

Domestic Politics and Socio-economic Pressures

Implications for Iran's Strategic Behaviour

By Kevjn Lim

Abstract

So long as the JCPOA remains in place, Iran's factions are likely to match tit-for-tat, with cautious calibration, including to eschew nuclear-related violations so that Russia and China would be hard-pressed to help Iran defend. On the other hand, should oil exports — an imperfect but important proxy indicator for Iran's socio-economic condition — continue dwindling or merely stagnate, Tehran may opt to militarily escalate around the Gulf to alter the status quo.

Iran's highly factionalised domestic politics has been a significant driver in the Islamic Republic's foreign, security and trade policies. At the same time, Iran's socio-economic condition has also exerted an important influence on those policies. Since 2013, President Hassan Rouhani's relatively moderate government has struggled to reverse his predecessor's confrontational stance and Iran's resulting diplomatic and economic isolation, investing precious political capital to secure a nuclear agreement known as the Joint Comprehensive Plan of Action (JCPOA) with six world powers in 2015. The Trump administration's withdrawal from the agreement in May 2018, together with a “maximum pressure” campaign of economic sanctions to force Iran to renegotiate a more stringent agreement constraining its nuclear program, ballistic missile development and regional activism has, however, reignited dangerous tensions and brinkmanship on both sides. Even if they cannot ultimately be disentangled from the external strategic setting, what role do domestic politics and socio-economic pressures play in all this, and how will they influence Iran's external response going forward?

Domestic socio-economic strains

Under renewed US sanctions, Iran's oil exports in June fell to 300,000 barrels per day (bpd) from 500,000 bpd in May, compared to an already historically modest 2.5 million bpd just before the US' JCPOA withdrawal.¹ More recent estimates for July place the figure at 100,000 bpd, which, when benchmarked against 2.5 million bpd, represents a 96 per cent decline and US\$53 billion in annual losses at current oil prices.² Despite ongoing attempts at diversification, oil continues to play a central role in Iran's economy. Oil exports remain Iran's primary source of foreign exchange revenues, and projected hydrocarbon earnings constitute a third of the country's current annual budget.

Given US sanctions, the International Monetary Fund (IMF) expects Iran's gross domestic product (GDP) growth to contract by 6 per cent this year, after already shrinking 3.9 per cent in

¹ Alex Lawler, “As Trump's sanctions bite, Iran's oil exports slide further in June”, *Reuters*, 24 June 2019.

² “Saderat-e naft-e Iran be ‘100,000 boshke dar ruz’ soqut karde-ast” [Iran's oil exports have fallen to 100,000 barrels per day], *Radio Farda*, 30 July 2019.

2018. This would again bring the economy close to recession levels seen in 2012 at the height of international sanctions against Iran.³ In 2018, the national currency's value plummeted 60 per cent and black market exchange rates currently soar at roughly three times the official rate, which stands at IRR 42,000 to the dollar. The inflation rate in the 12-month period ending this July has surpassed 40 per cent, breaking a 24-year record,⁴ and the government is looking to initiate legislative procedures to slash four zeroes from the Rial (and readopt the Toman, abolished in the 1930s, as the official currency). At street level, the prices of basic food items like milk, chicken, sugar and flour continue rising, along with unemployment levels.

Besides selling oil in the grey market at increasingly discounted prices, Tehran is attempting to mitigate sanctions through a number of creative measures, including increased mining and (unofficial) use of cryptocurrencies, attracting foreign investors and foreign tourists, especially from China, and offering oil for future deliveries in exchange for goods, investments and services.⁵ But even without sanctions, the economy suffers from deeply-rooted structural problems such as mismanagement and endemic corruption. Mr Rouhani's presidential chief-of-staff recently claimed that 1 billion euros in state currency reserves intended for medicine and basic goods imports have unaccountably vanished.⁶ Sanctions have reportedly also eroded Iranian funding for Hezbollah, its closest armed militia.

