



كلية الآداب والعلوم  
College of Arts and Sciences  
QATAR UNIVERSITY جامعة قطر

مركز دراسات الخليج  
Gulf Studies Center

**Covid-19 in the Gulf  
Special Coverage**

**How sanctions and the pandemic affect Iran's economy  
Djavad Salehi-Isfahani**

**Gulf Insights Series  
Nº 33 – July 2020**

## How sanctions and the pandemic affect Iran's economy

### Djavad Salehi-Isfahani

#### *Introduction*

Iran has been under international sanctions of one kind or another for four decades, but its economy has never been as bad as it is now. In May 2018, the Trump administration began its campaign of maximum pressure to force Iran to renegotiate the Iran nuclear deal. This deal, officially known as the Joint Comprehensive Program of Action (JCPOA), was signed on July 2015 but only eased the sanctions for two years. During those two years, the economy rebounded but then fell into recession. Economic growth turned from 13 percent in 2016 to minus 7.6 percent in 2019.

And now, since February 2020, the country has been hit by the Covid-19 pandemic. The two shocks together have put unprecedented pressure on the lives of ordinary Iranians.

The pandemic and sanctions both undermine economic recovery, but they do that in different ways.

The impact of sanctions on Iran's economy is through reduction in oil exports and cutting off Iran from the global financial system. The former has a [silver lining](#) in terms of promoting import substitution and non-oil exports, a development strategy which draws support from a large section of Iran's leadership, including the Supreme Leader, Ayatollah Ali Khamenei. The latter, which obstructs Iran's global trade, including the expansion of non-oil exports, is uniformly opposed in Iran.

The economic damage from reduced oil exports are well-known. They cut government revenues and the supply foreign exchange, both of which

cause inflation to rise and hurt living standards. In 2012 and 2018, with the tightening of sanctions and drop in oil exports, Iran's currency, the rial, fell by about 300 percent each time, spiking inflation.

Sanctions have so far come with a silver lining because the Iranian government has allowed the rial to depreciate, promoting import substitution. As the price of imported goods rise, domestic producers are encouraged to increase their production and as the price of Iran's non-oil exports drop, Iranian producers can increase their exports. This is the reason why employment has continued to increase during Trump's maximum pressure campaign and non-oil GDP increased by 1.1 percent during the Iranian year 2019/2020 (March 21, 2019 to March 20, 2020) according to Iran's Central Bank (Iran's Statistical Center estimated a 0.6 percent drop).

#### *The pandemic*

The pandemic has been similar to the experience of other countries, mainly resulting from social distancing and loss of jobs and production. The pandemic arrived in Iran sometime last winter. It was officially acknowledged in late February and with some delay. Very quickly, the pandemic spread throughout the country and Iran became a major epicenter of the coronavirus epidemic outside of China.

The figures below show the pace and the spread of the pandemic in Iran and Saudi Arabia. The comparison with Saudi Arabia is interesting because the two countries face very different

