THE IRANIAN ECONOMY BEFORE AND AFTER THE REVOLUTION

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THE victory of Algeria's Islamic Salvation Front (FIS) in the December 1991 general elections—not long after the solidification of an Islamic government under General Umar Hassan al-Bashir in Sudan—has renewed fears of the rise to power of Islamists in North Africa and elsewhere. The FIS triumph has likewise emboldened religious militants, and raised their hopes of government takeovers through democratic means. Some Islamists in Asia, the Middle East, and Africa now confidently talk of a day when Islamic rule—some modeled after Iran's—will be established in their homelands and with it an era of spiritual liberation, economic prosperity, and social justice.

Curiously enough, of those who long for a theocratic government of the Iranian variety, few among the hundreds of thousands of demonstrators and political activists in Algeria, Egypt, Indonesia, Jordan, Morocco, Tunisia, and elsewhere seem to know much about Iran's past or present. The publicized picture of Iran before the 1979 revolution is often of an economy mired by stagnation, suffering from an intolerable chasm between the rich and the poor, with agriculture neglected for the sake of rapid industrialization, and oil revenues largely squandered on useless weaponry. In contrast, the publicized image of the new Iran is that of a balanced, prosperous economy, with reduced inequalities of wealth and income, relying on its own resources, defending Islam against a hostile world, standing up for the rights of the poor, and challenging the "forces of imperialism and Zionism."

Because such misconceptions can lead to a hasty rejection of the status quo, or the mistaken pursuit of an uncertain future, a realistic assessment of the Iranian experience should be of interest to those who now favor such a regime as well as

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those who dread its emergence. This article discusses the economic elements of the Iranian experience.

THE PAHLAVI YEARS AND POSTREVOLUTION DEVELOPMENTS

The story of Iran's economic development under the Pahlavis, with all its successes and setbacks, is well documented. Between 1946 and 1979, Iran was gradually transformed from a largely farm-based economy to a modern society by way of major changes in the traditional socioeconomic order. Through public planning, urbanization, industrialization, diversification, and infrastructural investment, the state guided the economy and achieved sustained growth. Through control of imports, management assistance, and low-cost credit, the government helped the private sector, and maintained an essentially free-market system. In those years, and particularly the decade and a half ending in 1978, the government was successful in achieving most of its economic, social, and military objectives.

Data published by the World Bank show that, compared with other Third World countries during 1960–1977, Iran's annual real growth rate of nearly 9.6 percent was about double the average of countries in its category, and higher than the average for any other group of countries in the world.[1] Impressive rates of growth were also achieved in other areas: investment, savings, consumption, employment, and per capita income. All sectors of the economy showed significant expansion, albeit at different rates. Inflation was kept at a low rate until 1974, when the oil boom pushed price indices to double-digit heights. The overall external payments balance for much of the 1970s was positive. The exchange and trading system was liberal even by Western standards. The Iranian rial became effectively a convertible currency toward the end of this period. Government finances, while in deficit, were in good order, and internal debt was easily manageable as was external borrowing. Thanks to considerable outlays allocated to education and health, great strides were made in improving social welfare. Infant mortality, malnutrition, endemic diseases, and illiteracy were significantly reduced. Caloric intake, life expectancy, and school enrollment were all markedly increased. While rural-urban income gaps (and income inequalities within each sector) did not narrow, indicators showed that absolute poverty was measurably reduced.

The shah's quest for military superiority in the region, combined with his drive to see Iran join the ranks of the world's major industrial powers within a generation, and his desire to create a West European-style welfare state—all simultaneously with the aid of oil money—proved to be too ambitious a target to reach and too heavy a burden. The country's significant socioeconomic achievements, and considerable military preparedness, thus failed to establish a solid base of support for the leadership. Despite an elaborate military-industrial superstructure, the regime's sociopolitical foundations were not strong enough to

1. *World Development Report, 1979* (Washington, DC: World Bank, August 1979), pp. 128–9.

withstand the onslaught of growing public dissatisfaction, or to ward off the challenge of a would-be savior. The country's sizeable investments in infrastructures, human resources, and defense under the shah, however, would enable the Islamic regime that came to power in 1979 to cope with many formidable problems much better than expected or imagined. The subsequent ability of the Islamic republic to defend Iran's territorial integrity against the Iraqi invasion, to sustain its fast-growing population (albeit at a reduced level), and to reduce its external debt was due to a very large extent to the enormous investments and capital accumulation during the shah's reign.