Economic difficulties have in turn unquestionably exacerbated social tensions. Much of the protests and strikes occurring inside Iran — a daily average of 9-10 events based on a survey of Persian-language social media sources alone — relate to socio-economic issues. Parts of the public sector, including municipalities and transportation, are finding it increasingly difficult to pay wages on time or even at all. Another driver behind these social and economic tensions is a slew of recurrent natural disasters, including flash floods, freak dust storms, a chronic drought and frequent earthquakes, worsened by the government's often inadequate response. Although protests have not yet returned to the levels seen in late 2017 and early 2018, all the ingredients for another spontaneous, large-scale conflagration on Iran's streets remain in place.

Domestic politics

Given that President Rouhani came to power in 2013 promising sanctions relief and economic recovery, the fragile status of the JCPOA — his signature foreign policy achievement — places his government on the defensive against its hardline rivals. The JCPOA's economic benefits were already slow in coming, in part due to the deterrent effect of remaining US sanctions. And yet, hardliners have mostly preferred to blame the government, and at any rate oppose any move which might leave Iran open to western economic, political and especially cultural influences. Supreme Leader Ali Khamenei deeply distrusts the US. He has also over the past three decades consistently fallen out with every single Iranian president in the latter's re-elected term, irrespective of the latter's factional affiliation.

In a reflection of Iran's rising threat perceptions, Mr Khamenei has reshuffled the Islamic Revolutionary Guard Corps' (IRGC) top ranks, introducing an even more hardline cast, including the IRGC's new Commander-in-Chief Hossein Salami, Deputy Commander Ali Fadavi, and IRGC Naval Chief Alireza Tangsiri, who has been known to suggest suicide attacks against US warships. Elsewhere, the supreme leader's hardline former deputy representative to the IRGC Mr Mojtaba

³ International Monetary Fund, "Regional economic outlook: Middle East and Central Asia", May 2019.

⁴ "Nerkh-e tavarrom-e Iran rekord-e 24 sale ra shekast" [Iran's inflation rate has broken a 24-year record]", *Radio Farda*, 24 July 2019.

⁵ "Pishforush-e naft-e Iran be keshvar-haye qodratmand" [Presales of Iranian oil for strong countries], *Iranian Students' News Agency (ISNA)*, 9 July 2019.

⁶ "Rais-e daftar-e Rouhani: nazdik be yek milliard yuro arz-e dowlati gom shode-ast" [The head of Rouhani's office: nearly one billion Euros in state currency missing], *BBC Persian*, 20 July 2019.

Zonnur has also recently replaced the relatively more diplomatic Mr Heshmatollah Falahatpishe as head of parliament's National Security Commission.

Meanwhile, the domestic pushback continues against representatives and supporters of the government. A member of parliament close to the IRGC recently alleged that Mr Rouhani and over 70 other senior government officials possessed dual citizenship or foreign residency, though this is not technically illegal by Iranian law.⁷ State media recently carried a TV series, *Gando*, portraying a character resembling Foreign Minister Mohammad Javad Zarif as being weak against Iran's enemies. The judiciary, likewise, continues its inquisition against prominent reformist figures in particular, most recently jailing Mr Mohammad-Reza Khatami (brother of former President Mohammad Khatami and the husband of one of Mr Khomeini's granddaughters) for alleging that over eight million phantom votes helped Mr Mahmoud Ahmadinejad's disputed 2009 re-election.

All these signs notwithstanding, the relatively moderate elected government has not yet lost the initiative. Mr Rouhani refrained from retaliating for a full year after the US' JCPOA withdrawal. This past February, Mr Zarif resigned to protest his exclusion from Syrian President Bashar al-Assad's visit to Tehran, but Mr Khamenei rapidly reinstated him, a sign Iran's top diplomat still matters, at least in respect of the re-escalating nuclear tensions if not Iran's regional policy. Tehran has so far painstakingly calibrated its escalatory measures, matching tit-for-tat. And most importantly, despite many of the hardliners and Mr Khamenei's resistance to talks with the US — the supreme leader has likened it to poison — Mr Rouhani's government continues to leave the door half-open for negotiations. Support for talks has also come from unexpected quarters, including firebrand Mr Ahmadinejad.

