

The Re-Emergence of Iranian Petro-Populism

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Despite buoyant oil revenues, the Iranian economy is going through a difficult period. While its aggregate economic performance has improved over the last several years, there has been little progress made in alleviating poverty or unemployment.

The emergence of Mahmoud Ahmadinejad in 2005 signaled a shift towards a populist economic agenda designed to confront its long-standing economic malaise. Ahmadinejad's petro-populism condemns the size of the state and its bureaucracy, the budget's undue reliance on oil export income, wealth and income differentials, low wages, high unemployment, corruption, nepotism and monopolies. In his election campaign, he promised to "put the oil money on everyone's dinner table" by a distribution of "justice shares" to the masses and setting up special funds to offer no- or low-interest loans to young couples.

Unfortunately, while attractive sounding, Ahmadinejad's petro-populism has featured frequent, hurried and uncoordinated state interventions in the market for goods, money and capital, along with the pursuit of expansionary monetary and fiscal policies. This approach does not augur well for a thriving economy in the rest of Ahmadinejad's term. These policies, if continued, are also bound to fail by a wide margin to deliver his promised 'just' Islamic society during his tenure.



Introduction

When asked what he was going to do about rising rates of inflation, Ayatollah Ruhollah Khomeini replied, "This revolution is not about the price of watermelons." In another instance Khomeini noted that "some persons have come to me and said that now that the revolution is over, we must preserve our economic infrastructure. But our people rose for Islam, not for the economic infrastructure."¹

*The Soviets were communist, the Nazis had private ownership with state control, and Iran has heavily interventionist crony capitalism, plus an odd grab-bag of specifically Islamic economic regulations ...Everyone who makes serious money in Iran makes it because of a relationship with the state.
– Anonymous Iranian businessman*

Ahmadinejad openly speaks of a "clash of civilizations" both inside Iran and in the world at large. He does not want a seat at a panel in Davos; his dream is to abolish the capitalist system that produced Davos. He does not want Iran to become a member of the World Trade Organization, which he has described as "a club of global thieves." Nor is he tempted by the offer of preferential trade relations with the European Union that he sees as "a family of fat parasites living off other nations."²

He (Ahmadinejad) has more integrity than other politicians, but he is an ideologue, and ideologues see the world simply.³

The above quotes illustrate the sharp contrast in the way the Iranian Revolution has been perceived over the years. The charismatic populist Ayatollah

Khomeini projected the notion that the Revolution was about more than economic gains, that social justice was its primary goal. However, many cynics note that after Khomeini's death all that really took place was a reshuffling of elites, with a somewhat unique brand of Islamic crony capitalism replacing the Shah's crony capitalism.

Finally, the 2005 emergence of Mahmoud Ahmadinejad suggests populism is again on the ascendancy in Iran. Ahmadinejad rose to power advancing the proposition that the governments since Khomeini's neglected the principles of a true Islamic state. His populist message condemns the size of the state and its bureaucracy, the budget's undue reliance on oil export income, wealth and income differentials, low wages, high unemployment, corruption, nepotism and monopolies. In his election campaign, he promised to "put the oil money on everyone's dinner table" by a wholesale purification of the Oil Ministry, confiscation of government assets obtained through privatizations, distribution of "justice shares" to the masses and setting up special funds to offer no- or low-interest loans to young couples seeking employment, marriage and home ownership.⁴

While these are lofty and seemingly well-intended goals, difficult challenges confront Ahmadinejad.⁵ Data on the economy paint a gloomy picture. While aggregate economic performance has improved over the last several years following the dramatic increase in oil prices, the longer-run pattern is one of decline. At the time of the Revolution, Iran had an income equivalent to Spain's, pumped six million barrels of



oil a day, and nurtured a vibrant middle class. Today, Iran's real per capita income is considerably below what it was before the revolution, oil production is two-thirds of the 1979 level, and the middle class is being squeezed by high inflation, chronic unemployment, and stagnant wages.

