COMPARISON ANALYSIS OF FINANCIAL FREEDOM OF THE REPUBLIC OF KAZAKHSTAN WITH THE ISLAMIC REPUBLIC OF IRAN

Amir Mohammad Sohrabian, PhD, Associate Prof.
Mohammad Amin Sohrabian, PhD, Associate Prof.
University of Interntional Business (UIB), Kazakhstan

Abstract

In this article we will focus on the financial freedom of Kazakhstan versus Iran, emphasizing the proper reformation and implementation on ongoing reforms of financial and economical activities in Kazakhstan which makes Kazakhstan to be one of the 20 largest score improvements in the 2012 Index and an evidence for other capable Asian countries such as Iran with seriously degraded economic dynamism as a result of it's political instability. Comparison analysis of the current data of Financail Freedom published by reputed organization with the country's current financial climate.

Keywords: Financial Freedom, Financial System, Government Control, Central Bank, Financial Services, Economic Freedom, Policy Reforms, FDI, TSE, P/E

Introduction

For the begining we should know the simple and pure meaning of financial freedom. Financial freedom is a measure of banking security as well as independence from government control. State ownership of banks and other financial institutions such as insurer and capital markets is an inefficient burden, and political favoritism has no place in a free capital market. Financial freedom means a transparent and open financial system ensures fairness in access to financing and promotes entrepreneurship. An open banking environment encourages competition to provide the most efficient financial intermediation between households and firms and between investors and entrepreneurs.

Through a process driven by supply and demand, markets provide real-time information on prices and immediate discipline for those who have made bad decisions. This process depends on transparency in the market and the integrity of the information being made available. An effective regulatory system, through disclosure requirements and independent auditing, ensures both.

Increasingly, the central role played by banks is being complemented by other financial services that offer alternative means for raising capital or diversifying risk. As with the banking system, the useful role for government in regulating these institutions lies in ensuring transparency; promoting disclosure of assets, liabilities, and risks; and ensuring integrity.

Banking and financial regulation by the state that goes beyond the assurance of transparency and honesty in financial markets can impede efficiency, increase the costs of financing entrepreneurial activity, and limit competition.

Crucial Role of Financial Freedom for the Prosperity of Country's Economy

In most countries, banks provide the essential financial services that facilitate economic growth. They lend money to start businesses, purchase homes, and secure credit for the purchase of durable consumer goods, and they furnish a safe place in which individuals can store their savings. Greater direct control of banks by government is a threat to these functions because government interference can introduce inefficiencies and outright corruption. Heavy bank regulation reduces opportunities and restricts economic freedom; therefore, the more a government restricts its banking sector, the lower its economic freedom score will be.

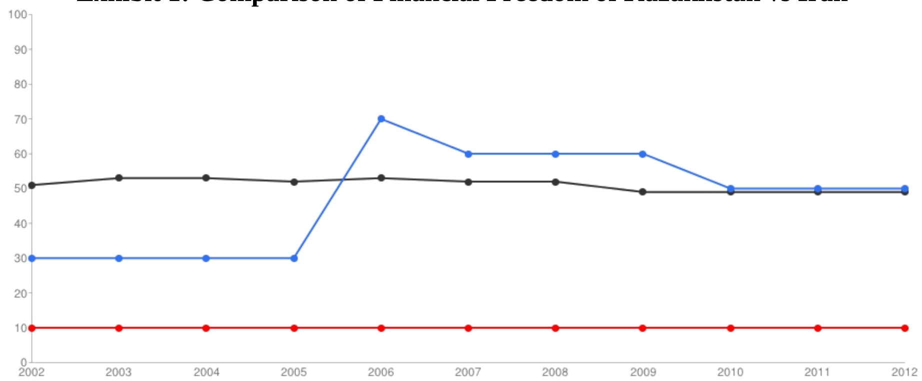
It should be noted that virtually all countries provide some type of prudential supervision of banks and other financial services. This supervision serves two major purposes: ensuring the safety and soundness of the financial system and ensuring that financial services firms meet basic fiduciary responsibilities. Ultimately, this task falls under a government's duty to enforce contracts and protect its citizens against fraud by requiring financial institutions to publish their financial statements and relevant data, verified by independent audit, so that borrowers, depositors, and other financial actors can make informed choices.

In a free banking environment, the marketplace should be the primary source of protection through such institutions as independent auditors and information services. Such oversight is distinguished from burdensome or intrusive government regulation or government ownership of banks, both of which interfere with market provision of financial services to consumers. It is such government intervention in the market, not the market itself, which limits economic freedom and causes a country's grade for this factor to be worse than it might otherwise be.