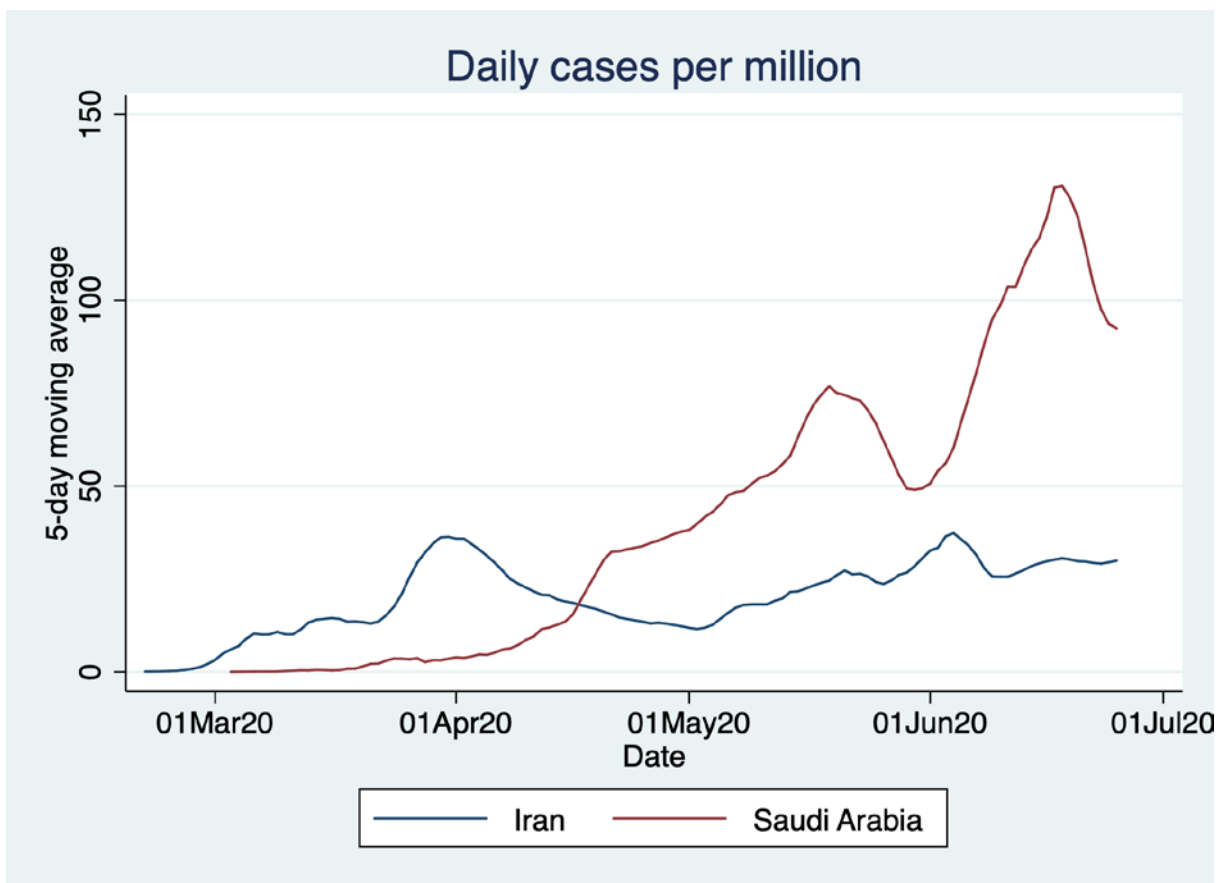
financial situations. Covid-19 arrived in Iran much earlier, in February 2019, and peaked relatively quickly. Iran adopted social distancing rules during March and April, but abandoned them, arguing that saving the economy had priority. Sure enough, by early May the trend in cases and deaths reversed, reaching previous peaks.

The contrast with Saudi Arabia in the number of deaths is sharper, which have been much higher in Iran. Being

in a stronger financial position, SA avoided the large number of deaths (1.5 per day per million) that Iran suffered in March and April. The higher number of cases in SA is in part caused by much greater testing there.

The limited testing and the higher number of deaths per million in Iran are evidence of the toll that the weak economy and the tight public purse have taken on Iranian public health.

Fig 1.



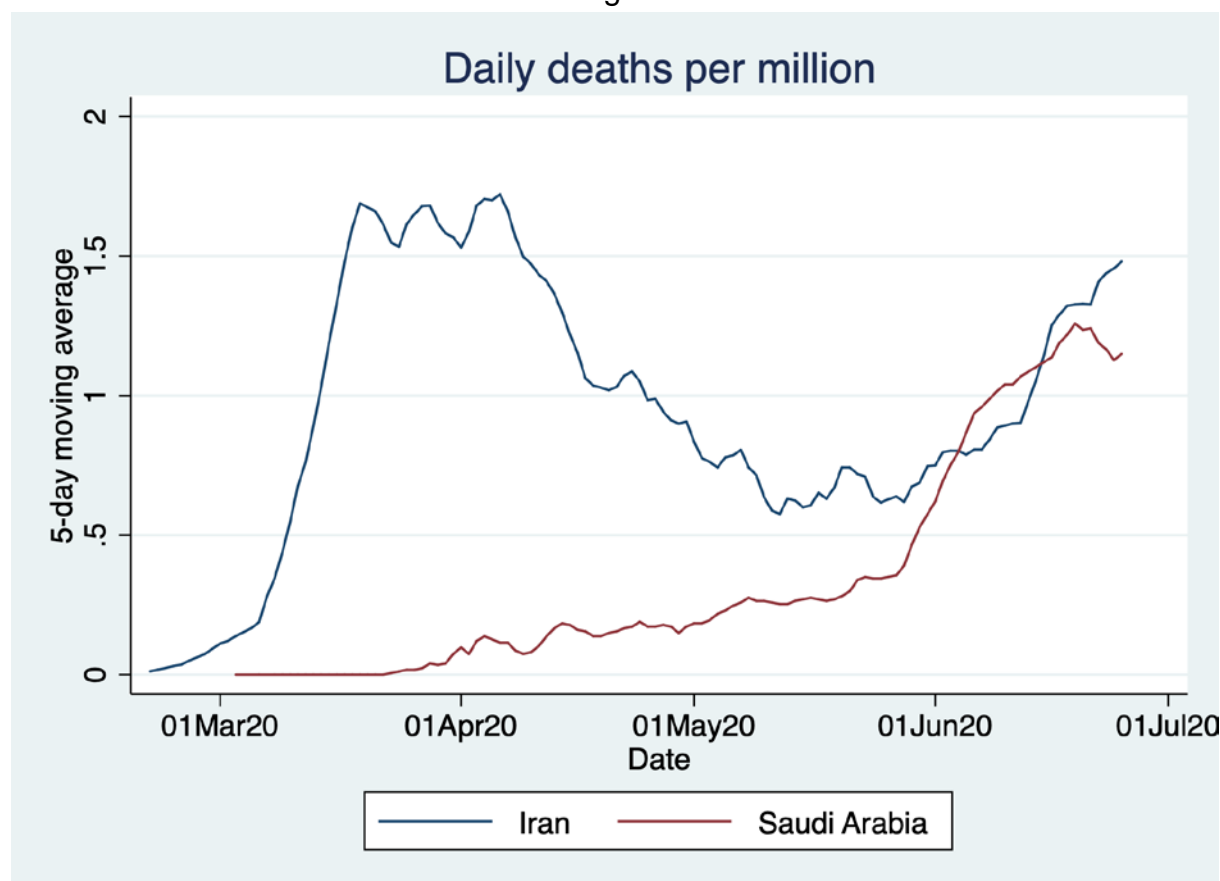
While in Iran the number of fatalities from the pandemic may not return to the levels we saw in spring, for the economy the worst is still ahead. The forecast by international organizations of 7-8% drop in Iran's GDP for 2020 will be presumably all coming from domestic non-oil production, which is likely because of