The sections below examine the economic dynamics in Iran that has led to sub-optimal rates of growth combined with high levels of unemployment and mounting inflationary pressures. Within this context how does Ahmadinejad's populist agenda propose to improve the lives of those at the lower ends of the income scale? Specifically, what key principles underlie Iranian populism? What are the particular populist programs/measures that comprise the Ahmadinejad revolution? What is their likely efficacy in combating inflation, unemployment and poverty? A final section sketches the likely ramifications of Ahmadinejad's brash petro-populism agenda.

1. Evolution of Iranian Petro-Populism

It is possible to identify at least six distinct periods⁶ of economic policymaking since the Revolution – three periods of populism and three of a more pragmatic approach towards the economy:

1. **The First Populist Phase**, from 1979 to 1981, included the wave of post-revolutionary nationalizations and confiscations of property from individuals associated with the Shah's regime;
2. **The Second Populist Phase** lasted from 1982 to 1984 and was marked by a shift from the more socialist-oriented policies of the first phase to strictly Islamic policies, such as interest-free banking, together with the dismantling of the Shah's indicative central planning system;
3. **The First Pragmatic Phase**, 1985-89, saw no major innovations in economic policy, but, instead, a tentative opening to the outside world as attitudes towards the United States softened under pressures from the Iran-Iraq war, as well as a decline in real incomes.
4. **The Second Pragmatic Phase**, 1989-1997, which coincided with Rafsanjani's presidency, was marked by the introduction of a five-year planning process still in effect today, some privatization of state enterprises, and attempts to integrate into the world economy that included obtaining a World Bank loan in 1993, although Islamic economics were maintained internally and support continued for the fundamentalist Islamic movements aboard.
5. **The Social Reform Phase** began with the ascension of Mohammed Khatami to the presidency in 1997. His policies, opposed by the conservative ulama, emphasized the rule of law and a relaxation of control of political discussion and social customs by the ulama and the security forces, while maintaining an Islamic framework. Economically, Khatami sought to establish a new type of transition economy in Iran that would combine modernization and globalization with continued adherence to Islamic law codes and economic practices. Externally, Khatami continued Rafsanjani's efforts to open Iran to the world economy, and with more success. Internally, there was a consolidation of state control where it already existed and few changes in Islamic economic institutions or practices.
6. **The Third and Current Populist Phase** began in 2004 when Islamic hard-liners gained control of parliament, culminating in the election of ultra-conservative President Mahmoud Ahmadinejad in the summer of 2005. This phase has shown little enthusiasm for building on the 2002 reforms. Instead, the tendency has been to revert to the general populist principles laid down by Ayatollah Khomeini in the immediate years after the Revolution.

Given the country's vast oil resources, Khomeini's





populist approach had a somewhat unique mix of features. In addition to the usual populist focus on the redistribution of income, Khomeini's petro-populism featured the establishment of para-governmental organizations for charitable purposes, the overvaluation of the national currency, a restricted scope for private sector activities, and chronic budget deficits with corresponding inflationary pressures. While economic factors play an important role in Iranian populism, they are clearly subservient to social (and religious) considerations:⁷

Iran has a distinctive populist economic approach. Thus by Iranian populism, I mean a political authority that tried to gain legitimacy from mass society without really threatening the whole principle of private property. In a simple definition, it can be argued that the main characteristic of this version of populist economics is an approach to economics that emphasizes income redistribution, i.e. social justice, as an ideology.

The emergence of Iranian populism also coincided with economic and political instability.⁸

... the effects of political instability on economic performance have led to the view that Iran is a discretionary state that lacks credibility rather than a protective state. The lack of credibility of the state excluded the private sector from its liquid resources and obliged it to retreat into informal relationships. Therefore, the levels of savings, investment and technology were lower under this unstable political authority (i.e. discretionary state) and as a consequence per capita income was lower.⁹

As might be expected, Iranian populism has had its greatest appeal to those groups who traditionally have been its main beneficiaries: (1) non-tradable goods sectors such as construction and services; (2) firms producing import substitutes; (3) farmers in rural

areas, and (4) urban groups who received generous food and energy subsidies. Not surprisingly these groups have been the most resistant to the various post-Khomeini attempts at economic reform.

