor a Shia-led central government in Baghdad that exerts control over the country's central and oil-rich, Shia-dominated southern regions. Tehran's policies have thus deepened the *de facto* fragmentation of Iraq into three parts: the effectively autonomous northern part (Kurdish Regional Government), the Sunni areas where IS(IL) could expand, and the above-mentioned Shia regions. Tehran operates with Shia militias, which it has set up or which it

supports, that have engaged –as have their Sunni counterparts– in numerous massacres, further alienating the Sunnis, many of whom started to consider IS(IL) as the only effective force that could re-establish their interests in the face of Iranian domination. Moreover, Iran also pursues a policy of economic development in those Shia regions of Iraq.

In Syria, Iran seeks to maintain the overall power structure and therefore the Syrian military and intelligence apparatus with which it has intimate links, and is willing to replace merely its head, namely President Bashar al-Assad. In Syria, Iran acts in a less sectarian manner as its support for the Syrian National Defense Front that lacks any sectarian or ideological affinity with Tehran. In addition, however, Iran entertains a network of co-sectarian, Shia militias, including Afghan, Iraqi and Pakistani regiments, as well as the Lebanese Hezbollah.

However, Iran's policies in Iraq and Syria rather than having an inherently sectarian outlook or strategic impetus has been subject to a process of 'sectarianization' fueled by domestic security dilemmas there with weak states and ongoing civil conflicts. Moreover, it would be simplistic to conceive Iran's relationship with the organizations it supports in both countries as merely a patron–client one. Rather those groups are, to varying degrees, embedded in the socio-politic context of their respective regions or countries.<sup>11</sup>

Due to these ultimately sectarian(ized) policies, Iran's formerly unrivalled "soft power," which it acquired throughout the region during the Mahmoud Ahmadinejad administration has now reached an all-time low. As a consequence, the Arab world is becoming increasingly anti-Iranian, which can have serious security ramifications down the road.<sup>12</sup>

Hence, the Offensive Realist school, which was dominant during the Mahmoud Ahmadinejad administration, espouses a zero-sum game rationale. Having been able to manage the uncertainties following the March 2003 U.S.-led invasion of neighboring Iraq, Iran emerged as West Asia's major, indeed indispensable power by the mid-2000s when the U.S.-led occupation had entered a 'quagmire.' Iran's success in Iraq has provided the Offensive Realists in Iran with a sense of hubris, arguing that the U.S. acceptance of an Iranian nuclear program and the ensuing nuclear negotiations under Rouhani were only rendered possible by Iran's strong regional standing. Iran's Syria and Iraq policies are directed by the Office of the Supreme Leader and the Islamic Revolutionary Guards Corps and executed by the latter's foreign operations arm, the Qods Force, alongside various Shia militias established by it. Of course, such Offensive Realist policies by Iran need to be seen in the context of a struggle over power and influence within a regional system characterized by systemic insecurity and great-power penetration, where a number of regional and non-re-

## In Germany, there is much excitement about the possibility of revitalizing its once booming trade with Iran

gional actors pursue equally problematic policies hardly apt to prepare the ground for a peaceful resolution. Here too, German pressure towards altering regional actors' Syria policies has been insufficient.

A case in point for Germany's misconception of Iran's role in the region was the convening of the Munich Security Conference (MSC) Core Group Meeting in Tehran on October 17, 2015 –the first-ever to have

taken place in Iran.<sup>13</sup> Discussing the thorny issue of the war in Syria and regional security, the conference was held without participation from key players such as Saudi Arabia, Qatar, Turkey, Russia, or the U.S. Instead, next to the Iranian, German and Iraqi foreign ministers, only representatives from Oman, Kuwait, and Afghanistan took part– countries, as one commentator shrewdly remarked, that “have to do with the Syrian crisis as much as Liechtenstein or Luxembourg does.”<sup>14</sup> This event and its very composition are indicative of Germany's insufficient understanding of the underlying logic of Iran's foreign policy agenda in Syria.

In the same vein, at the time of writing, Germany's Federal Foreign Office deems Iran's role in talks over Syria as “constructive” towards finding a political resolution. Yet, Russia's massive bombings in early 2016 that primarily targeted opposition forces have reduced the options for a future Syria, limiting them to a choice between the Assad regime or the so-called Islamic State. Given that choice, the Assad regime would be clearly favored by the West.