Increasingly, the central role played by banks is being complemented by other financial services that offer alternative means for raising capital or diversifying risk. As a result, the authors take related non-banking financial services, such as insurance and securities, into consideration when grading this factor. As with the banking system, aside from basic provisions to enforce contractual obligations and prevent fraud, increased government intervention in these areas undermines economic freedom and inhibits the ability of non-banking financial services to contribute to economic growth. If the government intervenes in the stock market, it contravenes the choices of millions of individuals by interfering with the pricing of capital, the most critical function of a market economy. Equity markets measure, on a continual basis, the expected profits and losses in publicly held companies. This measurement is essential in allocating capital resources to their highest-valued uses and thereby satisfying consumers' most urgent requirements. Similarly, government ownership or intervention in the insurance sector undermines the ability of providers to make available those services at prices based on risk and market conditions.

The below exhibit shows the financial freedom in both Kazakhstan and Iran in last Decades:

Exhibit 1: Comparison of Financial Freedom of Kazakhstan vs Iran



World Average Kazakhstan Iran

Source: http://www.heritage.org/index

As you can see, the above exhibit shows in 2012, the Financial Freedom in Kazakhstan is 50.0 although in Iran Financial Freedom is 10.0.

Please note that financial freedom is one of the main components of Eonomic Freedom Index. Totally we have 10 Economic Freedom Components. Besides Financial Freedom, there are several other factors as followings:

1- **Property Rights** - Property rights is an assessment of the ability of individuals to accumulate private property, secured by clear laws that are fully enforced by the state.

2- **Freedom from Corruption** - Freedom from corruption is based on quantitative data that assess the perception of corruption in the business environment, including levels of governmental legal, judicial, and administrative corruption.

3- **Government Spending** - Government spending is defined to include all government expenditures, including consumption and transfers. Ideally, the state will provide only true public goods, with an absolute minimum of expenditure.

4- **Fiscal Freedom** - Fiscal freedom is a measure of the burden of government from the revenue side. It includes both the tax burden in terms of the top tax rate on income (individual and corporate separately) and the overall amount of tax revenue as a portion of gross domestic product (GDP).

5- **Business Freedom** - Business freedom is the ability to create, operate, and close an enterprise quickly and easily. Burdensome, redundant regulatory rules are the most harmful barriers to business freedom.

6- **Labor Freedom** - Labor freedom is a composite measure of the ability of workers and businesses to interact without restriction by the state.

7- **Monetary Freedom** - Monetary freedom combines a measure of price stability with an assessment of price controls. Both inflation and price controls distort market activity. Price stability without microeconomic intervention is the ideal state for the free market.

8- **Trade Freedom** - Trade freedom is a composite measure of the absence of tariff and non-tariff barriers that affect imports and exports of goods and services.

9- **Investment Freedom** - Investment freedom is an assessment of the free flow of capital, especially foreign capital.

In the exhibit below you can see the Freest Countries such as Hong Kong, Australia and Singapore who reaches the Top and Cuba, Zimbabwe and North Korea who are repressed and shows the weakest countires with regards to the Economic Freedom Index in 2012.

The total number of countries are 184 countries but because there is not available data for 5 countries including Afghanistan, Iraq, Liechtenstein, Somalia and Sudan. 179 countries were having world rank and since the exhibit is too large we have cutback those which we did not find them necessary as we are focusing and comparing two countries Kazakhstan and Iran.

Exhibit 2: Comparison of Economic Freedom including Financial Freedom of Kazakhstan vs Iran

Name of Country	World Rank	Index year	*Overall Score	Business Freedom	Trade Freedom	Fiscal Freedom	Government Spending	Monetary Freedom	Investment Freedom	Financial Freedom	Property Rights	Freedom From Corruption	Labour Freedom
Hong Kong	1	2012	89.9	98.9	90.0	93.1	91.0	85.8	90.0	90.0	90.0	84.0	86.5
Singapor	2	2012	87.5	97.2	90.0	91.3	91.3	84.8	75.0	70.0	90.0	93.0	92.1
Australia	3	2012	83.1	91.9	86.2	63.4	67.1	84.5	80.0	90.0	90.0	87.0	90.6
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Poland	64	2012	64.2	61.4	87.1	74.4	40.3	79.1	65.0	60.0	60.0	53.0	61.3
Kazakhstan	65	2012	63.6	72.9	79.6	90.4	83.4	71.8	30.0	50.0	40.0	29.0	88.7
Cape Verde	66	2012	63.5	59.0	66.9	77.3	61.8	80.5	65.0	60.0	65.0	51.0	48.5
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Equatorial Guinea	170	2012	42.8	44.7	58.8	75.5	28.0	73.1	25.0	40.0	20.0	19.0	43.8
Iran	171	2012	42.3	64.8	45.7	80.6	76.9	62.0	0.0	10.0	10.0	22.0	51.5