Iranian populism's bias towards immediate consumption is also consistent with the country's traditional preference for short-run optimization as opposed to longer term growth. As Homa Katouzian has observed:¹⁰

Iran was a short-term society in contrast to Europe's long-term society. It was a society in which change – even important and fundamental change – tended to be a short-term phenomenon. This was precisely due to the absence of an established and inviolable legal framework “which would guarantee long-term continuity....it rendered very difficult cumulative change in the long term, including the long-term accumulation of property, wealth, capital social and private institutions, even the institutions of learning. These normally proceeded or existed in every short term, but they had to be reconstructed or drastically altered in the following short terms.

In sum, Iran's short-term society and massive oil revenues together with religious fervor has combined to produce a unique style of petro-populism. Iranian populist economics introduced by Ayatollah Khomeini resembled classical populism in the sense that it favored government intervention in the marketplace and the protection of workers. It also led to policies of cheap food and energy through massive subsidies in an attempt to close the standard of living gap between the poor and the rich.

The fact that Iran's initial attempts at populist policies did not produce their desired results is well known – clearly part of the problem stems from “petro-populism” itself rather than populism per se. The unfortunate fact is that, like Iran, most oil-rich



developing countries are underperformers across a whole spectrum of economic, social, political and governance standards. Large windfall gains associated with a rapid increase in oil prices have been a particular problem in that they create severe distortions in the economy and the political system, with strongly negative socio-political consequences. In countries as diverse as Iran, Nigeria, Venezuela, and Indonesia, the combination of state inefficiency and revenue windfalls has proved overwhelming, undermining even the best efforts to develop each country's non-oil economy, eradicate poverty, and improve living standards for broad-based segments of the population.

In Iran's case, no index of economic failure stands out as much as the country's chronic high unemployment rate. Between 1996 and 2000, 693,000 new workers entered the labor market, while only 296,000 jobs were being created. It is estimated that unemployment lies somewhere between 15 percent and 25 percent, mainly affecting the young urban population. According to the World Bank, the creation of between 700,000 to 800,000 new jobs each year to achieve unemployment rate stability would require an annual growth of the economy of at least 6 percent per annum. The post-2000 oil boom has not significantly reduced the rate of unemployment.

It has been argued that job creation and improved efficiency in Iran's post-revolutionary economy have been hindered by the existence of a structural trap¹¹, whereby political and economic obstacles facilitated by oil revenues avert the reallocation of capital from low productivity firms to ones that are more productive. There is abundant empirical evidence to support this explanation. The International Monetary Fund¹² has found suggestive patterns of total factor productivity (TFP), a key indicator of technological change that

reflects the adaptability of firms and institutions. The Fund's measurement of this critical variable shows that it was positive and quite high during the 1960-76 period, contributing between 3.2-4.7 percent per annum to the country's overall growth rate. However, after the Revolution, it averaged between -5.5 to -9.6 percent from 1977-88 and between -1.8 per cent and 1.0 percent from 1988-2000. Comparable figures for many non-oil developing countries are in the 2.0 to 3.0 percent range.

Other obvious factors behind the economic inefficiency and stagnant productivity in the post-revolutionary period are distortions in prices and subsidies. Annual subsidies on fuel, electricity, and basic foodstuffs run into billions of dollars, and energy subsidies alone account for \$15.7 bn in government expenditures.¹³

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Total consumer subsidies were equivalent to 14 percent of GDP in 2001/02.¹⁴ The system encourages over-consumption and waste and a bias toward capital-intensive industries.