Another pressing and related question has been how Iran will utilize the repatriation of tens of billions of dollars of its frozen assets after nuclear-related sanctions have been removed. Especially in the West there have been concerns that Tehran might use that money to intensify its regional ambitions in Syria and elsewhere. According to Valiollah Seif, the head of the Central Bank of Iran (CBI), the nuclear deal would give Tehran access to \$32bn in overseas assets.<sup>15</sup> While concerns might be justified given the limitations of transparency within the Iranian system when it comes to the whereabouts of the entirety of its unfrozen assets, there is indeed the chance that some of this money will further fund Iranian activities in Syria and other regional theatres of conflict if circumstances so dictate. Yet, one has to bear in mind that in comparison to many regional powers' military budget and acquisitions, Iran's military expenditure is actually very modest as the country primarily relies on militias.

In his testimony before Congress on February 25, 2016, U.S. Secretary John Kerry stated: “The IRGC [Islamic Revolutionary Guard Corps] has actually pulled its troops back from Syria. Ayatollah Khamenei pulled a significant number of troops out. Their presence is actually reduced in Syria. [...] That

doesn't mean that they're still not engaged and active in the flow of weapons from Syria through Damascus to Lebanon. We're concerned about that and there's an ongoing concern." Regarding the amount of unfrozen Iranian assets, Kerry added that "Our estimates are it's somewhere in the vicinity of \$50 to \$55 billion at some point in time but it's way below that right now. [...] And in fact, they [Iranians] are complaining about the slowness with which there has been a process of repatriation."<sup>16</sup> In fact, Kerry may have overstated Iranian 'compliance' in the Syrian conflict in the attempt to deflect domestic criticism over Iran in the wake of the nuclear deal. Despite the relative withdrawal of Iranian forces since the latter half of 2015, it is estimated that Iran still has hundreds of 'military advisors' in Syria, alongside a number of Shia militias, including thousands of Afghans.<sup>17</sup> The relative reduction of Iranian involvement can be rationalized against the increasing Russian military engagement since summer 2015.

## **Economic Ties after the Nuclear Deal: Potentials and Hype**

### ***Potentials***

The nuclear agreement paved the way for Iran's return to the global economy. In late 2015, Morgan Stanley, a U.S. multinational financial services corporation, stated:

Iran is the largest economy to return to the global fold since the break-up of the Soviet Union and similarities include the complexity of the sanctions regime involved, the attempt at political rapprochement with the West and Iran's vast energy wealth. [...] In many respects, there is no direct comparator for Iran, given its economic size, the scale of the sanctions imposed and its political structure. In particular, the potential reintegration of Iran into the global economy is arguably uncharted territory in that there is no other hydrocarbon frontier economy that has been subjected to comparable economic and political sanctions.<sup>18</sup>

Indeed, Iran has been the only major country in the world to be cut off from the international financial and banking systems due to the sanctions regime, as well as the only one not to participate in the process of neoliberal globalization and its institutions for decades. The complete novelty of the situation can, in part, explain the hype that is currently surrounding Iran.

In Germany, there is much excitement about the possibility of revitalizing its once booming trade with Iran. Immediately after the signing of the JCPOA, a German business delegation headed by Sigmar Gabriel, Minister for Economic Affairs and Energy and the country's Vice Chancellor, was the first to Tehran in order to secure trade deals. Prior to the sanctions, Germa-



German Economy and Energy Minister Sigmar Gabriel and Iranian Oil Minister Bijan Namdar Zanganeh attend a meeting at Iran's Chamber of Commerce in Tehran on July 20, 2015, immediately after the nuclear deal.

AFP PHOTO / ATTA KENARE

ny was Iran's second largest business partner after the UAE, according to the Iran Chamber of Commerce, Industries, Mines and Agriculture (ICCIMA). During the nuclear crisis, German-Iranian trade relations suffered.<sup>19</sup> In 2014, German exports to Iran amounted to €2.4mn, about half the level of 2005. The Association of German Chambers of Commerce and Industry (DIHK) expects exports to Iran to increase to €5bn in the coming years and further believes that this figure is likely to double in the long-term.<sup>20</sup>