Congo	172	2012	41.1	38.7	63.0	72.5	76.1	51.2	20.0	20.0	10.0	20.0	39.0
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Cuba	177	2012	28.3	10.0	62.7	61.5	0.0	71.3	0.0	10.0	10.0	37.0	20.0
Zimbabwe	178	2012	26.3	34.9	50.4	65.2	38.7	0.0	0.0	10.0	10.0	24.0	29.6
North Korea	179	2012	1.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	5.0	5.0	0.0

*** Overall Score:**
80 – 100 Free
70 – 79.9 Mostly Free
60 – 69.9 Moderately Free
50 – 59.9 Mostly Unfree
0 – 49.9 Repressed
Source: Complied by Author from the Heritage Foundation, in partnership with Wall Street Journal

Ranked countries are given a score ranging from 0 to 100 on each of the 10 components of economic freedom, and these scores are then averaged (using equal weights) to get the country's final *Index of Economic Freedom* score. In addition to the scores, the country pages include a brief introduction describing economic strengths and weaknesses and the political and economic background influencing a country's performance, as well as a statistical profile giving the country's main economic indicators. Information about a country's public debt is included this year for the first time. To assure consistency and reliability for each of the 10 components on which the countries are graded, every effort has been made to use the same data source consistently for all countries; when data are unavailable from the primary source, secondary sources are used.

Methodology of Financial Freedom

There is always important to know that what are the related methodology applied and how these figures are measured, thus the below mentioned are the methodology of measurement of Financial Freedom score (0-100).

The financial freedom factor measures the relative openness of each country's banking and financial system. The authors score this factor by determining the extent of government regulation of financial services; the extent of state intervention in banks and other financial services; the difficulty of opening and operating financial services firms (for both domestic and foreign individuals); and government influence on the allocation of credit. The authors use this analysis to develop a description of the country's financial climate and assign it an overall score between 0 percent and 100 percent.

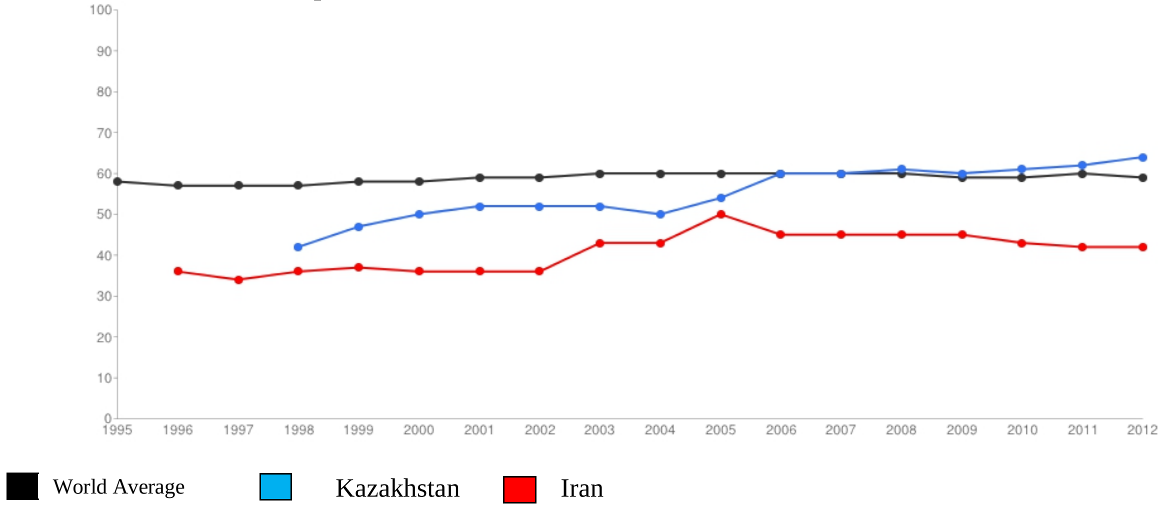
The following criteria are used in determining a country's score for this factor:

- **100%—Negligible government influence.** Independent central bank supervision and regulation of financial institutions are limited to enforcing contractual obligations and preventing fraud. Credit is allocated on market terms. The government does not own financial institutions. Financial institutions may engage in all types of financial services. Banks are free to issue competitive notes, extend credit and accept deposits, and conduct operations in foreign currencies. Foreign financial institutions operate freely and are treated the same as domestic institutions.
- **90%—Minimal government influence.** Same as above with the following exceptions: Independent central bank supervision and regulation of financial institutions are minimal but may extend beyond enforcing contractual obligations and preventing fraud.
- **80%—Nominal government influence.** Same as above with the following exceptions: Independent central bank supervision and regulation are straightforward and transparent but extend beyond enforcing contractual obligations and preventing fraud. Government ownership of financial institutions is a small share of overall sector assets. Financial institutions face almost no restrictions on their ability to offer financial services.

- **70%—Limited government influence.** Same as above with the following exceptions: Credit allocation is slightly influenced by the government, and private allocation of credit faces almost no restrictions. Foreign financial institutions are subject to few restrictions.
- **60%—Significant government influence.** Same as above with the following exceptions: The central bank is not fully independent, its supervision and regulation of financial institutions are somewhat burdensome, and its ability to enforce contracts and prevent fraud is insufficient. The government exercises active ownership and control of financial institutions with a significant share of overall sector assets. The ability of financial institutions to offer financial services is subject to some restrictions.
- **50%—Considerable government influence.** Same as above with the following exceptions: Credit allocation is significantly influenced by the government, and private allocation of credit faces significant barriers. The ability of financial institutions to offer financial services is subject to significant restrictions. Foreign financial institutions are subject to some restrictions.
- **40%—Strong government influence.** Same as above with the following exceptions: The central bank is subject to government influence, its supervision and regulation of financial institutions are heavy, and its ability to enforce contracts and prevent fraud is weak. The government exercises active ownership and control of financial institutions with a large minority share of overall sector assets.
- **30%—Extensive government influence.** Same as above with the following exceptions: Credit allocation is extensively influenced by the government. The government owns or controls a majority of financial institutions or is in a dominant position. Financial institutions are heavily restricted, and bank formation faces significant barriers. Foreign financial institutions are subject to significant restrictions.
- **20%—Heavy government influence.** Same as above with the following exceptions: The central bank is not independent, and its supervision and regulation of financial institutions are repressive. Foreign financial institutions are discouraged or highly constrained.
- **10%—Near repressive.** Same as above with the following exceptions: Credit allocation is controlled by the government. Bank formation is restricted. Foreign financial institutions are prohibited.
- **0%—Repressive.** Same as above with the following exceptions: Supervision and regulation are designed to prevent private financial institutions. Private financial institutions are prohibited.

Sources of Methodology: Unless otherwise noted, the authors used the following sources for data on banking and finance, in order of priority: Economist Intelligence Unit, Country Commerce, Country Profile, and Country Report; official government publications of each country; U.S. Department of Commerce, Country Commercial Guide; Office of the U.S. Trade Representative, National Trade Estimate Report on Foreign Trade Barriers; and World Bank, World Development Indicators.

