The Iranian political elite, state and society relations, and foreign relations since the Islamic revolution

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Chapter 3
Factional Rivalries and Economic Policies

3.1 Introduction
This chapter discusses the varying approaches of the different political factions in Iran to economic issues and the impact of the rivalries for power, between the factions, on economic developments since the Islamic revolution.

In the early years after the Islamic revolution the position that became dominant in the IRI was that of the Radical Left faction which promoted state intervention, high taxation, and the limitation of property rights. This was followed by comprehensive economic restructuring policies in all sectors of the economy: industry, services, and agriculture. The expansion of the governmental role in the economy, in the first ten years after the revolution, was not primarily characterized by a shift from private to public ownership but by direct state intervention in the economy. However, this did not mean that the market economy was replaced by a planned economy. To the contrary, it was the first time since 1949 that no medium-term development planning was applied.

Economic restructuring in the first ten years after the Islamic revolution had a great impact on economic developments in Iran (see Karshenas and Pesaran 1995: 97 and Karshenas and Hakimian 2000: 34-35). By the end of the 1980s the country was confronted with high unemployment rates, inflation, a large budget deficit, and a wide balance-of-payments gap.

In the late 1980s gradually a new political faction, the Pragmatist faction, emerged, led by Hashemi Rafsanjani. The election of Rafsanjani as president in 1989 and the appointment of Ayatollah Khamenei as the new supreme leader, after the death of Ayatollah Khomeini, had a decisive impact on the course economic policies would take. The Pragmatist faction, under the leadership of President Rafsanjani, aimed at market-based rapid economic reform and a non-isolationist foreign policy, for full reintegration of Iran into international economic institutions. In his two terms of presidency (1989-1993 and 1993-1997) Rafsanjani was able to remove some constraints on the economy, but could not resolve its structural problems, including a poor production sector, reliance on oil and gas revenues, uncompetitive markets, and an improper budgeting system.

When Mohammad Khatami won the presidential elections in May 1997, in a nationwide popular longing for change, he was considered as the ideal agent to bring about that change. Though the economy was in a much better condition than during the first ten years of the IRI, when President Khatami took over the economy from Hashemi Rafsanjani, it was still badly planned and managed, centralized, and structurally distorted. During his presidency Khatami was relatively successful in pushing forward his political, socio-cultural, and especially foreign policy agenda, but failed on the economic front. Since the election of Mahmoud Ahmadinejad as president in 2005 the economic situation in Iran has not changed for the better. Ahmadinejad is even criticized by his neo-Conservative allies of the Conservative faction for his poor economic policies.
3.2 Economic Restructuring during Khomeini’s Leadership (1979-1989)

From the early days in post-revolutionary Iran, the economy became a central point of rivalry among the various political groups who had supported the revolution. In general, two positions on how to organize the economy could be distinguished:

(1) The first position promoted the protection of private-property rights and limited nationalization policies. From this viewpoint the state should provide sufficient space for the private sector to function. The representatives of this position were democratic secularists like the National Front and also Mehdi Bazargan’s Liberation Movement of Iran, the \textit{bazaaris}, the industrial and agricultural entrepreneurs, and the Conservative faction of the Iranian political elite. Also, a significant part of the urban middle class and even the Grand Ayatollahs supported this view, except for Ayatollah Khomeini and Ayatollah Montazeri who did not want to take clear positions in order not to confront the different views (Behdad 1995: 104-105, 1988: 111-112; Halliday, 1983: 187; Ajami 1989: 155). Despite their ideas on the organization of the economy similar to the Conservative faction, the liberal Islamic social (counter) forces where gradually eliminated from the political arena, while the Conservative faction surrendered;

(2) The second and dominant position represented by the Radical Left faction promoted an interventionist state and the imposition of far-reaching limitations to private-property rights. Among the supporters of this view were Ayatollah Beheshti, Hashemi Rafsanjani [then speaker of Parliament and later President (1989-1997)] and Ayatollah Montazeri. It was also these people who initiated the setting-up of different revolutionary foundations to create a grass-roots support for the Islamic regime (Behdad 1995: 105, 1988: 112).

The only aspect that united the two positions of the Conservative faction and the Radical Left faction, as the economist Jahangir Amuzegar points out, was:

“the allegation that the economy under the Pahlavis was unhealthy and non-viable […].”

But, at the same time:

There was no consensus of opinion on an appropriate new economic model. In fact, there were

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55. The high-ranking ayatollahs are considered indisputable authorities on Islamic jurisprudence. Their opposition to the interventionist economic policies of the Radical Left faction, that was to become the dominant faction among the political elite after the Islamic revolution, was a serious challenge (Behdad 1995: 105, 1988: 111).
profound differences in analysis and outlook between traditional bourgeois elements in and out of the bazaar on the one hand, and radical reformers in and out of religious circles on the other” (Amuzegar 1993: 310).

Those segments of the political elite that favored state intervention, the Radical Left faction\textsuperscript{56}, finally gained power and expanded the public sector in the IRI. One of those figures that, to a great extent, put the economic restructuring policies into practice was Abolhassan Banisadr, who in 1980 became the IRI’s first elected president. The \textit{Economist} stated in 1980 (23 February) that Banisadr’s intellectual as well as political guidance, his function as Khomeini’s economic theoretician, principal adviser, minister of finance, and his presidency enabled the transformation of the Iranian economy into Islamic radicalism. In 1981, however, Banisadr was forced to abdicate because he openly criticized the \textit{velayat-e faqih} system (Bazargan 1983, 1984; Rahnema and Nomani 1990).

After Banisadr’s abdication, the clerics gained complete control of the state institutions and an open conflict broke out between the two main factions: the Conservative and the Radical Left factions. This conflict was most clearly carried out between the Radical Left dominated first (1980-1984) and second (1984-1988) \textit{majles} and the Conservative dominated Council of the Guardian. According to the constitution of the IRI the Council of the Guardian is empowered to ratify laws passed by parliament. During the first and second majles parliament, dominated by the Radical Left faction, kept passing laws, whilst the Council of the Guardian kept rejecting them, arguing that they were un-Islamic or against the writings of the \textit{Quran}. The bazaar merchants supported the Council of the Guardian in its decisions, as well as the industrialists and the proprietors, who considered the domination of the state over the economy a serious restraint on their activities. Thus, the position, which in the early post-revolutionary period was proclaimed by Bazargan’s Liberation Movement, was now represented by a powerful faction of the clergy, with strong Islamic revolutionary background, and those who strongly believed in the tradition of Islamic jurisprudence (Behdad 1995: 107).