The elected government has repeatedly stated it would negotiate if the Trump administration lifted sanctions and returned to the JCPOA, and Mr Rouhani himself has declared his willingness to pursue “just, legitimate and respectful negotiations” as long as he remains president.⁸ Despite President Donald Trump's provocative and unpredictable bearing, some in Tehran see him as a transactional dealmaker seeking to retrench the US' overseas commitments, so much so that Mr Zarif has drawn a distinction between the US president and his “B-Team” (Mr John Bolton, Mr Benjamin Netanyahu and Mr Mohammad Bin Salman), which he accuses of warmongering.

Strategic signalling has assumed a more substantial form too. Mr Zarif has, for instance, suggested that the US should stop selling arms to Saudi Arabia and the UAE if it wished to discuss Iran's missile program (although he then seemingly backtracked, saying missiles were Iran's only defensive recourse). He has more recently, though unsuccessfully, offered for Iran to ratify the Additional Protocol entailing tighter nuclear inspections, four years ahead of its 2023 deadline, if US sanctions were lifted. That such statements continue suggests that even for Tehran's hardliners, Mr Rouhani's government remains the best shot at crisis diplomacy.

The JCPOA's other signatories, who oppose the US' withdrawal and unilateral sanctions likewise influence Iran's domestic politics and vice versa. Mr Rouhani's government is increasingly losing faith in the EU3's (Germany, France and Britain) ability and will to compensate Tehran, chiefly through the Instrument in Support of Trade Exchanges (Instex). Already frail relations with the EU3 could in turn suffer a major setback if Iran's powerful Expediency Council headed by hardline cleric Ayatollah Sadeq Larijani ignores an October deadline by the Paris-based Financial Action Task Force (FATF) to approve the ratification of two remaining terrorism-financing and transnational organised crime conventions. Yet, even Tehran's hardliners for now maintain an interest in keeping the Europeans on side and away from referring Iran back to the Security Council, as transpired in February 2006 to Iran's substantial detriment.

⁷ “Karimi-Qodusi: Hassan Rouhani ehtemalan do-tabiati ya dara-ye eqamat-e khareji-st” [Karimi-Qodusi: Hassan Rouhani probably has dual citizenship or foreign residency], *BBC Persian*, 23 July 2019.

⁸ “Rouhani: be esm-e mozakere kenar-e miz-e taslim neminshinim” [Rouhani: we'll not surrender for the sake of negotiations], *Tasnim News*, 24 July 2019.

Chinese state-run energy companies continue to load Iranian crude (and liquefied petroleum gas), albeit at lower volumes and reportedly in exchange for earlier assistance in developing Iranian energy fields rather than for monetary settlement. Still, China's sanctions-busting in the current circumstances could help mitigate Iran's economic crisis and, ironically, reduce the risk of armed conflict. Furthermore, in the event that Iran's JCPOA non-compliance faces a Security Council referral, China and Russia would be the key veto players standing between Iran and renewed international sanctions. Given that Iran's hardliners prioritise closer relations to Russia and China while their moderate and reformist rivals have generally preferred closer relations with the West, even Mr Rouhani's domestic rivals are likely to avoid any response that might alienate both major powers, including nuclear-related violations that neither power can justify defending on Iran's behalf.

Between 2013 and 2015, despite his distrust of the US, Mr Khamenei helped spur domestic consensus in support of Mr Rouhani's government and the JCPOA. The agreement's perceived defects notwithstanding — its short-term provisions in particular approximated appeasement — the supreme leader had accepted that under the circumstances, negotiations — which, with his full knowledge, first secretly began with the US in 2012 through Oman's mediation — were the least bad option. Even if talks failed, Iran could be seen to have at least attempted diplomacy. If hardline conservatives including the IRGC's top brass moved towards Mr Rouhani's accommodationist position in 2015, faced with a common threat from the Trump administration, it is now Mr Rouhani's government which is cleaving closer to the hardline, including to pre-empt domestic rivals. Moreover, the Trump administration has so far bludgeoned Iran's hardliners and moderates alike with little nuance, including by sanctioning Iran's primary diplomatic interface with the West, Mr Zarif.