Fuel prices are about one-tenth of world prices, and Iran uses about twice as much energy per capita as Turkey and Jordan, albeit still considerably below the rates of energy use in the much more affluent GCC countries.¹⁵

Just as importantly, oil revenues have, in effect, enabled the government to maintain loss-making state enterprises (SOEs), which would have been impossible for non-oil developing countries. As might be expected, the SOEs have not been able to provide a dynamic growing job market. During the 1990s, about 70 percent of the employment creation in Iran was in the private sector, despite the dominant contribution of the SOEs in the production of goods and services. In addition, Iran's SOEs are typified by their lack of fiscal transparency, which has been one of the main factors contributing to pervasive corruption, and the branding of the Revolution by cynics as just





another form of crony capitalism.

Iran also has a host of semi-autonomous groups, associations and organizations with a direct impact on the economy that have remained largely unchanged over the years, failing to adapt to new economic conditions or challenges. Among the most important of these economic organizations are the multifaceted private religious foundations (bonyads).

As is well known, charitable foundations enjoy a long history of social and communal service and promotion of public good in the Muslim world. In some countries, they have been put under the direct control of a ministry. In others, they function semi-autonomously but with some degree of government supervision. In Iran, these checks are largely absent.

The foundations' heads are appointed by the supreme leader and report to him, rather than to the president, parliament, or even a minister, so that there is no clear system of accountability. With the supreme leader's approval, they control their own economic and

political decision-making. Periodic attempts by the parliament to control these foundations have so far been unsuccessful.

On the positive side, the government has used these foundations and their enormous wealth to help the poor, as well as victims of the Revolution and the Iran-Iraq War. This policy has created an important social base of support for the regime and an enduring patron-client relationship. The regime can cash in and draw support from this large clientele group in times of social unrest. On the negative side, with their billions of dollars in assets and direct support from the supreme leader, strict economic profitability is not required, nor are there the normal competitive checks on efficiency and productivity.

The SOEs and bonyads have been allowed to

monopolize widespread areas of trade and business. In turn, this has created an environment allowing for non-rational and self-interested economic decisions and promoted systemic corruption. Because so little data on their operations is available, their net effect on the economy is hard to quantify, although it can safely be assumed that the bonyads, along with the SOEs, have had an adverse effect. The bonyads alone control 25 percent of GDP and enjoy preferential access to bank credit, hard currencies, government licenses, and lucrative contracts, thus crowding out potentially much more efficient private sector activities.

The chronic losses of these firms require massive subsidies from the government. In turn, these subsidies, along with those for energy and food, are

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one of the main reasons for the country's chronic budgetary deficits and inflationary pressures. Apart from the expenditure for the Iran-Iraq war, to many observers, the country's post-1980 excessive monetary expansion and inflation can be traced directly

back to the government's unwillingness to oppose the credit demands of such politically powerful groups. Currently inflation is running at 13 percent per annum, while unemployment is in the 10 percent - 11 percent range. While the recent increase in oil prices has improved the overall fiscal position of the government, expanded expenditures (2004/05) resulted in the non-oil fiscal deficit of the central government reaching a nine year high of 19.5 percent of GDP.¹⁶

The net effect of the government's pervasive price controls, excessive subsidies, support of highly inefficient state enterprises and bonyads has been to keep the country dependent on oil and discourage the more productive private modern sector activities needed for the country to escape from its structural trap. Oil revenues still provide 80 percent of Iran's total

exports and 50 percent of total budgetary receipts, and the IMF estimates that the country's fiscal and current account balances could deteriorate by 0.75 percent and 1.0 percent relative to GDP for every % one percent fall in oil prices on average over the medium term, making for a precarious economic future.