Many observers, not just in Europe, regard Iran as one of the few guaranteed growth markets this year. In the context of China's boom slowing down and the fact that demand from former growth markets Russia and Brazil is plummeting, hopes of exporters worldwide are pinned on post-sanctions Iran.<sup>21</sup> Indeed, after a decade of unparalleled restrictions due to sanctions regarding imports from the West, demand in Iran is huge and varied: The country needs trucks, cars, machinery, power stations, medical technology, consumer goods, as well as numerous other things. Expectations are particularly high in Germany because German firms have been instrumental in building up Iran's industrial infrastructure for decades. In this vein, the head of Foreign Trade Department at the German Engineering Federation (VDMA, *Verband Deutscher Maschinen- und Anlagenbau*) that represents over 3,100 mostly medium-sized companies in the capital goods industry, making it the largest industry association in Europe, stated: "Iran is the only country in the region with a broad industrial base. It's got demand for everything."<sup>22</sup>

## While Germany plans to revitalize its exportation of industrial goods to Iran, conducting investments will be much more difficult to realize

Furthermore, Iran is very rich in terms of natural resources. Besides having the world's second-largest hydrocarbon energy reserves (oil and gas combined), the country holds 7 percent of the world's total minerals, a substantial part of it untapped, potentially presenting a big opportunity for foreign mining companies.<sup>23</sup> Iran has the world's largest reserves of zinc and the second-largest reserves of copper. Morgan Stanley states that while the state essentially owned all mining assets until the last decade, "industry controls are being eased."<sup>24</sup> Additionally, Iran has a very young (over half of 80 million Iranians are under the age of 30), highly educated and tech-savvy population (Iran ranks second in the region after Turkey in terms of Internet usage).

### ***Challenges: Intricacies of the Islamic Republic's Political Economy and the Inadequacy of Rouhani's Neoliberal Economic Policy***

While these developments look promising, both for the Iranian economy and for international investors and businesses, there are still a number of obstacles when it comes to doing business with Iran. For one, the sanctions against Iran –according to U.S. President Obama the most comprehensive that have ever existed in history– have not been entirely abolished. While a large part of the sanctions have been removed –those imposed during the nuclear crisis–, extraterritorial U.S. sanctions tied to terrorism charges and human-rights violations remain in place. While according to Michael Tockuss, Managing Director of the Hamburg-based German–Iranian Chamber of Commerce (DI-HKEV), "Iran has practically no foreign debt, so actually it would be a dream client for international banks,"<sup>25</sup> the banking sector still remains a challenge. On the one hand, transactions by Iran with the world's lead currency, the U.S. dollar, remain impossible. On the other, following the JCPOA's implementation, the U.S. Treasury's Office of Foreign Assets Control (OFAC) issued reminders to U.S.-based companies, stating that "[...] U.S. persons, including U.S. companies, continue to be broadly prohibited from engaging in transactions or dealings with Iran or the Government of Iran [...]."<sup>26</sup> Foreign banks can be penalized by the U.S. for knowingly facilitating transactions with designated entities, above all the IRGC,<sup>27</sup> which is still on the EU's terrorism list. This poses a specific challenge because the IRGC entertains a vast economic empire (see below) that is difficult to circumvent when engaging in business with the country. However, U.S. sanctions experts do not expect heavy penalization against European and other actors, and rather anticipate much more tolerance towards dealings with that vast business empire.<sup>28</sup>

For the current Iranian year, the latest annual IMF Iran country report has projected a stagnating GDP, further stating that “Iran faces multiple constraints to unleash its growth potential and to achieve single-digit inflation sustainably. [...] Placing the Iranian economy among the top emerging market economies over the next decades will require comprehensive reforms.”<sup>29</sup> However, owing to nuclear-related sanctions relief taking effect on the JCPOA’s implementation on January 16, 2016, bringing about higher oil production, lower costs for trade and financial transactions, and restored access to foreign assets, both the IMF and the World Bank expect Iran’s GDP to grow by roughly 5 percent in 2017. The oil market is saturated, with prices expected to continue to remain low; the IMF expects a further \$5–\$15 per barrel reduction in prices as a result of increasing Iranian oil supplies.<sup>30</sup> Therefore, the focus will lie on Iranian gas export capabilities.