\textsuperscript{56} The influence of the Radical Left faction can be found in the economic dimensions of the constitution. According to Article 44 in chapter IV the national economy comprises 3 sectors: first state, then co-operative, and finally private sectors. The state sector should include all the large-scale and major industries, foreign trade, major mineral resources, banking, insurance, and energy. The co-operative sector should include co-operative companies and institutions that are involved in production and distribution. The private sector is limited to those economic activities that “supplement the economic activities of the state and co-operative sectors” (Algar 1981: 44-45). In July 2006 Supreme Leader Khamenei issued a decree to privatize state industries by amending Article 44 of the constitution, which had banned the privatization of state institutions. Articles 47 and 49 define the right to own property based on the legitimacy or illegitimacy of ownership. According to Article 47 of the constitution “private ownership, legitimately acquired, is to be respected. The relevant criteria are determined by law.” In Article 49 illegitimate sources of ownership are defined. These include, in addition to usury, bribery, theft and illicit sources, the usurping and misuse of endowments (\textit{waqt}), i.e. landed property belonging to the clergy (Algar 1981: 46-47).
3.2.1 Economic Policies 1979-1989

In midsummer 1979 the Provisional Government introduced the Law for the Protection and Expansion of Iranian Industry. The government confiscated enterprises of people who had fled the country (Bayat 1987), the country’s banks, insurance companies, and major industries. By late 1983 about 14 percent of large industries (986 units out of 6,142 units) were owned and managed by the state. Of these enterprises 28 percent produced basic metals, 24 percent chemical, 23 percent paper, and 24 percent wood. The public industries were responsible for about 62 percent of industrial investment and accounted for 70 percent (432,000 people) of the workforce in these units (Statistical Center 1985).

Many of the deprivatized enterprises that originally had been owned by the Shah, his ruling elite and other Iranians who had fled the country after the revolution, including hundreds of companies in all sectors of the economy, were given to state-supported and clerical controlled religious foundations (Karbassian 2000: 621; Amirahmadi 1995), among which the Foundation of the Oppressed and Disabled (the biggest economic entity in the Middle East) and the Martyrs’ Foundation. Together with the Industrial Development and Renovation Organization (IDRO), the religious foundations continued to control a significant portion of the Iranian economy.

57. The restructuring of industries took place in heavy industries, industries of the 51 families that had closely been aligned to the Shah and his family, and those industries whose liabilities exceeded their assets. The most important industrial families before the revolution, that all together owned about 390 big enterprises, included: Farmanfarmaian (74 enterprises), Khosrow-Shaby (67 enterprises), Lajevardi (61 enterprises), Reza (38 enterprises), Sabet (33 enterprises), Akhavan (22 enterprises), Wahabzadeh (21 enterprises), and Elqanian, Taymor Tash and Khayami (respectively 17, 16 and 10 enterprises) (Ravasani 1978).

58. The Foundation for the Oppressed and Disabled was established in March 1979, to take over and manage the wealth of the Pahlavi family and those that had cooperated with them. The resources the foundation has had under its control since then were to be used to improve the living conditions of people in need. It operates as a non-profit organization using the revenues from its property and private contributions to finance its welfare activities. Despite being a semi-private organization it is exempted from taxes and from public accountability. According to reports in 1984, the Foundation of the Oppressed and Disabled owned or had interests in: 64 small and large mines, 5,000 small productive units, 20,000 real estate properties, nearly 150 industrial enterprises, 140 construction firms, 250 commercial and trading companies, and three of Tehran’s leading newspapers, thousands of hectares of confiscated land, houses, theatres, and more than US$ 280 million of personal property, such as cars, carpets, and jewels (Amuzegar 1993: 100-101).

59. The Martyrs’ Foundation was established in March 1980 to financially support surviving relatives of the martyrs and the disabled veterans of the revolution and later the families of martyrs of the war with Iraq. It supports the families of more than 188,000 people who have lost their lives during the war (Yarshater 1987: 360-61). It also provides in-kind transfers, educational support, and housing services to widows, orphans, and victims of the war. The foundation does not support all victims, but limits its help to those who are most affiliated with the government. The foundation is subsidized by the government, receives private contributions, and has expropriated wealth at its disposal (Amuzegar, 1993: 101). In 1992 the Martyr’s Foundation owned 150 enterprises active in industrial production, construction, agriculture, commerce, and services, about 6,000 items of real estate in Tehran such as: villas, apartments, shops, malls, schools, hospitals, and hotels. Most of these buildings are used as housing for families of war dead. Additionally, it owns 140 orchards and plots of land (Yarshater 1987: 361). The foundation’s chairman since 1992 is Mohammad-Hossein Rahimian, appointed by Supreme Leader Ayatollah Khamenei.

60. IDRO was established in 1967 by the Shah to develop the industrial sector in Iran. In recent years it...
trolled almost all of the country’s state owned (large) industries (Amirahmadi 1990: 145).

Within the service sector the private banking system suffered most under the revolution. By early summer 1979 the private banks had been put under state control. In the fall of the same year six commercial and three specialized banks were formed61. The banks had to become involved in development projects and, thus, changed their credit policy and sectoral priorities. Agriculture, non-oil exports, backward regions, rural activities, and small-scale industries received more credit, while domestic and international commerce, large-scale industrial establishments (units employing ten or more workers), and construction received less. The idea behind this was that involving banks in the production sector would bring about long-term benefits (Amuzegar 1993).

Another important development was the setting-up of Islamic Interest-Free Loan Funds (Sandogh-e Qarz al-Hassaneh, IFLF)62. These funds were mainly used by ba-
zaaris to establish religious foundations. Before the revolution the official number of the IFLFs was about 200. After the revolution it had increased to 3,000 by 1988. Its number is now expected to be about 10,000 (Kayhan-e Havai 4 Aban 1988: 24, 27 Mehr 1988: 11; Motee and Namazi 2000: 9). According to a study by Fariba Adelkhah of 1988, in the same year the IFLF’s had a liquidity of 500 billion rials or 5 percent of Iran’s liquid cash (in Motee and Namazi 2000: 11).

There was also great pressure on the revolutionary government to prioritize reforms in the agricultural sector. Along with these reforms went the breakdown of law and order in the countryside. Farmers and farm workers seized land abandoned by their owners. Former landlords re-claimed their land which had been distributed under the Land Reform Program of Mohammad Reza Shah63. They did this based on the argument that this Land Reform Program was “un-Islamic.” Revolutionary committees and local courts confiscated the land of those who were accused of having cooperated with the Shah regime and put it under control of the Foundation of the Oppressed and Disabled (Ashraf 1982; Bakhash 1985: ch. 8; Amirahmadi 1990: ch. 2). In September 1979 the Revolutionary Council passed a bill for “Transfer and Revival of Land” to distribute mawat (barren land) and arable estates confiscated from supporters of the Shah regime. An amended draft of the law was passed by the Revolutionary Council in April 1980 under the title of “Land Allocation and Rehabilitation” to regulate the

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61. Among which the Central Bank of the IRI (Bank-e Markazi Jomhouri Islami-e Iran); Agricultural Bank of Iran (Bank-e Keshavarzi-e Iran); Bank of Industry and Mine (Bank-e Sanat va Madan); Export Development Bank of Iran (EDBI).

62. The IFLF follow the Islamic banking system. Islamic banks claim to operate in accordance with the rules of sharia that is prohibiting raising interest on credits.

The Iranian political elite embarked on redistributing large-scale land. This law and another land law, passed by parliament in 1982, were rejected by the Council of the Guardian as “un-Islamic.” By December 1990 about 1.25 million hectares of barren land, according to the headquarter of the Land Allocation Boards, had been distributed among 200,000 rural families. Some 130,000 hectares of land out of 850,000, that had been occupied by peasants, were distributed among 20,000 farmers and 400,000 hectares of land given to their occupiers by 1992 (Kayhan Havai 19 December 1990: 10). The private ownership of confiscated land remains unclear, due to the different ideas on ownership rights between the political factions. As a result, private investors are reluctant to make long-term commitments.