This is therefore the context in which the IRGC's current belligerence should be viewed. To be sure, in Mr Rouhani's first term (2013-2017), the IRGC often undermined the president's efforts at détente with the West. But now, despite the very real risks of unintended escalation, the IRGC's military stick complements rather than contradicts the government's diplomatic carrot. Mr Rouhani has even praised the IRGC for seizing the British oil tanker *Stena Impero* and suggested that the world should thank the Guards for ensuring the Gulf's security.⁹

Within one and the same speech, Mr Khamenei ruled out talks with the US, but also explicitly ruled out war, defining resistance in terms of willpower instead.¹⁰ Supreme National Security Council Secretary Ali Shamkhani, Iran's highest-ranking ethnic Arab, has also dispelled the prospects of a hot war given that an economic war is already being waged.¹¹ Still, none of this rules out Iran's use of limited military measures looking ahead. IRGC Commander Salami has threatened to shift from a defensive to an offensive footing in response to miscalculations in the Strait of Hormuz.¹² Escalation may benefit no one, but it can create leverage for negotiations, if not raise oil prices.

Iran's potential response going forward

So far, attacks on two occasions blamed on Iran have damaged six oil tankers, Iran has downed a US Global Hawk drone, nearly triggering retaliatory strikes, the US has allegedly responded in kind, and Iran has seized a British oil tanker and attempted to seize yet others after UK forces helped impound an Iranian vessel allegedly transporting oil to Syria. Iran-backed militias have similarly

⁹ "Rouhani: be esm-e mozakere کنار-e miz-e taslim neminshinim" [Rouhani: we'll not surrender for the sake of negotiations], *Tasnim News*, 24 July 2019.

¹⁰ "There will be no negotiations and no war", *Khamenei.ir*, 14 May 2019.

¹¹ "Iran-US military confrontation won't happen: Shamkhani", *Mehr News*, 19 June 2019.

¹² "Sardar Salami dar jazayer-e se-ganeh: dar surat-e khata-ye mohasebati-ye doshmanan, rahbord-e ma az defa'i be tahajomi taghir mikonad" [Commander Salami on the Abu Musa and Tunb Islands: in the event of miscalculation by enemies, our strategy will shift from defensive to offensive], *Fars News*, 18 July 2019.

targeted assets belonging to the US and its allies in Iraq, Saudi Arabia and elsewhere. Meanwhile, Iran has begun scaling back its nuclear commitments by breaching its 300kg light enriched uranium stockpile limit and raising its enrichment levels beyond the 3.67 per cent cap to 4.5 per cent. Tehran has pointed to the JCPOA's paragraphs 26 and especially 36 to justify these two measures in response to the P5+1's non-compliance. It has now given the European Union another 60-day ultimatum until 6 September to honour its nuclear-related economic commitments before Iran undertakes a third step.

Short of abandoning the JCPOA altogether, Tehran still has recourse to a range of technical measures, including: repurposing the Arak Reactor back to its original plutonium separation objectives, raising heavy water production and stockpiling, increasing the quantity and quality of installed centrifuges, including at the Fordow Facility, and enriching uranium at higher levels. While Iran technically requires 20 per cent enriched uranium (its previous threshold) for producing medical isotopes at the Tehran Research Reactor failing supplies from external providers, enriching at this level onwards would likely be considered unambiguous political intent to develop a weapon. During the JCPOA negotiations, the scope of its enrichment program and the nuclear weapon breakout time it implied constituted Tehran's main bargaining chip. At the moment, calibrated escalation in reversible doses both pressures the JCPOA's other signatories (especially the EU3) to help Iran offset US sanctions, and avoids alienating Russia and China. This is so long as Tehran believes it still maintains some measure of support from the JCPOA's other signatories, and absent another Security Council referral.

But the combination of Tehran's hardening stance and its socio-economic stresses, notably dwindling or even stagnating oil exports, may also tempt Iran towards a range of non-nuclear-related responses to force a change in the status quo. Given the central importance of Iran's oil exports, the Strait of Hormuz and its vicinity remain Tehran's primary theatre of retaliation, with consequences for seaborne oil, liquefied gas, petrochemicals and merchandise, including to regions farther afield like South-east Asia. The two ships sabotaged on 13 June were carrying Saudi Arabian and Qatari methanol to Singapore, and Emirati naphtha to Taiwan — two Asian countries with generally positive relations with Iran.