Exhibit 3: Comparison of Overall Score of Economic Freedom of Kazakhstan vs Iran

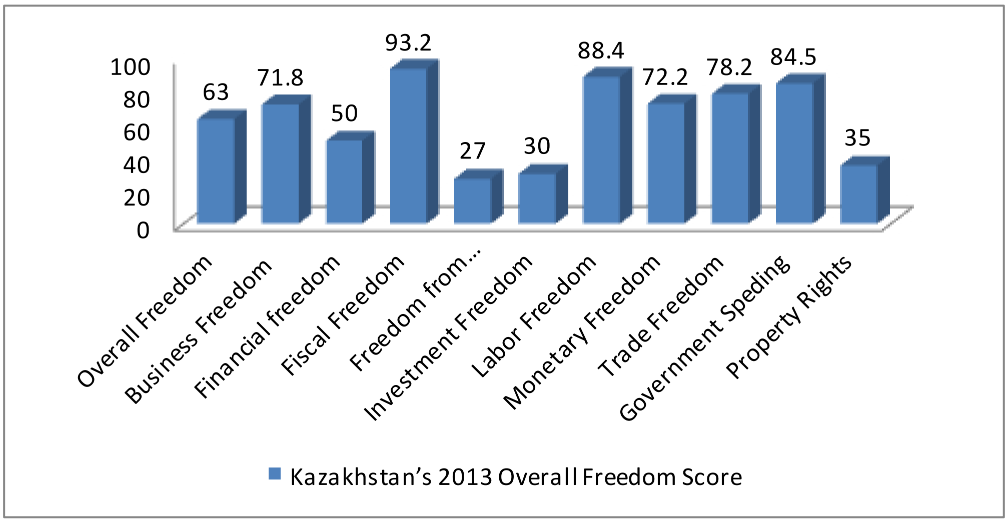


Source: http://www.heritage.org/index

According to 2012 Index, Iran's economic freedom score is 42.3 with word rank 171 amoung 184 countries and regional rank of 16 out of 17 shows very bad down economic situation, Its score has increased by 0.2 point from last year, with a notable decline in business freedom offset by small improvements in five of the 10 economic freedoms. Iran is ranked 16th out of 17 countries in the Middle East/North Africa region, and its overall score is well below the world and regional averages.

Although Kazakhstan's economic freedom score is 63.6, making its economy the 65th freest in the 2012 Index. Its score is 1.5 points higher than last year, reflecting improvements in six of the 10 freedoms including property rights, freedom from corruption, and the control of public spending. Kazakhstan ranks 11th out of 41 countries in the Asia–Pacific region, and its overall score is above the world and regional averages.

Please note that the country recorded Kazakhstan as one of the 20 largest score improvements in the 2012 Index.



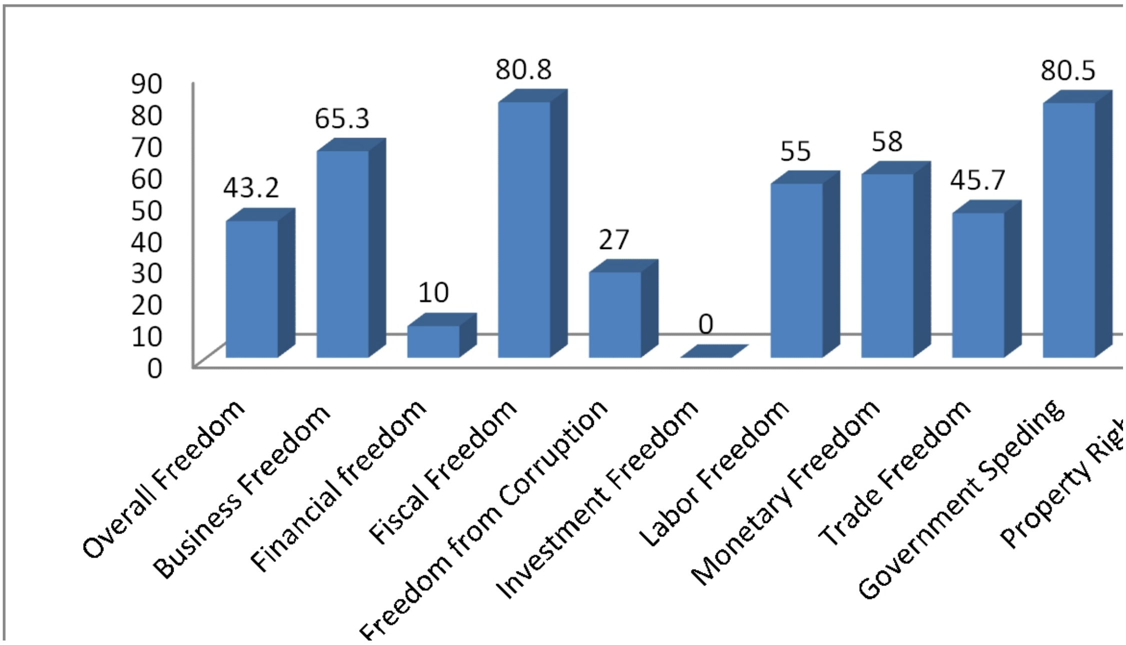
Source: Complied by Author from http://index-of-economic-freedom.findthedata.org/l/1011/Kazakhstan

On one hand the Policy reforms in Kazakhstan was dynamic and helpfull, indeed. Kazakhstan continues its positive trend of advancing economic freedom. The country has become one of the first to return to the path of steady economic expansion since 2009, partly because of ongoing policy reforms that have enhanced regulatory efficiency. Substantial oil revenues enable a high degree of fiscal freedom.

On the other hand because of lack of policy reforms in Iran and continuation of sanctions on the Iran’s Economy, heavy state interference undermines economic freedom in every category measured in the Index and seriously degrades economic dynamism. As a result of rampant corruption and deficiencies in the legal framework, the rule of law remains fragile and uneven. The government dictates most production and investment activity and derives most of its revenue from the oil sector.