The post-revolutionary political elite also embarked on reforming the oil sector. President Banisadr was one of the main figures to propagate a new oil policy. In the first months after the revolution both the Conservative and the Radical Left factions agreed on the necessity to reduce oil production and export. Furthermore, the activities of foreign oil companies in the Iranian oil sector should be terminated or at least decisively reduced (Bakhash 1984: 12-15).

The new oil policy ended the control of the oil consortium, which had been set-up by Mohammad Reza Shah in 1971. This consisted of the United Kingdom (46 percent); the United States (40 percent); the Netherlands (8 percent); and France (6 percent). Thus, the control of Iranian oil production, export, and marketing was transferred from the consortium to the National Iranian Oil Company (NIOC). As a result, all joint-venture oil companies were handed over to the NIOC, which was put under the supervision of the Ministry of Oil that was created in 1979. The war with Iraq, during which important oil installations were destroyed, resulted in a reduction of oil production and export and, therewith, a decline in the country’s oil revenues (Amirahmadi 1990: 72-75) diminishing the financial resources available to the government (Behdad 1995: 109).

3.2.2 International Trade Relations

International trade also came under supervision of the state. In line with the revolutionary ideology of economic self-sufficiency and inward-oriented growth, the Radical Left faction of the Iranian political elite demanded the strict management of imports and exports by the state. The control of foreign trade became a major issue in the rivalry between the Conservative and the Radical Left factions. In 1981 the majles passed the Foreign Trade Nationalization Act, according to which Iran’s imports and exports should fully be put under the supervision of the state. The Foreign Trade Nationalization Act required the setting-up of specialized public agencies in charge of imports, exports, commercial services, and other trade activities within the public sector. The government argued that foreign trade carried out by the private sector was against the “national interest” (Ministry of Commerce April 1981: 34-41). When the Council of the Guardian reviewed the Foreign Trade Nationalization Act it ultimately rejected it
as both “un-Islamic” and “unconstitutional.” The Council stated that the inclusion of foreign trade in the public domain did not mean that, according to Articles 4 and 72 of the 1979 Constitution the state should get a complete monopoly on all exports and imports. The Council of the Guardian concluded that the Foreign Trade Nationalization Act was un-Islamic, as it would undermine the entrepreneurs’ right to sell their products at free market prices. Additionally, the Council of the Guardian did not believe that state bureaucracy would be able to handle some 200,000 import items every year, thus limiting economic progress and the service of the public interest. A state monopoly on trade would turn the state into a “giant employer” which was prohibited by Article 44(2) of the Constitution (see Ettela‘at 6 Azar 1361).

In 1984 the majles approved a revised version of the Foreign Trade Nationalization Act. This revised version forbade the state on the one hand to have a total monopoly over imports, but on the other hand it assigned four fifths of the import trade in all “essential” goods to the government. Non-governmental importers needed the approval of the Ministry of Commerce and had to operate in a system of quota allocation and price supervision. Exports were also to be put into state hands. After the Council of the Guardian had reviewed the revised law it again rejected it. No other law regarding the legislation of foreign trade was put on the table thereafter. But the government finally achieved dominance and control over external trade and imports of non-oil products in the second half of the 1980s through the allocation of foreign exchange and the annual regulation of imports and exports.

The state became the prime importer of goods and services. A first step to put foreign trade under state control was the setting-up of a number of centers that would supervise the distribution of imports at the Ministry of Commerce. The centers had an exclusive monopoly over the import of metals, textiles, pulp and paper, machinery, spare parts, electrical equipment, foodstuffs, plastic materials, chemicals, and electronic wares. The centers were also allowed to import these goods themselves and then distribute them to various consumer co-operatives, guilds, wholesale outlets, and licensed retail stores. These had to be sold at the invoice cost plus 5 percent profit (Amuzegar 1993: 142-43).

Due to its ideological orientation, concerning foreign relations after the revolution (see chapter 5), Iran’s external trade relations underwent considerable changes. Britain and France’s share of trade with Iran declined considerably, however, only in the first years after the revolution. Turkey’s share rose tremendously in the 1980s. As can be seen in Appendix 2, in the second half of the 1980s, the newly industrialized countries such as Argentina, Brazil, South Korea, Thailand, and Yugoslavia increased their share of exports to Iran at the expense of Japan and the countries of the EU (Amuzegar 1993: 388; Central Bank of the Islamic Republic of Iran 2001). The US, which was the third biggest exporter to Iran in terms of goods and services before the revolution, since the establishment of the IRI has had no noteworthy exports to Iran (Amuzegar 1993: table 10.4, 388). This situation emerged when the hostage taking of US diplomats and staff at
the US embassy in Tehran took place in 1979. The US imposed a trade embargo on Iran banning all imports and exports, except for food and medicine.

Since the disintegration of the Soviet Union in 1991, Russia and Kazakhstan became important trading partners for Iran. Both Germany and Japan maintained their top position among the trading countries with Iran, but their exports to Iran fell immensely in the first and, also, the second decade of the IRI. The United Arab Emirates (UAE) became the second most important importer of non-oil products in the second half of the 1980, rising in just one year, from 1982 to 1983, from US$18.1 million to US$ 50.2 million (Appendix 1). One reason might be that many Iranians went to the UAE after the Islamic revolution to work with Iran from there, but as UAE-based companies. Trade with the UAE has also been a means to circumvent the economic sanctions imposed on Iran by the US (Martin 24 October 2006).

Being confronted with Western, in particular US, opposition Iran turned towards the Soviet Union, despite some political problems between the two countries (see 3.2.3 and chapter 5.3.2) during the first decade of the IRI. Playing one major power against the other has been Iran’s strategy since the 19th century when it played Russia against Britain. But when the Soviet Union disintegrated, these policy calculations became more difficult for Iran (see chapter 5) (Moshaver 2003: 290).

Important for Iran’s relations with other countries was the break out of the Iran-Iraq War in September 1980, which resulted in political and military support for Iraq from Western countries as well as the Soviet Union. The Western countries hoped that President Saddam Hussein would be able to save the world from the “fundamentalists in Iran.” During this period, Iran became more inward looking and distrustful of the outside world (Tarock 1999: 43).

The Iran-Iraq war, which started in 1980, on the one hand came as a relief to the Iranian government, as with the right propaganda it could be used to cover up the economic problems. On the other hand, it worsened even further Iran’s economic crisis.

3.2.3 The Impact of the Iran-Iraq War on the Economy
Although Iraq was the aggressor in the Iran-Iraq war (1980-1988), Iran did not get much regional and international support during the war, whilst Iraq had support from a great number of Arab and Western countries. France was a major arms supplier to Iraq during the war, as well as the US, which also developed a great military presence in the Persian Gulf area. Iran also alienated the Soviet Union with which it had had hostile relations since 1983 (see chapter 5.3.2), when leaders of the Iranian communist Tudeh party\textsuperscript{64} were arrested and Soviet leaders expelled from Iran. Iran supported the anti-Soviet rebels in Afghanistan and rejected the Soviet Union’s efforts to settle the war with Iraq on the basis of the status quo ante. To compensate for its isolation from the great powers (i.e. The US and the Soviet Union) during the war with Iraq, Iran entered

\textsuperscript{64}. Founded in 1941 the Tudeh party is the oldest Communist movement in Iran.
into relations with other countries, among which were Japan, West Germany, and Italy. Iran continued its diversified relations with Third World countries and Eastern Europe. The cease-fire with Iraq in 1988 and the withdrawal of the Soviets from Afghanistan improved relations with some countries, especially the Soviet Union (Keddie 1990: 7).