In short, while the shah's basic development strategy, and his principal socioeconomic policies, were a matter of controversy throughout the period—and the debates continue to this day—today's Islamic militants' image of pre-1979 Iran is skewed. Most specifically, Iran's prerevolution economy was far from stagnant: It was registering positive growth every year between 1963 and 1977, and unemployment was relatively small and localized. Domestic income distribution, while not ideal, was no worse than most developing, and some developed, countries'. Agricultural growth was higher than in all but a handful of nations. Industrialization was pushed through not at the expense of agriculture, but thanks to oil revenues. Although oil income was used to purchase a sizeable volume of sophisticated arms, it also served as the mainstay of foreign exchange needs for infrastructural expansion and for investments.[2]

The religious elements that coalesced behind Ayatollah Ruhollah Khomeini and ultimately triumphed over the other revolutionary groups opposed to the shah had no clear economic agenda beyond repudiating Pahlavi strategies and policies. The shah's regime was castigated for having adopted a Western development model that made the country's economic survival and prosperity dependent on foreign raw materials, managerial know-how, technology, and trade. The regime was further faulted for the too-rapid exploitation of oil reserves, insufficient investment in agriculture, an industrialization drive geared to assembly-plant operation, undue reliance on oil export revenues to finance domestic public expenditure, scant attention to non-oil exports, a widening gap between individuals, classes, and regions, and the promotion of a "consumerist" economy.[3]

An Islamic and appropriate model had thus to be found to right these wrongs, develop a healthy economy, and reduce the country's economic dependence on the outside world. This model—frequently idealized by the religious leadership, but never clearly delineated—was ultimately devined from different ideological tendencies within the clerical hierarchy. The 1979 constitution served as the initial

2. For a discussion of economic strategies and policies under the Pahlavis and their criticisms, see Jahangir Amuzegar, *The Dynamics of the Iranian Revolution* (Albany: SUNY Press, 1991), chapter 4 and part 2.

3. For a typical exposition of these criticisms, see *Bar-rasi-e tahavvolat-e eqtesadi-e keshvar baad az enqelab* (A review of economic developments after the revolution) (Tehran: Bank Markazi [Central Bank], [1984?]); see also Hooshang Amirahmadi, *Revolution and Economic Transition: The Iranian Experience* (Albany: SUNY Press, 1990), pp. 1–16.

step toward the Islamicization of the Iranian economy. The crucial difference between the new constitution and those of other contemporary nations—including Iran's own 1906 constitution—is in its emphasis on life's purpose. The economy, the 1979 constitution declares, is not an "end in itself" but only a "means" of moving toward God. To this end, it has to be planned in a proper and just manner to abolish all forms of unmet needs with respect to life's basic necessities and to attain national self-sufficiency in output, science, and technology. The chapters dealing exclusively with economic matters and the people's rights provide a mixture of "Big Brother" controls, comprehensive welfarism, cooperative associations, and private enterprise. The document as a whole prescribes an idealistic model wherein a benevolent theocratic government controls the commanding heights of the economy—basic industry, banking, insurance, foreign trade, and public utilities; cooperatives engage in vital production and distribution functions; and the private sector plays an important but residual role.