2. Ahmadinejad and the New Petro-Populism

As noted earlier, Ahmadinejad campaigned on the notion that his two predecessors had neglected the principles of a true Islamic state. Specifically he faulted the size of the state and its bureaucracy, the budget's undue reliance on oil export income, wealth and income differentials, low wages, high unemployment, corruption, nepotism and monopolies. He promised to "put the oil money on everyone's dinner table" by a wholesale purification of the Oil Ministry, confiscation of government assets obtained through privatizations, distribution of "justice shares" to the masses, and setting up special funds to offer no- or low-interest loans to young couples seeking employment, marriage and home ownership.¹⁷

No doubt, Ahmadinejad's campaign promises that Iran's oil revenues would end up on Iranians' tables, contributed greatly to his winning the 2005 presidential election. Since more than half of the people who voted for him reportedly did so for purely economic reasons, his success or failure in delivering on promises on employment creation, poverty eradication, fairer distribution of income and wealth, and measures against corruption and discrimination are likely, in addition to the nuclear issue, to define his presidency.

To address these issues, Ahmadinejad presented (on August 17, 2005) the Iranian Parliament (Majlis) his economic plan in the form of a series of main objectives to be met through the implementation of 58 specific strategies and policies. His nine main

goals – enumerated without any particular priority or sequence – include:¹⁸

1. Self-reliance in national production and output;
2. Activation of the nation's total economic capacities and potential;
3. Export promotion;
4. Equitable distribution of wealth and income;
5. Employment creation;
6. Empowerment of the disadvantaged;
7. Removal of discrimination;
8. Improving people's purchasing power; and
9. Higher social welfare.

Of his 58 policies and programs, 12 appear to be central to his approach towards the economy:

1. Improving the economy's international competitiveness through higher efficiency in all economic factors of production.
2. Achieving self-sufficiency in basic consumer goods.
3. Targeting subsidies at those in the poorer social strata.
4. Reducing inflation (and bank loan rates) along with more efficient distribution of goods and services in order to increase people's purchasing power.
5. Rationalising energy consumption.
6. Protecting domestic industries in a 'rational' manner.
7. Ensuring investment security, and protecting investments through monetary reforms and strengthening of the stock market.
8. Reforming the fiscal sector (reducing public expenditure, improving the budget process, lowering dependence on oil income, better tax collection).
9. Ending private monopolies and special privileges, and guaranteeing equality of opportunity for all.
10. Fighting corruption and underground economic activities.



11. Conducting foreign economic policies (including all commercial contracts with foreign firms) within the context of the level and quality of diplomatic relations with the country in question.
12. Promoting tourism.

Like many populist programs, in Ahmadinejad's program individual components often sound reasonable and well-intended. Yet, upon closer examination, one often finds a number of inconsistencies and several contradictions stand out:¹⁹

- While improvement in international competitiveness tops the list of economic objectives, self-reliance in national output, self-sufficiency in consumer staples, and protection of domestic industries are also important objectives.
- On the one hand, Ahmadinejad appears to be attempting to shift the government towards bureaucratic downsizing. On the other hand, state controls, regulation, and protective measures in various economic sectors – particularly agriculture, small industries, handicrafts, and 'deprived regions' – also feature prominently.
- The program notes the necessity of strengthening the domestic capital market in order to increase private investment. At the same time Ahmadinejad has noted that "as long as banks are allowed to operate as profit-making institutions, there is no hope for a thriving national production."
- While note is made of the necessity of targeting subsidies, rationalising energy consumption, and value-added taxation all involve comprehensive deregulation and price liberalization, Ahmadinejad or his hard-line supporters have shown little enthusiasm in pursuing these goals.
- Private monopolies are, in many cases, the source of income for the new president's individual or institutional backers.
- Tourism is to be enhanced as a strong potential foreign exchange earner. However, Islamic moral

codes are to be more forcefully enforced on all foreign tourists.