An immediate consequence of the start of the war in 1980 was an increase in military spending and arms imports, which reversed the decline in Iran’s military spending since the revolution. In the first years of the war the Iranian regime could rely on the arms it had inherited from the Shah. According to the US Arms Control and Disarmament Agency, as the war continued, annual average arms imports by Iran rose from US$ 1.1 billion in 1981-83 to US$2.3 billion in 1984-88. The highest estimates of Iran’s total defense burden during the war were as high as 20 percent of GDP (including both domestic and military expenditures, arms imports, and allocations for reconstruction). To compare, the US defense burden during the Second World War was about 40 percent of its GDP (Clawson 1988: 375). The total military expenditure for the war has been estimated at US$110 billion (Amirahmadi 1994: 69). On the Iranian side, the Iran-Iraq war resulted in more than 350,000 dead people (Entessar 1995: 155). In total 52 cities were damaged, of which 6 were totally destroyed, and 14 suffered 50 percent damage. 4,000 villages were damaged or partly destroyed. In total 130,000 totally damaged and 190,000 heavily damaged houses were counted (Amirahmadi 1991: 304).

The war had a devastating effect on the Iranian economy, a negative impact on domestic output and oil revenues and caused damage to infrastructure, industrial facilities, farmland, and population centers. Estimates show a US$90 billion in direct damages as the war costs for Iran (i.e. these estimates exclude indirect damages such as loss of production in oil and other sectors, neglect of infrastructure, and loss of further development) (Chubin 1994: 87). This is about the equivalent to Iran’s total oil export revenues from 1989 to 1994. Amirahmadi estimates the direct and indirect damages of the war until 1987 as high as US$ 592 billion (1991: 84).

The end of the bi-polar international political system and the disintegration of the Soviet Union in 1991 opened up new perspectives in terms of foreign economic relations for Iran. This period coincided with the election of Hashemi Rafsanjani as president in 1989 and the appointment of Ayatollah Khamenei as supreme leader.

### 3.3 Economic Reform during Rafsanjani’s Presidency (1989-1997)

In the mid-1980s, there gradually emerged a new faction among the Iranian political

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65. During the reign of Mohammad Reza Shah military expenditure rose very rapidly, as a percentage of gross national product (GNP), from an annual average of 8-9 percent in 1970-73 to 15 percent in 1974-78. A major factor in this was the oil crisis in 1973. Arms were mainly imported from the US and Britain. In the first year of the IRI military spending dropped sharply, particularly the purchase of sophisticated equipment, to US$ 1.5 billion in 1979 and US$420 million in 1980 (US Arms Control and Disarmament Agency, World Military Expenditures and Arms Transfers 1991-92).

66. According to other sources the Iranian arms imports during the Iran-Iraq War was US$ 2 billion annually, see Middle East Economic Digest (MEED), (17 April 1989), 27.
The Iranian political elite, the Pragmatist faction under the leadership of Rafsanjani. Its influence on the IRI’s policies increased with the death of Khomeini. When Khomeini was still alive he nourished the Radical Left faction by his political slogans of the “Export of the Revolution” and “Neither East Nor West” (to be discussed in chapter 5). After the death of Khomeini the influence of the Radical Left faction declined. Those members of the Radical Left faction, who remained, had little backing from the Iranian people. During the first decade of the IRI the Radical Left faction had been too greatly associated with contemptuousness, repression, bureaucracy and arbitrary decision. It had repressed both the political forces of the revolution who opposed Khomeini and his followers and the minorities in Iran. The promises it made to the peasants, the urban poor, and the working class, were also not kept.

The Pragmatist faction, in contrast, promoted socio-economic reforms. It opposed corrupt bureaucracy, as well as state intervention in the economy. It, also, made the rule of law a priority. Its slogans were peace, economic prosperity, employment, and, no less significant, “a kinder and gentler nation” (Behdad 1995: 116-117).

The end of the Iran-Iraq War in 1989 provided the framework for economic reform in Iran. The need for economic reforms was based both on economic exhaustion during the Iran-Iraq War as well as the economic problems the country had been dealing with since the early days of the revolution. When Rafsanjani became president in 1989 four issues became central to his socio-economic reform program:

1. Address the financial constraints of the first ten years after the revolution with economic reform to meet the needs of a growing population;
2. End the political and economic isolation of Iran and restore relations with the US;
3. Address the growing demands of the Iranian population for greater political participation;
4. Reform the political system of the IRI and redistribute power among the supreme leader, the president, the parliament, and the judiciary (Gheissari and Nasr 2004: 95).

Rafsanjani’s policies of socio-economic liberalization and foreign policy reorientation received mixed reactions from the different factions. While the Conservative faction, especially the bazaaris, welcomed economic liberalization, it opposed his liberal attitude in socio-cultural issues and his pragmatist approach to foreign policy. The Radical Left faction in contrast, opposed Rafsanjani’s economic policies and pragmatic foreign policy while supporting his socio-cultural views. Although reforms of the Iranian economy had been on the agenda since the mid-1980s, it was only from 1989, with Rafsanjani as president, that parts of the Iranian political elite were willing to look closely at the problems of the economy and the war damage in order to develop policies to improve the economy. Part of this economic reorientation was also a reorientation in the country’s foreign policy after the disintegration of the Soviet Union, including the establishment of a critical dialogue with the EU (chapters 6.3 and 7.2); active engage-
ment with neighboring states, Russia and the countries of CEA (chapter 5.4.2), as well as a cautious rapprochement with the Persian Gulf States, particularly Saudi Arabia (chapter 5.4.1).

The new economic policies introduced by Supreme Leader Khamenei and President Rafsanjani, received minimal support from the Radical Left faction, which until 1992 dominated the majles. Of the members of parliament, 40 percent were openly hostile to the economic reform strategy. But, as President Rafsanjani’s reforms had great popularity among the lower middle and modern (secular) middle classes, the majles had no other choice than to accept them.

As has been outlined in detail in chapter 2, the different political factions do not speak with one voice on economic, socio-cultural, and foreign policy issues. The picture of Iranian politics is complex, not only because of the different factions, but also the contradictions within each faction. This has led, on the one hand, to some opportunism as it gives room to individual members of the Iranian political elite to move from one faction to the other. On the other hand, however, it has given room to establish ad-hoc political groups whenever needed, who favor certain economic, socio-cultural, or foreign policies or are against them. In this environment the Rafsanjani government had two choices to put through its policies, either to construct a powerful coalition of factions or by creating a forceful counter-bloc to his opponents (Ehteshami July 1995: 10).

As has been outlined in chapter 2, in the early years of his presidency Rafsanjani aligned himself with the Conservative faction, while in the mid-1990s he gradually turned to a wing within the Radical Left faction, namely Mohammad Khatami and his supporters, who later were to establish the Reformist faction. During his presidency Rafsanjani set-up and carried out the First and Second Five Year Development Plans (the Second Plan was terminated under President Khatami in 2000). The last Shah, Mohammad Reza Shah, had also used these Five-Year Development Plans during his modernization policies in the 1960s and 1970s (see Amineh 1999: chapter 9).