In line with these constitutional provisions, a series of measures were taken to expand the role of the state in the economy beyond what had been the case under the shah. All major industries were taken over from private owner-managers and placed in state hands. Banking and insurance were totally nationalized. Thousands of business firms in farming, industry, and trade that belonged to supporters of the previous regime were confiscated and turned over to a number of new revolutionary "foundations." In two principal areas, however—land reform and foreign trade—the conservative clergy rebuffed all moves toward radicalization; the matter is still in legal limbo. The most specific action taken in the direction of economic Islamicization was the enactment of interest-free banking legislation in 1982. Islamic transaction modes replaced regular bank lending practices, and bank depositors, instead of being creditors, subsequently became partners in profit-sharing. The nationalized banks also became owners of a large number of money-losing public industrial enterprises, previously confiscated from, or abandoned by, their former private owners.

The end of the war with Iraq in August 1988, the death of Ayatollah Khomeini in June 1989, the need for reconstruction, and problems from delayed development ushered in a new era. The ideological compass shifted in the direction of pragmatic considerations and fiscal realism. The election of Ali Akbar Hashemi-Rafsanjani to the presidency, following an amendment to the constitution, and the inauguration of the Five-Year Development Plan (1989/90–1993/94) provided impetus for a shift in development strategy, and changes in economic policy. Although deplored and denounced by the radical press and an articulate faction within the ruling clergy, the regime's new socioeconomic orientation and agenda began to overshadow revolutionary slogans and religious dogma. As a result, since 1989 the government's declarations and actions differ from the ideas and ideals expressed at the outset of the revolution. Except in inspirational terms, or in nomenclature, major economic policies now make scant reference to things specifically Islamic.

Talk in government circles as well as in the bazaar is no longer about rejection of materialism, the imposition of a frugal consumption model, the establishment of a classless society (*ommat-e vahed*), or a return to Islamic social justice, piety, and brotherhood according to the Prophet's prescriptions. The principal concerns are inflation, employment opportunities for college graduates, sales of state factories to the private sector, joint ventures with foreign firms for increased automobile production, expansion of electric power production, promotion of foreign investment in oil and petrochemicals, abolition of rationing and subsidies, deregulation of industry, establishment of free-trade zones, and promotion of non-oil exports.[4] The expansion of oil output, renewed emphasis on industrialization (including the assembly-plant variety), defense build-up, and the pre-1979 goal of "grow first, redistribute later" are again in vogue. Export promotion strategy seems to have replaced the import-substitution dogma.

THE STATISTICS

In the 13 years since the revolution, the Iranian economy has experienced four cycles: a deep recession immediately after the establishment of the Islamic republic in 1979; a strong revival between 1981 and 1986; a mild recession between 1987 and 1989; and a respectable recovery since the cease-fire with Iraq. Despite the regime's early intention of reducing dependence on the petroleum sector, during this entire 13-year period the economy has been closely tied to oil revenues. Several internal and external factors also affected the country's economic course.

Internal factors included political turmoil, the mass exodus of talent and capital, economic uncertainties regarding private property, ideological strictures relating to wealth and income, legal ambiguities concerning land tenure, and the preference for Islamic commitment over professional expertise in the choice of managers. Significant external considerations included the long and costly war with Iraq, major fluctuations in world oil prices, the freezing of Iranian foreign exchange assets abroad following the seizure of the US embassy and hostages, Western credit and trade sanctions, diplomatic isolation, and the influx of an estimated 3–4 million refugees from Afghanistan and Iraq.

Postrevolution economic developments reflect the impact of these adverse factors. Their influence, however, has been mitigated by an extensive infrastructure, a large industrial capacity, foreign exchange reserves, and trained bureaucratic cadres inherited from the previous regime. Nevertheless, as extensively reported in both the local and the foreign press, and widely acknowledged by the political leadership and high government officials, the economy's performance has been anything but laudatory.