In sum, while no one expected his administration to solve Iran's endemic economic problems of high unemployment, double-digit inflation and low overall factor productivity in a short time span, his approach has not inspired confidence. In an open letter to him in June, 50 leading Iranian economists described his economic strategy as devoid of "expertise and scientific basis."²⁰ Perhaps as a result, the country's economic progress throughout 2006 has not lived up to its potential.²¹

At the macroeconomic level, despite record high oil export receipts of nearly \$45 billion in 2005 and \$55 billion expected this year, none of the main economic indicators has shown progress:

- GDP growth of about 5.3 percent to 5.5 percent this year and last year is far below the targeted 8.0 percent in the Fourth Five-Year Development Plan (2005-10).
- The official unemployment rate – huge underestimate – has risen to 12.4 percent.
- Private economists also question the official consumer price index figure of 12.1 percent – down slightly from the previous year – estimating it to be nearer 20 percent.
- The record \$41 billion of imports in 2005 not only make Iran the most subsidized economy in the region but also damage domestic industrial production, creating 40 percent idle capacity.

Monetary policy: High bank loan interest rates have received most of Ahmadinejad's attention. However, the results have been unsatisfactory.

- Ignoring both the 1982 Banking Act and international banking practice, and disregarding double-digit inflation, the Council on Monetary Policy and Credit has ordered both state and private banks to lower their lending rates from 16-24 percent to 14 percent for state banks and 17





percent for private banks.

- Rates paid to depositors have been ordered to be cut to 7-16 percent.
- As expected, state banks facing lower incomes have reduced a good part of their services to customers, and private banks have refused to grant new loans. New deposits in state banks have lagged behind fresh loans.
- Given the exorbitant rates prevailing in the 'informal' money market (the bazaar and the underground economy) of 30-40 percent, depositors have shifted to other opportunities, as evidenced by sudden price rises in gold, foreign exchange, cell phone permits and other informal outlets.
- Influential borrowers from state banks have, in turn, made a profit by diverting low-interest borrowed funds from promised projects to the informal market for lending to speculators and others at higher rates.

There has been no notable progress in implementing other campaign promises.*

- The size of the government, instead of shrinking, has expanded as the two supplemental budgets in 2005, and 27 percent larger 2006 budget attest.
- There has been no progress against corruption or nepotism. On the contrary, the wholesale dismissals of experienced managers of state banks and industrial enterprises and their replacement by the relatives of the new cabinet members has negated the promised pursuit of meritocracy.
- A reduction in petrol imports, which cost about \$6 billion, or some 12 percent of total crude oil export revenues, now looks unlikely.²²
- Ahmadinejad's plans for the distribution of public enterprise shares among the lowest strata in so-

ciety, establishment of the Imam Reza Love Fund to lend money to young people for marriage and home ownership, and a fund to finance "quick start" employment projects are fraught with practical weaknesses and are meeting fierce opposition from vested interests.

Conclusion

Ahmadinejad views Iran's protracted economic problems as rooted in the skewed distribution of wealth and income. He is convinced these socio-economic shortcomings can be effectively remedied with a compassionate and social justice-oriented government program. However, despite its crowd-pleasing tone and

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tenor, Ahmadinejad's populist economic agenda provides neither a solution to Iran's economic woes, nor an assurance of its people's medium-term economic welfare. Nearly all

the targets of his critical focus are systemic, and inseparable parts of the Islamic Republic's politico-economic order. None can be dealt with decisively without a wholesale restructuring of the Iranian political economy. Unfortunately petro-populism addresses only the symptoms, not the underlying structural causes of the country's economic maladies.

Specifically, instead of a comprehensive approach to Iran's economic difficulties, petro-populism has featured frequent, hurried and uncoordinated state interventions in the market for goods, money and capital, along with the pursuit of expansionary monetary and fiscal policies. This approach does not augur well for a thriving economy in the rest of Ahmadinejad's term. These policies, if continued, are also bound to fail by a wide margin to deliver his promised 'just' Islamic society during his tenure.

The widespread realization of this has resulted in a fairly dramatic fall in his domestic popularity



with up to 65 percent of Iranians unhappy with his performance.²³ The recent local municipal council elections (December 15, 2006) represented a clear rebuke for failing to deliver on promises to improve

the economy.²⁴ Clearly, Iran's economic linkages with the GCC countries will depend critically on how the Iranian government responds to growing internal discontent over its policies.

Endnotes

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