3.3.1 Towards a Liberalization of the Economy?
The First Five-Year Development Plan (Appendix 3a), which is also known as Siyasat-ye Ta’dil-e Iqtisadi (stability politics of the economy or structural adjustment program), implied a radical reform of economic policies of the Iranian government. The First Five-Year Development Plan had many goals, the most important of them, according to Amirahmadi (1990: 123-24), was: fostering economic growth. The weak economic performance during the Iran-Iraq war had resulted in a decline in per capita income and falling living standards. Economic growth was therefore a top priority of the First Five-Year Plan, as well as: controlling population growth; managing the budget deficit and inflation; adopting import substitution and export promotion policies; optimizing resource exploitation; and completion of unfinished projects. The First Development Plan coincided with the introduction of the IMF Economic Adjustment Program to Iran (1988-1993).
An important aspect of the Economic Adjustment Program was the privatization of large parts of the economy which were, and still are, under control of state or semi-public organizations, particularly the religious foundations, especially the Foundation of the Oppressed and the Disabled and the Martyrs’ Foundation.

The religious foundations are the main institutions that continue to be opposed to, and prevent, large-scale privatization policies. When the new privatization process started, some foundations agreed to sell parts of their assets to the private sector, worth 62.2 billion Rials (Amuzegar 1993: 100). During the fourth majles (1992-1996) the most powerful individuals within the foundations put pressure on the Conservative faction to change the implementation of the privatization process by giving the state enterprises to the foundations. In 1994 the majles passed a law, allowing the government to sell state enterprises to those people devoted to the war, the prisoners of war, and the relatives and members of those who were killed in the war (Ettela’at 1995). As these people did not have the financial resources to buy these enterprises and to run them, the law accepted the religious foundations as their representatives. The Martyrs’ Foundation and the Foundation of the Oppressed and Disabled were the main religious foundations that started to buy state enterprises (Rakel 2006: 123). The result was that instead of creating competition, the liberalization reforms led to monopolization by the religious foundations.

The First Five-Year Development Plan was financed through state revenues from oil exports, foreign borrowings, and borrowings from the Central Bank and the domestic banking sector. The IRI was able to strengthen its economic ties with countries in Asia, Africa, and Latin America on a bilateral or multilateral basis (for example: the International Fund for Agricultural Development (IFAD), the Islamic Development Bank, and the Association of South East Asian Nations (ASEAN) group). Iran received World Bank credit for domestic development projects, grants and loans from the Islamic Development Bank, and applied for loans from the International Fund for Agricultural Development. From January 1989 it reached “agreements in principle,” or signed trade protocols, with countries such as Australia, Bahrain, Belgium, Canada, France, Germany, Great Britain, Italy, India, Japan, Libya, Malaysia, The Netherlands, New Zealand, Romania, South Korea, and Sweden for cooperation in the fields of:

“automobile assembly, construction materials, electric power generation, housing, iron and steel production, oil and mineral exploration, offshore drilling, gas and oil refining, petrochemicals, storage facilities, ship building, atomic research, and others” (Amuzegar 1993: 155-56).

Central Bank loans and commercial bank credit facilities financed the state budgetary deficits. This led to a dramatic increase in inflation averaging of 24 percent per year and reaching 50 percent in 1996. Foreign borrowings, prohibited by the Iranian
constitution, were only possible through massive short-term credit financing of imports by suppliers. The import of luxury goods created a foreign debt of between US$ 35 and US$ 45 billion, largely due to high import duties.

The Rafsanjani government increased the state’s regulation of prices and the market. The idea was to stop profiteering by shopkeepers, middlemen, and merchants at the expense of the consumers. Starting with the Iran-Iraq War, and continuing through the 1990s, the payment of consumer subsidies increased substantially. This, also, included essential goods such as wheat, sugar, vegetable oil, and rice. No such subsidies were paid to the producers. As the Iranian government was the only buyer of wheat and the Economic Council set the prices at the production costs, way below world market prices, farmers were not only discouraged from producing, but even penalized for it. Consequently, many farmers left the countryside and migrated to the periphery of the larger cities. There they searched for better jobs but ended up in shantytowns with only limited access to basic needs. The production of wheat was far below the country’s needs and much wheat had to be imported. Imports fluctuated between 6.5 and 8 million tons of wheat annually. During that period Iran became the second largest importer of wheat in the world behind Japan (Karbassian 2000: 637-38).

The Second Five-Year Development Plan (Appendix 3b) was scheduled to begin on 20 March 1994, the first day of the Iranian New Year 1373 (1994/95). However, the launching of the new plan lost its urgency. This was due to: the significant internal and external imbalances resulting from earlier miscalculations; excessive credit creation; foreign short-term borrowing; a fall in crude-oil prices; a growing volume of external payment debts; and arguments about the wisdom and efficiency of President Rafsanjani’s Structural Adjustment Program. Under the pretext of the need to evaluate the First Development Plan’s achievements, the majles postponed the starting date of the Second Development Plan to March 1995. Although, more realistic in calculations and less ambitious in its goals, the new plan was admittedly prepared with similar strategies to those of the First Development Plan and as a continuation of the same efforts (Amuzegar March 2001: 27, 29). It promised to accelerate the structural reforms envisaged in the First Development Plan and to continue macroeconomic adjustments already underway (Plan and Budget Organization August 1999: 11-16).

Both the First and the Second Development Plans did not achieve their goals. Still, the First Development Plan can be considered a watershed in the development of Iran’s economy, after the Iran-Iraq war. It contributed to dismantling the centrally administered economy and set the stage for a new agenda for economic adjustment and economic reform (Karshenas and Hakimian 2000: 44-45). Iran’s Second Development Plan (1995-2000) came to an end on 20 March 2000, leaving behind an economy with stagnating growth, high inflation, high unemployment, a weakened national currency, a widening income gap between rich and poor, and an uncertain future. In addition to falling short on most of its macroeconomic targets, a significant number of promised structural reforms were also not implemented but passed on to the Third Five-Year
Development Plan (2000-2005), that was initiated under the presidency of Khatami. What were the main obstacles to realizing the First and Second Development Plans? Khajehpour (2000: 583-586) summarizes them as follows:

(1) Absence of a competitive environment. Although the Iranian government in the early 1990s embarked on the privatization of a number of state owned enterprises, a great part of the economic structure is still dominated by the public and semi-public sector (such as the religious foundations), thus is in the hands of small interest groups;

(2) Lack of legal stability;

(3) Absence of institutions that represent the interests of the private sector. The only institution representing the private sector is the public Chamber of Commerce that is subordinate to the Ministry of Commerce;

(4) Distorted market structures, through the subsidy policies of the government, which derived from the ideas of the post-revolutionary government for: bringing social justice to the country; supporting limited groups that are closely connected to the political establishment; limiting private sector investment; and using discriminatory trade policies (Khajehpour 2000: 583-586).

The state remained the dominant actor in the economy (the religious foundations included). Prices were controlled, government bureaucracy grew, and privatization was limited. Whilst, in the beginning of the 1990s, some degree of economic prosperity could be noted, since 1993, the structural problems of the Iranian economy became apparent and the Iranian government was no longer able to argue that the reform policies would benefit everyone (Ehteshami 1995).