Iran's conventional military advantage lies in its naval capabilities, which are tactically, operationally and strategically geared towards anti-access/area denial. The IRGC may continue attempts to interdict, seize or damage vessels including outside of Iranian territorial waters in the Strait, but is extremely unlikely to sink ships in the absence of full-fledged hostilities. To demonstrate its defiance rather than be seen to fold, Iran may prove even more aggressive during contact with foreign forces increasingly conducting maritime close-protection, raising the likelihood of hostilities with human casualties this time. In this connection, Iran may also further militarise several islands bottlenecking the Strait, and through its regional allies target southern Gulf (especially Saudi and UAE) energy infrastructure, US military bases in Iraq and around the Gulf, and Saudi assets, including near the Red Sea.

The probability of conventional military retaliation far beyond the Gulf remains rather low given Iran's force projection capability limits. In regions like southeast Asia, covert operations may instead seek to strike US and potentially Saudi and Israeli interests and 'soft' targets, as occurred when external pressures on Iran peaked around 2012. But this at present remains improbable, absent a similar campaign targeting, for instance, high-value Iranian government military or civilian figures (including by means of Iranian armed opposition groups). Even more improbable but not entirely inconceivable if hostilities subsequently spill over from the Gulf are covert attacks against hostile interests along other major maritime bottlenecks, including the Strait of Malacca.

Another separate arena nonetheless entangled with Iran-US tensions is the ongoing Israeli-Iranian military contestation in Syria. How this pans out there, more recently in Iraq, possibly again in Lebanon and eventually even within Iranian territory (including through US strikes) could also

prompt Tehran to ramp up retaliatory attacks inside Israeli-controlled territory and against Israeli (and US) interests abroad.

For the moment however, any Iranian covert measures are likelier to assume non-kinetic rather than kinetic forms. Iran-affiliated or -employed hackers have previously targeted Saudi Aramco, major US financial institutions and other commercial and government entities, causing damage on the cheap while maintaining a degree of plausible deniability, although cyber-attacks run the risk of also affecting non-hostile countries. Electronic warfare can include spoofing, which confuses GPS systems aboard unmanned aircraft, redirecting them into Iranian territory as Iran did to a US drone in 2011. Such measures however also put at risk civilian aviation transiting or coasting Iranian airspace. Unidentified interference from within Iran, most likely by the IRGC, has affected even Iranian aviation and internet networks.¹³

Conclusion

Iran's response going forward clearly depends on and cannot be disentangled from its strategic interaction with the US and the other JCPOA signatories, notably the extent to which the latter continue guaranteeing trade benefits promised by the nuclear agreement. But even taken alone, internal socio-economic pressures and the balance of political power in the domestic arena point to the higher likelihood of certain responses. Despite the growing prominence of hardline voices, Mr Rouhani's government, itself now adopting a harder stance, still maintains control over the country's foreign diplomatic policy where the current crisis is concerned. Even if it may irk Mr Rouhani, the IRGC's current belligerence broadly overlaps with rather than overrides the government's stance by generating leverage shaping any subsequent negotiations.

So long as the JCPOA remains in place, Iran's factions are likely to match tit-for-tat, with cautious calibration, including to eschew nuclear-related violations that Russia and China would be hard-pressed to help Iran defend. On the other hand, should oil exports — an imperfect but important proxy indicator for Iran's socio-economic condition — continue dwindling or merely stagnate, Tehran may opt to militarily escalate around the Gulf to alter the status quo. Should hostilities escalate further still, and the US' maximum pressure campaign acquires a more kinetic dimension whether overt or covert, covert Iranian retaliation, including as far afield as southeast Asia, cannot be ruled out. Meanwhile, Tehran is more likely to resort to greater use of non-kinetic means, especially cyberwarfare, to create additional leverage without inviting large-scale retaliation.

The possibility — faint for now — that a democrat might replace Mr Trump at the White House in 2020 may give Iran additional reason for restraint. But meanwhile, a lot of damage could still be done. And if it persists, the US' current strategy could help pave the way for a very different successor to Mr Rouhani in Iran's 2021 presidential elections, one willing to take far greater risks in Tehran's 40-year confrontation with Washington.

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¹³ "Suspensions fall on IRGC for dangerous interference with GPS in Iran", *Radio Farda*, 2 July 2019.