A rise in world oil prices in 2011 increased Iran's oil export revenue by roughly $28 billion over 2010, easing some of the financial impact of international sanctions. However, expansionary fiscal and monetary policies, government mismanagement, the sanctions, and a depreciating currency are fueling inflation, and GDP growth remains stagnant. Iran also continues to suffer from double-digit unemployment and underemployment. Underemployment among Iran's educated youth has convinced many to seek jobs overseas, resulting in a significant "brain drain."

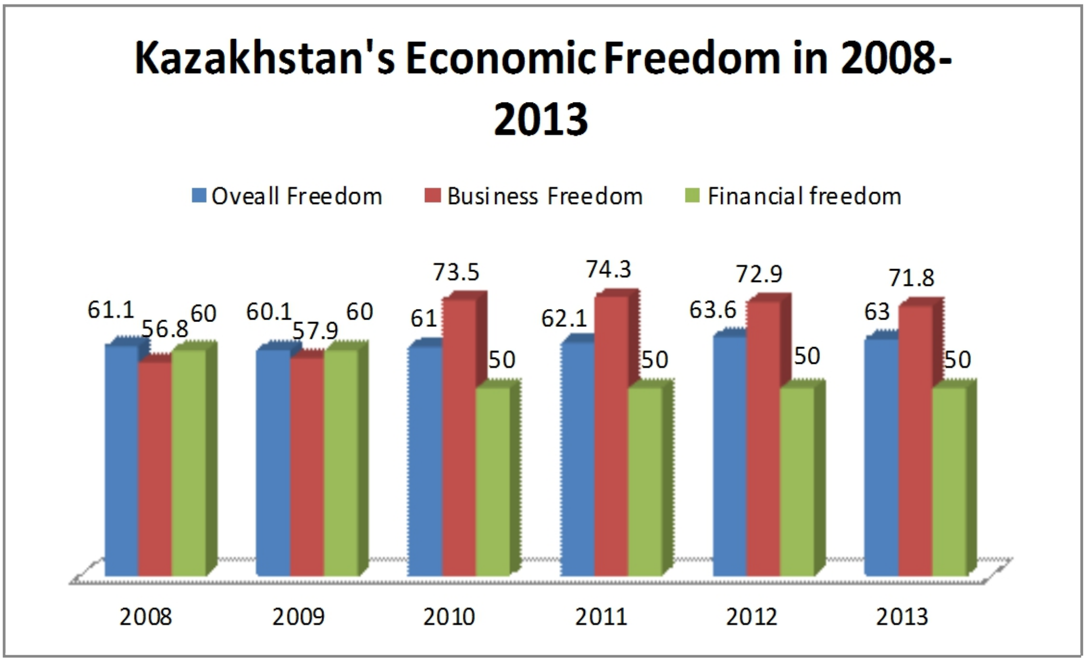
In Kazakhstan, growth progressing, strengthening the foundations of economic freedom has become even more critical to the country’s long-term economic prospects. Institutional shortcomings such as a weak judicial system and widespread corruption hold down diversification and modernization.



Source: Complied by Author from http://index-of-economic-freedom.findthedata.org/l/1003/Iran

The Private sector never could play significant role in Iran’s Economy just because first of all it was operated by those people who were rulling government previously and now with the name of Private company still following the state policy. On the other hand for those who were independent from the state, never could have a serious progress because of the state restriction over their activities continued and continued not in a right ways.

Even according to Real Clear World, Iran has been listed amoung the countries with the least economic and financial freedom. The private sector, largely marginalized by the restrictive regulatory environment, is further weighed down by government inefficiency and mismanagement. Efforts to enhance the business climate have been modest, undone on occasion in the interest of maintaining the status quo. A recent move to cut subsidies, which had swollen to a level equal to roughly one-third of economic output, has been implemented erratically, causing substantial uncertainty in the affected sectors.



Source: Complied by Author from http://index-of-economic-freedom.findthedata.org/l/1011/Kazakhstan

Conclusion

Financial freedom of Kazakhstan is at current level of 50, although from 2008 till 2009 it was 60. However, financial freedom of Kazakhstan fom 2010 till 2013 drop to 50 and remains stable during last 3 years, Kazakhstani financial freedom of 50 shows that the central bank is not fully independent, its supervision and regulation of financial institutions are somewhat burdensome, and its ability to enforce contracts and prevent fraud is insufficient. The government exercises active ownership and control of financial institutions with a significant share of overall sector assets. Credit allocation is significantly influenced by the government, and private allocation of credit faces significant barriers. The ability of financial institutions to offer financial services is subject to significant restrictions. Foreign financial institutions are subject to some restrictions. The above mentioned info matches with the fact. Now let’s consider Financial Freedom score of Iran.