An important negative influence on state intervention has been the minimal interest shown by the private sector in investing in the country. The main reasons are high taxes on profits, non tax-charges, unfavorable labor laws for the employers, and great obstacles on starting manufacturing sites. Trade is more profitable than industry as it is easy to evade taxes in trade. The service sector constitutes about 50 percent of the GDP of the IRI, much more than a progressive economy would have (Karbassian 2000: 637-38).

### 3.3.2 Economic Liberalization and Social Response

The impact of the liberalization policy on large parts of the population provoked popular opposition to the government and intensified the political struggle among the political factions. The Iranian people had to experience the negative consequences of the economic policies, e.g. the reduction of state subsidies for essential goods such as food. They felt alienated from the political system.

The Iranian people had no legitimate organ to show their protests against the governmental economic policies. The only possibility for protest was on the street and in the workplace. Street protests and strikes in key industrial centers took place in 1992, and again in 1994, in many towns and cities all over Iran. Although the riots followed similar patterns and may also have had similar objectives, they were all based on local
events. The regime responded immediately and forcefully. In the various riots dozens of people were killed, hundreds were injured, and hundreds arrested of whom many were executed.

After the riots in the first half of the 1990s the main political factions drew different conclusions on how to react to these events. The Conservative faction demanded the integration of a greater amount of Islamic doctrine into society. Alarmed by the increasingly visible symbols of cultural liberalization, since the beginning of the 1990s, Supreme Leader Ayatollah Khamenei, in various statements, warned the Iranian government of “Westernization” of the economy. He asked the security forces to apply the principle of *amr al ma’ruf nahy az monke* (follow the correct and righteous path and avoid the forbidden) to come to an eradication of “corrupt Western culture and attitudes” (Haeri 24 July 1992: 13-14). Conservatives like Ayatollah Mohammad Yazdi (head of the judiciary 1989-1999) supported a greater use of force to confront the protestors.

In contrast to this, the *majles* and other state institutions recognized that the riots of 1992 had deeper social roots and urged that these social issues be put on the government’s agenda. Hojjatoleslam Mostafa Mohaqqeqdamad, head of the country’s National Inspectorate Organization, commented that the real background to the riots was the “discontent” of the Iranian people with the government and the bureaucracy (*Kayhan* 9 July 1992):

> “[In Mashahd] 100 hooded men, armed with sophisticated weapons designed for urban warfare, turned the demonstrators into a mob which attacked specially chosen targets. They controlled and directed the furious mob to destroy banks, attack buildings, set fire to buses, rob, and loot shops and commercial centers. They did their best to transform the justified anger of the poor, who are sick and tired of the government’s broken premises and endless bureaucracy, into horrifying revolt” (cited in Haeri 26 June 1992: 11-12).

The Radical Left faction was unable to use the popular unrest to strengthen its own position within the government. This had three reasons:

1) Its strict interpretation of Khomeini’s ideas on domestic and foreign policies, that were no longer supported by the mass of the people;

2) It could not function as an effective political group because its political stance had been weakened since the parliamentary elections in 1992;

3) It knew that a failure of Rafsanjani’s policies would be a danger to the entire political system. Additionally, if the reform policies were supported by the supreme leader the Radical Left faction could not go in opposition to them.

Despite the institutional weakening of the Radical Left faction, criticism of the lack of social justice, with regard to the economic policies of the executive branch of government, became very common. Also, the Friday Prayer was used as a platform for protest against government policies. For example, Ayatollah Ahmad Jannati, now head of the Council of the Guardian, said in October 1992
“the return of the capitalists to the country means the disappearance of the values of the Islamic Revolution” (cited in Waldmann 8 May 1992).

Jannati clearly expressed his concern that economic liberalization would entail the introduction of Western cultural values and consumption patterns. The Conservatives also viewed returning exiles as potential accelerators of Westernization in the IRI (Waldmann 8 May 1992). Under these circumstances in 1997 Khatami appeared on the scene.

3.4 Economic Impasse during Khatami’s Presidency 1997-2005
Khatami’s period as president differs from the former presidents. While the other presidents were always the favored candidates of the supreme leader, in the presidential elections of 1997 the people voted for a candidate that was not favored by the supreme leader. The candidacy of Khatami as president was seen by the younger and more progressive elements, among the Iranian political elite, as the last chance to reform the political system “from within.” The more secular elements of the politically relevant elite considered him to be the best person to start a gradual transition to democracy, by establishing the rule of law and promoting a civil society.

He was also expected to bring about the achievements of the Second Development Plan’s goals. The Second Development Plan was still active when Khatami was elected president (MEED 8 August 1997: 3). Khatami convinced the Iranian people that they “deserve a better deal” having suffered and made many sacrifices during the war with Iraq and the subsequent economic reconstruction, (IRNA 8 April 1999). President Khatami promised that he would take up these challenges through a policy of rapid development but also “social justice.”68 His economic policies included: a balanced budget; the privatization of public enterprises that were making no profits; the completion of projects before starting new ones; larger bank credit to the private sector; and adjustment of the exchange rate to the expected rate of economic growth. President Khatami declared the state of the economy the number one priority of his government (Jehl 5 February 1999: A6).

In an unusually open television statement President Khatami admitted that the Iranian economic structure was “sick” in production, distribution, and regulation. He criticized the great dependence of the economy on the oil sector, called for a reduction of the public sector and state monopolies, and complained about income disparities (See Iran Focus 1998). If we consider that his predecessor, Hashemi Rafsanjani, had, during his presidency of 1989-1997, called the Iranian economy dynamic and a model for the Middle East region (Kayhan-e Havai, 29 December 1993, 29 May 1994), then Khatami’s speech was very courageous and challenging.69 But President Khatami was

68. For the President’s initial economic policy statement see Iran Times, (Washington), (13 June 1997).
69. Khatami repeated his criticism of the economy again, a year and a half later, while visiting the
unable to realize his promises. He had to convince the Conservative faction in the *majles* and the *bazaaris*, as well as his own supporters, that neither Mir-Hussein Musavi’s (Prime minister in Iran until 1985) nor Rafsanjani’s economic policies had been able to lift Iran out of its economic crisis, and that therefore a different economic policy was necessary. That meant, Khatami needed a broad basis to effectively put through his reformist policies (Amuzegar 1999).

President Khatami presented his economic policy plan in August 1998, on which he further elaborated in November 1998 when presenting the Budget Bill 1378 (1999/2000) to the *majles*. Khatami’s plan was very diplomatic. It consisted of the views of both political factions, the Pragmatists and the Conservatives. On the one hand, like the Pragmatist faction, he supported the mobilization and attraction of foreign capital by the elimination of restrictions on private ownership. To satisfy the Conservatives, on the other hand, he pledged that his government “will do its best to maintain social justice and a more equitable distribution of income” (Hamshahri 30 November 1998; Behdad 2000: 135).

### 3.4.1 Further Attempts at Economic Liberalization

When the Third Five-Year Development Plan was introduced, in March 2000, it represented a significant change in economic policy making, addressing: the question of economic reform; the enlargement of the private sector; increases in domestic and foreign investment, as well as export; and the development of the non-oil sectors.\(^\text{70}\) The start of the Third Development Plan coincided with a sustained rise in oil prices.