Covid-19. Earlier forecasts were [too pessimistic](#) because they gave a large role to oil, which is no longer important in Iran's economy. Going forward, employment and income will depend on keeping the momentum in domestic production going, which is difficult with the pandemic.

Resulting from devaluation, this momentum has come at a very high cost in terms of the living standards of ordinary Iranians. During 2019/2020,

when the pandemic was absent for 10 months of the year, household per capita expenditures fell by 9.8% in rural areas and 11.6% in urban areas.

Fig 2.



The government has tried hard to prevent extreme poverty from rising, and given its cash transfer programs it has probably succeeded. Iran is one of a few countries with a nearly universal cash transfer program aimed at alleviating poverty. Since 2011, when it first went into effect, inflation had reduced its effectiveness in poverty reduction. Then, in November 2019, as compensation for a hefty increase in gasoline prices, the government increased the amount of the transfers, to about 10 percent of the median household income. In addition, in June 2020, about 49 million lower income individuals who were given shares of

public enterprises a decade ago, were allowed to sell their shares on the booming Tehran Stock Exchange. The cash from the sale of the shares, valued at over 100 million rials (about \$3000-\$4000 PPP) is an obvious boost for the poor, but for the most needy who may choose to sell their shares and spend the proceeds, it will be a one-time boost only.

Iran entered the crisis with [relatively low poverty rates](#) – near zero with the \$1.90 (Purchasing Power Parity) per person per day with which the World Bank uses to measure extreme poverty, and 10 percent with the \$5.5 line used for middle income

countries. However, more Iranians are under this poverty line today than in the past two decades because rising prices have dragged many lower income households to below the poverty line.

While the Trump administration has dealt a serious blow to Iran's economy, its use of the blunt instrument of sanctions has punished ordinary Iranians. The economy has not collapsed as it had hoped back in May 2018 when it withdrew from the nuclear deal imposed its unilateral sanctions, nor has the leadership of the Islamic Republic caved under pressure.

While the severity of the crisis Iran faces suggests that Tehran may be amenable to negotiate with a new US president if Trump is not re-elected, given how hard they have tried to resist maximum pressure, Washington would do well to abandon its maximum pressure campaign.

### **About the author**

Djavad Salehi-Isfahani is a Professor of Economics at Virginia Tech in Blacksburg, Virginia, and Non-Resident Senior Fellow at the Brookings Institution in Washington, DC. He is also a Research Affiliate of the Iran Project at the Belfer Center of Harvard Kennedy School. He obtained his BSc (Econ) from the University of London in 1971 and Ph.D. in Economics from Harvard University in 1977.

### **About the Gulf Insights series:**

The "Gulf Insights" series is published by the Gulf Studies Center on a weekly base with the aim to promote informed debate with academic depth. The Gulf Insights are commentaries on pressing regional issues written by the GSC/GSP faculty, staff PhD and MA

students, as well as guest scholars, and they can be between 1,200 to 1,500 words.

All articles published under "Gulf Insight" series have been discussed internally but they reflect the opinion and views of the authors, and do not reflect the views of the Center, the College of Arts and Sciences or Qatar University.