Financial freedom index of Iran is at a current level of 10, and from 2008 till 2013 remains stable (This is a change of 0.00% from 5 years ago); which means the central bank of Iran is not independent, and its supervision and regulation of financial institutions are repressive. Credit allocation is controlled by the government. Bank formation is restricted. Foreign financial institutions are prohibited. But we are disagree with the current rate of Financial freedom index of Iran (10) because in reality foreign financial institutions are not completely prohibited in Iran, since 2001 the Iranian Government has moved toward liberalising the banking sector, although progress has been slow. In 1994 Bank Markazi (the central bank) authorised the creation of private credit institutions, and in 1998 authorised foreign banks (many of whom had already established representative offices in Tehran) to offer full banking services in Iran's free-trade zones.

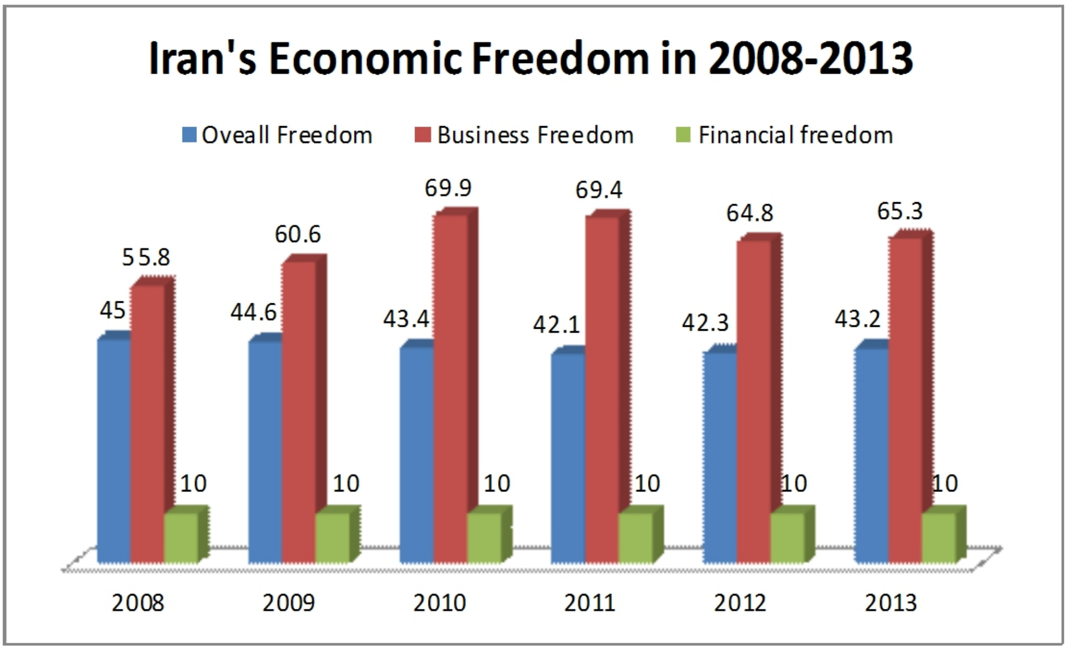
According to CBI, 5 offices of foreign banks (German, Iraqi, Bahrani and British Banks) as of May 2012 operate in Tehran and Kish free trade zone.

They are as follows:

1- Commercial Bank of Iran and Europe - eihbank (Europäisch-Iranische Handelsbank AG)

2- Islamic Regional Cooperation Bank – (a.k.a. BANK-E TAAWON MANTAGHEEY-E ESLAMI; a.k.a. REGIONAL COOPERATION OF THE ISLAMIC BANK FOR DEVELOPMENT & INVESTMENT) 2 branches in Tehran city and Kish Island
3- Bank Al-Mustaqbal (Future) - Futurebank
4- Standardchartered Bank

Besides the above mentioned 4 banks, there is also common bank of Iran and Venezuela which is another evidence of existence of foreign branches and participation of foreign financial institutions with direct participation of Iranian Government.