Iran has gas reserves in 117 oil and gas fields either as independent fields or as gas layers in oil wells. About 50 percent of the natural gas fields have not yet been developed, meaning that Iran has the potential to produce even more natural gas. The South Pars gas field is the world’s largest, jointly shared between Iran and Qatar. Iran has nine refineries with an approximate capacity of 1.5 mbbl/d (million barrels per day). The oldest and largest of which being the Abadan Refinery with a nominal capacity of 420,000 bbl/d (Oil Ministry of Petroleum of Iran 2000: 30-32). Revenues from oil and gas export amount to 70 percent of the state’s general budget and about 80 percent of all foreign exchange earnings (Karbassian 2000: 629). However, economic dependence on oil revenues is not sustainable in the long run. It needs, even if the government can limit the impact of price fluctuation through the operation of an oil stabilization fund, a continuous upward trend in oil prices to continue economic growth. Thus, only by a structural economic reform could the IRI reach sustainable economic growth.

An important area of reform was the unification of the exchange rate system in March 2002. This gave a strong signal to international investors about the seriousness of Iran’s

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efforts for economic reform (Karshenas and Hakimian March 2005: 77). The main goals of the Third Development Plan (Appendix 3c) were largely the same as those of the Second Development Plan (Amuzegar 2005: 47-48). But even under Khatami’s presidency the goals set in the Third Development Plan could not be achieved. As Amuzegar states, the Third Development Plan had some greater achievements than the Second Development Plan, but still they were rather modest. The Third Development Plan:

“[...] has achieved some tactical successes while falling behind in strategic goals – mostly because the plan has been neither effectively formulated nor meticulously implemented.”

Among the main failures were:

1. The inability to reorganize state administration and decrease the state bureaucracy. The ratio of annual government expenditure to GDP even rose from 24.5 percent in 1999 to 27.2 percent in 2004 (IMF 2004). In his last report as president in the majles, Khatami claimed that the total number of government employees was reduced by 2.9 percent during the Third Development Plan period (Hamshari 2 August 2005). But, as no concrete figures can be given on the number of employees in several state institutions (e.g. defense, security, and intelligence) no official figures can be given showing whether the total figure was actually reduced. According to a World Bank report, governance effectiveness in Iran declined between 2000 and 2004 from position 119 to 149 out of 208 countries (World Bank 2005a);

2. The slow process of privatization. There are many reasons why privatization goes so slowly in Iran. The most important is the absence of an appropriate political-economic climate and the reluctance of state and semi-public organizations (especially the religious foundations) to give up their economic privileges (Amuzegar 2002);

3. Another important failure of the Third Development Plan was the inability to reduce poverty in Iran. According to a recent report by the majles Research Bureau, about 50 percent of the rural population and 20 percent of the urban population fall below the relative poverty line71. A majles committee chairman states that 10-12 million of Iran’s 70 million people “live under the poverty line” (Radio Farda 19 January 2005). The former Minister of Welfare and Social Security explained that some 7.5 million Iranians fall below the absolute poverty line72, and 1.5 million people go to bed hungry (Kayhan (London) 1 June 2005). According to the director of the

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71 “The relative poverty line is defined to be a specific percentage (mean) of a community’s income or an income boundary under which a certain percentage of the individuals in that community may stand. However, selection of relative poverty line would always result in regarding a number of individuals in a community as poor” (Kashi et al Autumn 2002).

72. “[A]bsolute poverty line is the amount of income essential to satisfy the minimum needs of the individuals (i.e. food, clothing, and housing) considering the cultural and socio-economic conditions of the community under study, or it consists of the lowest properties such as minimum level of income, education, housing, etc., which, if unsatisfied, cause the related individual to be regarded as poor” (Kashi et al Autumn 2002).
Anti-Poverty Program Reports, 2 percent of the rural and 4.5 percent of the urban population live under the absolute poverty line, and some 15 percent of the rural and 17 percent of the urban population suffers from relative poverty (Siasat-e Rooz (Tehran), 21 July 2005; Jomhouri Eslami 29 July 2005). In a World Bank report of 2005, it was shown that the wealthiest 10 percent of the population in Iran earned and spent almost 34 percent of national income, with the poorest 10 percent’s share being no more than 2 percent. Also, the wealthiest 20 percent earned and spent about 50 percent of national income, whilst for the poorest 20 percent this was only 5.8 percent (The World Bank 2005b). Based on these estimates the number of people living on US$2 a day was 7.3 percent or 5 million people. The number of people living on US$1 was 2 percent or 1.4 million of the population (Hamshari 13 June 2005). It is even argued that, during the Third Development Plan period, the number of poor people increased by 1.7 million people (Jomhouri Eslami 5 May 2005). By the end of the Third Development Plan period about 50 percent of Iran’s population did not have any social insurance (Iran Emrooz 30 November 2004);

(4) The government also failed in reducing unemployment. The overall goal was to bring down the official rate of about 15 percent unemployed in 2000 to 11.5 percent by March 2005. In an interview with IRNA in July 2006 the Deputy Minister for Labor and Social Affairs, Ebrahim Nazari-Jalali, stated that the government had the goal to reduce the unemployment rate to 8.4 percent by 2010 by creating 900,000 jobs annually and that it would spent 180 trillion rials (US20.5 billion) for small businesses to create jobs (Samii 29 July 2006). In the past, the Iranian government had failed to meet similar goals. Of the 3.8 million new jobs that were planned to be created during the Third Development Plan period only 2.9 million new jobs materialized (Hamshari 5 May 2005) and the number of unemployed had actually increased (Jomhouri Eslami 21 May 2005; Iran Times 13, 20 and 27 May 2005; and Payvand’s Iran News 24 April 2005);

(5) The government also missed the goal to reduce its dependence on oil revenues to less than 12 billion dollars. Instead dependence on oil revenues even increased to more than 40 billion dollars in 2006 (Nili May 2006);

(6) Another important missed goal was the continuing wasteful use of natural resources (oil, gas, power, and water). Between 2000 and 2005 total energy consumption rose almost 10 percent annually (gasoline 12 percent), which is five times more than the world average. Iran has only one percent of the world population but consumes 9 percent of global energy production. This is due to subsidized energy prices and the lack of regulations for the construction of private homes, public buildings, and industrial and commercial plants (Hamshari 25 November 2004; Jomshouri Eslami 25 November 2004). It is estimated that some industrial factories in Iran use 35 percent more energy than the world average, refrigerators built in Iran consume more electricity than those imported; and cars built in Iran use 37 percent more gasoline than foreign cars.
The Third Development Plan did much better than the Second Development Plan but the results were rather limited. The size of the government did not shrink, as had been planned, and the state machinery became less disciplined, more oil dependent and more corrupt (Amuzegar 2005: 60-61). When Ahmadinejad took office in 2005 he, like his predecessors, promised to improve Iran’s economy and especially the economic situation of the poor people in Iran.

3.5 Poverty Alleviation - The Main Goal since Ahmadinejad’s Presidency in 2005

In his electoral campaign Mahmoud Ahmadinejad promised that he would raise the standard of living (especially for those Iranians living in poverty), create jobs, curb inflation, alleviate corruption etc. Many of the 17 million people who voted for him did so, on the grounds of these promises. Instead, since Ahmadinejad’s election as president, inflation has risen, unemployment has not declined, prices in the housing sector have risen, and the gap between rich and poor has not been narrowed. However, as president Ahmadinejad has only been in office for two and a half years, it remains to be seen what the long-term consequences of his economic policies will be.