### ***The Peculiarities of the Islamic Republic’s Political Economy***

The Islamic Republic of Iran’s political economy reflects the country’s high degree of political and economic monopolization of power. Not surprisingly, the National Iranian Oil Company (NIOC) constitutes the largest economic entity. The second important economic factor is the IRGC’s socio-politico-economic conglomerate, which is believed to form one- to two-thirds of Iran’s GDP. Its largest entity, *Khâtam al-Anbiyâi*, entertains a vast array of affiliated companies (estimated at 800), active in all conceivable branches of the economy, the most important of which are tied to infrastructure, energy and the military-industrial complex. The third important entity is the clerical-commercial complex, consisting of a network of para-statal religious foundations (*Bonyads*), estimated to be in control of one-fifth of the GDP. Although Rouhani plans to start taxing them, this remains to be seen.

Aside from these vast economic areas affiliated with the state, there is also a private sector, which came into existence during the Akbar Hashemi-Rafsanjani presidencies, and which accounts for one-fourth to one-third of the GDP. Yet, according to Iran’s Ministry of Cooperatives, Labor and Social Welfare, the private sector harbors four-fifths of Iran’s employment opportunities. This shows that most capital-intensive sectors remain in government control (above all the energy and petrochemical industries), while the private sector is focused on labor-intensive activities.

At least on paper, the Iranian economy is a dream for foreign investors. Yet the economic reality is much more complex. Currently, in the post-sanctions era, a fierce economic competition between two rivaling factions of the Iranian élite is taking place: One faction is centered around the Supreme Leader, the IRGC and the *Bonyads*, the political and economic fortunes of which are tied to a monopolistic, mercantilist, and authoritarian form of capitalism. The other faction is a neoliberal one, largely connected to the old élite, which was

dominant during the Hashemi-Rafsanjani and Khatami administrations and which is now re-emerging within the current administration. This faction is mostly composed of centrists, technocrats, reformists, and pragmatic conservatives who will benefit once Iran is reconnected to global capitalism. Iran's domestic politics will continue to be the stage for intra-élite power struggles centered around politico-economic stakes. While the two factions have engaged in a fierce battle in daily politics, they share the common aim of safeguarding the regime from which they both significantly benefit, given the exclusion of the rest of society.

**Germany is putting more efforts into exporting goods to Iran rather than investing in production inside the country; Iran on the other hand is looking forward to expanding domestic production to create jobs for its youth and polish its own industry**

The blurred line between Iran's political and economic actors poses a peculiar challenge to foreign economic actors. A case in point is an incident in 2004 when the IRGC basically occupied the Tehran Imam Khomeini International Airport, successfully torpedoing a contract about the airport's management, which had been given to a Turkish–Austrian consortium. Since assuming office, President Rouhani has repeatedly called for the IRGC to reduce its economic involvement, arguably both to pave the way for other Iranian economic actors to gain ground, and as a way not to dissuade foreign actors to enter the Iranian market. Yet, it remains to be seen which politico-economic wing of the élite will prevail in the end.

In conclusion, it can be said that there remain challenges for the Iran hype to actually materialize. The country's economy is to a large part controlled by state and semi-state entities. Corruption, ambiguous legal provisions, and the lack of the rule of law continue to pose problems. Rouhani's pledge to alleviate all these shortcomings will indeed be difficult to realize, given the stakes that the monopolistic-authoritarian faction holds. Hence, while we have recently seen a lot of hype surrounding the opening of Iran as a market for foreign investors, it will take a while until we will witness any deep-seated change.

### ***The Centrality of the Economic Development Model for Iran's Future***

The Rouhani administration aims at an ambitious eight-percent annual growth for the next five years and has announced that Iran needs \$50bn of investment per year. Yet, there remain serious concerns about the adequacy of Iran's neo-liberal economic policy agenda to tackle the country's problems. Rouhani's budget plan for the last Iranian year (ending on March 19, 2016) has accrued considerable deficits: The entire planning was predicated upon the supposi-

tion that sanctions would be lifted (whose economic benefits will be slower to materialize than expected by the administration), and on a prediction of an oil price of \$72/barrel (currently, the price is at less than half of this figure).