Source: Complied by Author from http://index-of-economic-freedom.findthedata.org/l/1003/Iran

Article 44 (fifth clause) of the Iranian Constitution Law had heretofore placed banking activities exclusively in the hands of government. In tandem with the Law on Usury Free Banking Operations, these two measures effectively blocked foreign banking operations from conducting business in mainland Iran. In 2009 the Constitution was to be amended to allow foreign banks to operate normally in mainland Iran.

"The main provisions of the establishment of foreign banks in Iran via a joint investment by natural or legal persons and through an approval by the Iranian money and credit council, have been approved," Spokesman for the Majlis' economic committee Mohammad-Reza Khabbaz told IRNA. He added that the setup of foreign banks in Iran would be allowed in different forms of commercial companies.

Shares of the banking sector witnessed an average growth of 11.8% in July 2013, continuing its previous positive trend. Analysts believe that there are two main reasons that contributed to this growth. Firstly, there is the market's general optimism towards the improvement of conditions in the banking sector with the coming of the new government. The second factor is related to the foreign currency balance of the banks relating to their banking activities with international currencies. The market expects the banks with a positive foreign currency balance to adjust their profits favorably since the official reference rate of the dollar was increased by about a factor of 2 in the second half of July 2013. Unofficial reports suggest that two banks, Mellat and Tejarat, are in a better position than the others. The Central Bank is however unlikely to authorize this adjustment, especially in the case of semi-governmental banks. In addition, a portion of the banks' positive adjustments come from customers holding dollar denominated loans, debt holders who have made a loss as a direct result of the appreciation of the official rate of foreign currencies. In their three months corporate earnings reports, the banks averagely covered 23% of their annual projected budget.

In 2009, Iran had the world's largest Islamic banking sector valued at 235.5 billion US dollars. Banking is one of the most profitable sectors of economy in Iran, indeed.

According to IMF Country Report No. 11/242 dated August 2011, Iran's financial system, the largest Islamic financial system in the world, has undergone major transformations. A significant deepening of bank intermediation occurred in the past decade, spurred by the licensing of private banks. Private bank assets have become the largest in the system following the privatization of large public commercial banks in 2008-2009. Iran's equity markets have become viable channels of finance for the real economy. The seven largest private banks are listed on the stock exchange and count among the most actively traded stocks. The performance of banking stocks is underpinned by the public's perception that banks are blue chip companies that pay reliable dividends and benefit from implicit government backing.

According to the electronic newsletter, Iran Investment Monthly, dated July 2013 - Volume 7, No 82; Foreign Direct investment (FDI) in Iran grew by 17.35% in 2012, reaching a historic high of almost USD 5 billion. The FDI volume worldwide decreased to USD 1.35 trillion in 2012, falling by around 18%. FDI flows in Iran's regional group—South Asia—along with neighbouring West Asia and Central Asia also fell by 24, 4, and 6 percentage points respectively. Accordingly, Iran ranked 35th in FDI (inflows) in the world in 2012 up from its position of 49th in 2011, placing the nation behind neighbouring countries such as India, Kazakhstan, Turkey, Saudi Arabia, and the UAE but above the likes of Lebanon, Turkmenistan, Egypt, Iraq, Azerbaijan, Uzbekistan, Bangladesh, and Pakistan. 76.46% of Iran's incoming FDI (USD 3.5 billion) were directed toward the extractive mining, quarrying and petroleum sectors (including the oil, gas, and mining industries).

Following the victory of moderate Hassan Rowhani as Iran's next president, the month of June ended up being an exceptionally good month for the Tehran Stock Exchange (TSE), with a 14% leap in the TSE's main index. The 2013 year to date performance of the TSE stood at 35% at the end of June, representing a higher return compared to other parallel investment classes such as gold, real estate, and foreign currencies.

Meanwhile, the weighted average price to earnings ratio (P/E) of the market increased from 5.8 in the previous month to 6.6 in June, almost 1 above the market's 10-year average P/E of 5.8.

This is obvious that becuase of political conflicts between two countries of the United States and Iran for more than 3 decates and recently because of Iran's nuclear program, the United States is attempting to isolate Iran from the international financial and commercial system in an effort to promote policy change in Iran. But in our opinion the mass media having some unfair practices against Iran and its Financial and Economical potential anyway.

Based on the above mentioned study and analysis, the Financial Freedom Score of Iran should be 30 instead of 10. Having the current score (10) lower than the fact (30) is another part of the story and must be revised, that's why we strongly advise the respectable Heritage Organization and other related organizations to review the Financial Freedom Index of Iran again and upgrade the score honestly and fairly. Undoubtedly, we will be witness of a considerable increase of Financial Freedom Score of Iran in near future.

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