Criticism of Ahmadinejad’s economic policies has come from all factions, the Reformists, Pragmatists, as well as the Conservative faction, and even his neo-Conservative allies. Both the Reformist and the Conservative faction of the Iranian political elite criticized Ahmadinejad’s presentation of the annual budget to parliament on 15 January 2006. The main points of criticism were that the budget overestimated the price of oil and relied almost exclusively on oil revenues. They also criticized the allocation of funds to religious institutions, instead of other cultural and educational ones (RFE/RL Iran Report 3 March 2006). Conservative members of parliament warned that the proposed budget could lead to a “Dutch disease” and raise the inflation up to 33.5 percent (Shargh 2 March 2006).

One of Ahmadinejad’s greatest critics is former President Rafsanjani. He declared that he would even use his position as head of the Expediency Council to influence economic policies (Tait 7 March 2007). In 2005 Supreme Leader Khamenei granted the Expediency Council additional oversight responsibilities, based on which the Expediency Council can overturn decisions of the Council of the Guardian, if they are challenged by parliament (Ritter 3 November 2006). Rafsanjani consolidated his position in December 2006 when he was chosen vice president of the Assembly of Experts (in early September 2007 he was elected head of the Assembly of Experts) and reinstated as the head of the Expediency Council. On 5 March 2007 he declared that the government had had enough time to implement its promises. Thus, the Expediency Council would now examine government decisions and expenditure to make sure that they were in conformity with the goals of the Fourth Five-Year Development Plan, the 20 year forecast, and Article 44 of the constitution envisaging large-scale privatization policies (Sepehri 13 March 2007).

“Now the trial period is over and the supervising role of the Expediency Council should be enacted more seriously,”
Mr. Rafsanjani further said:

“Under the 20-year outlook plan the country’s reliance on oil should be reduced by more than 10 percent each year but during the last two years this process has been reversed. Next year’s budget depends on oil to an even greater extent than those of the last two years […] People should hear about such issues from me as the person responsible for establishing these policies” (cited in Tait 7 March 2007).

The expansion of the Expediency Council’s powers caused some upheaval among members of the Iranian political elite, fearing that it would undermine the independence of the executive and legislative branches of the political system. What gained less attention, but is equally important, is that granting the Expediency Council new rights also meant the Expediency Council now has more say in the Fourth Five-Year Development Plan (Samii and Aman 26 October 2005).

The Fourth Five-Year Development Plan is a continuation of the Third Development Plan putting special emphasis on:

“a more open economy based on competitiveness; privatization and a smaller role for the government in the economy; more autonomy for the central bank in monetary policy design and implementation; greater independence for the National Iranian Oil Company (based on a royalty scheme); Implementation of a clear legal framework for foreign investment in Iran; achievement of an annual growth rate of 8 percent, with 2.5 percentage points from growth in total factor productivity” (Kornijani 2006).

No effective steps to alleviate poverty, to decrease the unemployment rate, and to reduce state dependence on oil revenues etc. were taken during the first two years of Ahmadinejad’s presidency.

At the end of June 2007 President Ahmadinejad became even more unpopular with Iranians when the government imposed gasoline rationing to 100 liters (26.39 gallons) per driver. The price of gasoline in Iran is subsidized at a cost of about US$0.42 per gallon (Cohen 5 July 2007).

3.6 Summary

The first ten years after the Iranian Islamic revolution, when Khomeini was the supreme leader, were characterized by the following economic goals: state intervention, “self-sufficiency,” and “inward-oriented growth.” Enterprises that had been owned by the Shah or people close to him were deprivatized and put under the control of religious foundations. The same happened with arable land. All private banks were put under state control and joined together in six commercial and three specialized banks. All joint ventures in the oil sector were abolished and their companies handed over to the NIOC, which is part of the Iranian Ministry of Oil.
Because of the IRI’s ideological orientation international trade relations changed considerably. Most significantly, the US, the third biggest exporter to Iran in terms of goods and services before the revolution, has had no noteworthy exports to Iran since then. Germany and Japan remained important trading partners for Iran, as did Britain and France (after some years of limited trade). The UAE and Turkey developed to become major trading partners. Since the disintegration of the Soviet Union in 1991, Russia and Kazakhstan have become trading partners.

The death of Ayatollah Khomeini in 1989, the end of the Iran-Iraq War and the rise of Hashemi Rafsanjani as president created the framework for a shift in economic policies away from state intervention into the economy and self-sufficiency, towards privatization and market liberalization. Both the First and Second Five-Year Development Plans were carried out during Rafsanjani’s presidency. Although it can be said that the First Development Plan laid the basis for dismantling the centrally administered economy, economic adjustment, and economic reform, both the First and the Second Development Plans did not achieve their goals.

When the Second Development Plan was terminated, the economy was confronted with stagnating growth, high inflation, high unemployment, a weakened national currency, and a widening income gap between rich and poor. The economic policies, and their negative consequences for large parts of the Iranian population, led to street protests and strikes in key industrial centers. The protests were heavily suppressed with dozens of people killed, hundreds injured, hundreds arrested some of whom executed.

After the failed economic reform program during Rafsanjani’s Presidency, many Iranians laid their hope in Mohammad Khatami, who was elected President in 1997. President Khatami very openly criticized the Iranian economy, its dependence on the oil sector, the large public sector and state monopolies, and the increasing gap between rich and poor in Iran. All of which he promised to change. Khatami was unable to live up to his promises. He needed a broad basis among the political elite, to put through his economic policies, of which he could not be assured because of the very different views on the economy of the various political factions. His economic plan considered the views of both the Pragmatist and the Conservative factions. Like the Pragmatists, he supported further privatization to attract FDI, but he also did not want the traditional forces of the Conservative faction, who objected to privatization, to be against him. Although the Third Development Plan did much better than the Second Development Plan, its success was still rather limited. The public sector remained large, and the state bureaucracy became more oil dependent and corrupt.

During his electoral campaign Mahmoud Ahmadinejad promised that he would alleviate corruption and narrow the income gap between rich and poor. Many people voted for him on the grounds of these promises. Having only been in office for two and a half years, President Ahmadinejad has not been able to achieve his goals. Even worse, he is heavily criticized by all political factions for his economic policies, even his neo-Conservative allies. One of President Ahmadinejad’s greatest critics is his rival during the
presidential elections of 2005, Hashemi Rafsanjani. In 2005 Supreme Leader Khamenei expanded the power of the Expediency Council (of which Hashemi Rafsanjani is the head) over the economy and, therewith, the Fourth Five-Year Development Plan.

The Iranian economy requires major structural reforms, including the privatization of the religious foundations. Without a privatization of the foundations and the application of the rule of law, it is very unlikely that Iran can stimulate private investments, which it desperately needs. Other obstacles to economic reform have been Iran’s difficult relations with the US and more recently the nuclear issue. Without a secure political environment there will be no investment resulting in major effects on Iran’s production capacity, living standards, and ultimately the legitimacy of the IRI. The Iranians no longer trust the power of the Islamic ideology, as Khomeini’s mixture of religion and politics was not able to bring the promised rewards of prosperity and social justice to Iran. The ailing economy has put the legitimacy of the Iranian government further into question. The decline of the Islamic ideology, combined with the failure of economic reform, confronts the IRI with its greatest challenge to its legitimacy since the revolution. Both the public and the press openly question the role of Islam and the concept of the *velayat-e faqih*, as will be discussed in the following chapter.