Moreover, the budget rested upon two problematic pillars: Austerity and security. On the one hand, social welfare services (except for the health sector) have been cut significantly. On the other hand, the defense and security sectors have been considerably alimeted.<sup>31</sup> In other words, Rouhani's goal appeared to be neither alleviating the plight of almost half of the population living below the poverty line nor weakening authoritarian structures. In fact, Rouhani's agenda of economic rehabilitation is subjected to the primacy of security policy as a means to reduce the possibility of social unrest.<sup>32</sup>

As has been seen in other countries, following a neoliberal paradigm constitutes an inadequate means to solve pressing socio-economic problems. Since Rouhani assumed office, poverty and income inequality have increased. The budget for the current Iranian year foresees lower incomes from oil sales and instead relies on proceeds coming from taxation and privatization. A novelty in post-war Iran, taxes account for a larger share of the government's total budget than oil, one-third in comparison to one-quarter.<sup>33</sup> Whereas taxation of important entities will remain a thorny political-economic issue, privatization is unlikely to satisfy the administration's large expectations, which can only be realized if large state companies become privatized –an unlikely scenario. Since Rouhani has assumed office, poverty and income inequality has risen, according to calculations made by the economist Salehi-Isfahani.<sup>34</sup>

All this also relates to Germany's role. While Germany plans to revitalize its exportation of industrial goods to Iran, conducting investments will be much more difficult to realize. Germany and Iran are caught in a specific dilemma. According to Golverdi Golestani, a Tehran-based entrepreneur and former president of Iran's Auto Parts Manufacturers Association (IAPMA), "Germany is putting more efforts into exporting goods to Iran rather than investing in production inside the country; Iran on the other hand is looking forward to expanding domestic production to create jobs for its youth and polish its own industry."<sup>35</sup>

## Conclusion

In the post-sanction landscape, German–Iranian relations are bound to improve on all levels. However, the scale and extent of their cooperation on regional security issues remains to be seen, since the EU is still entertaining its business-as-usual relations with its traditional partners in the region, many of whom are part of an anti-Iran front. The emergence of a new anti-Iranian

alignment poses formidable challenges to European policies in a region that is increasingly marked by a rejection of strong Iranian influence over an Arab-majority part of the world. While Saudi Arabia will remain the most important Arab player for Europe, the mass executions in early 2016 have –perhaps for the first time ever– prompted Europe to question its close partnership with Saudi Arabia. This might cause Riyadh to lose its privileged position as Europe’s main ally in the long term. However, for the foreseeable future, the West is likely to continue to cooperate closely with Saudi Arabia. As a result, the balancing act between pursuing the process of rapprochement with Iran and keeping business-as-usual ties with Saudi Arabia is going to present the West with even greater difficulties in the future. As many have noted, the West’s Middle East policy lacks a coherent strategy. The latest escalation between Iran and Saudi Arabia has surely turned the idea of an inclusive regional security architecture into mere wishful thinking. The next escalation in the region will only be a matter of time as long as the regional security issues have not been properly addressed.



**Despite many positive signs, the future of German–Iranian relations will depend on a number of convoluted international, regional and domestic factors whose developments are difficult to foresee with any certainty**

Meanwhile, it is important to gauge the trajectory of German–Iranian relations in particular and Western relations towards the region in general, against the backdrop of past experiences. As the Arab uprisings have forcefully shown, the West’s arrangement with the region’s autocracies for the sake of ‘stability’ and its neoliberal economic policies merely benefitting local political and economic élites has been all but a sustainable strategy. Instead, efforts shall be made by Western actors in their dealings with the Iranian side towards bringing about inclusive and sustainable economic development. Therefore, these goals need to be seriously integrated during Germany’s revitalization of lucrative trade ties with Iran, a process that follows the motto of former Chancellor Willi Brandt’s foreign policy: change through trade and rapprochement (*Wandel durch Handel und Annäherung*).<sup>36</sup> In that vein, the German Development Institute (DIE) has recently called for harmonizing foreign and development policy, which should serve as guiding principle for policies towards the Middle East.<sup>37</sup>

For the West and many Iranian neighboring states, getting rid of that face of Iranian foreign policy that is seen as problematic will not be an easy undertaking. For it can be argued that there is an interconnectedness between the Islamic Republic’s domestic and foreign policy: On the one hand, the administration’s ‘constructive engagement’ towards the West cannot be detached from its allies’ domestic political and economic standing, which ties their fortunes

to an economic opening towards the West. On the other, the IRGC's policies in Iran's neighborhood cannot be easily disconnected from its political and economic stakes at home, as it seeks to keep banking on its indispensable role in Iran's security and foreign affairs, as well as to maintain its economic fortunes, which are, to a great extent, predicated upon Iran's relative isolation and antagonism with the West.

In brief, despite many positive signs, the future of German–Iranian relations will depend on a number of convoluted international, regional and domestic factors whose developments are difficult to foresee with any certainty. ■

## Endnotes

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