4. See, for example, *Middle East Economic Digest* (MEED), November 15, 1991, p. 4.

According to the government's own figures,[5] Iran's gross domestic product (GDP) at constant prices declined by some 1.5 percent a year on average between 1977/78 and 1988/89, with the result that the total GDP in the latter year was approximately equal to that 15 years earlier, i.e., 1973/74. In the postwar period of reform and reconstruction, GDP registered 7.2 percent annual growth on average in 1989/90–1990/91. Real output at the end of the decade, however, was still below that of 1977/78. Due to an estimated average 3.5 percent annual rise in population during the postrevolutionary period—largely in response to an initial government policy of encouraging early marriages and high birth rates—per capital GDP at constant prices in 1988/89 was not much more than the level 21 years earlier. Private per capita consumption in real terms—as the best indicator of material well-being—dropped from 153,000 rials in 1977/78 to 125,000 rials in 1990/91. Added to this already reduced per capita consumption are such problems as periodic shortages of necessities, power blackouts, rationing, long waiting lines, polluted air, and other daily aggravations prevalent during the 1980s compared to the 1970s and 1960s.

Other major economic indices show similar unfavorable trends. The share of aggregate consumption in GDP rose from about 62 percent in 1977/78 to more than 77 percent in 1990/91 while that of total investment fell from 33 percent to about 12 percent during the same period, with public investment outlays down to 7 percent from more than 18 percent of GDP. Figures on employment are sketchy, but also discouraging. The 1986/87 official population survey showed a total population of 49.4 million, an active labor force of 13 million, and an employed portion of 11 million—indicating an official jobless rate of 14 percent. Private estimates put total unemployment at twice that figure. Nearly one-third of the jobs were in the public sector. According to unofficial estimates, between 1979 and 1991, employment in the agriculture sector increased by about 10 percent, while service sector employment nearly doubled. The largest number of workers in the private services was engaged in small retail and itinerant petty trade, with relatively low labor productivity.

Individual economic sectors showed vastly different rates of growth, and their share in GDP changed accordingly. Because of the attention and official priority attached to agriculture, and the adoption of policies designed to increase farm productivity, the agriculture sector performed better than the rest of the economy. Total farm output is shown by the authorities to have on average grown

5. Facts and figures cited in the following paragraphs are all compiled, calculated, and analyzed by the author from the following sources. I. Bank Markazi: *Hesabhaye melli-i Iran, 1353–1366* (Iran's national accounts) (Tehran, 1992); *Gozaresh-e eqtesadi va taraznameh* (Annual economic report and balance sheet), for each year from 1977/78 to 1989/90; *Annual Review, 1369* (1990/91). II. Plan and Budget Organization, *Gozaresh-e eqtesadi (Annual economic report)*, for each year from 1984/85 to 1990/91. III. Iranian Statistical Center, *Salnameh-e amari* (Statistical yearbook), various years 1977/78–1990/91. IV. Iran's Customs Administration, *Foreign Trade Statistics*, annual. V. Organization of Petroleum Exporting Countries, *Annual Statistical Bulletins*; International Monetary Fund, *International Financial Statistics*, monthly; *IMF Survey*, July 30, 1990; and other data; World Bank, *World Development Report*, annual; and other data.

by 4 percent a year between 1978/79 and 1990/91 due to an increase in yield per acre and area under foodgrain production. The share of farming in GDP thus rose from 12.4 percent in 1977/78 to more than 18 percent by the decade's end. Nevertheless, some 17 percent of the country's total annual imports on the average consisted of foodstuff. While this sector performed better than other sectors, its annual growth, according to World Bank data, was no more than the rates achieved in the 1970s and 1960s. Not only was self-sufficiency in agricultural staples not achieved by the end of the decade as promised, but national dependence on imported food items actually increased. Imports of cereals and grains—wheat, barley, rice, and corn—which amounted to less than 2.7 million tons in 1977/78 reached more than 8.2 million tons in 1989/90. Foreign purchases of sugar, red meat, and edible oil were also much larger than before.

Performance and growth in the oil and gas sector were severely affected by the war with Iraq and its damage to oil installations and facilities. Crude production fell to a low of 1.46 million barrels a day (b/d) in 1980/81 and 1981/82, compared to 5.6 million b/d in 1976, but subsequently ranged between 2.2–2.9 million b/d for the rest of the decade—less than Iran's Organization of Petroleum Exporting Countries quota in some years, and exceeding it in others. After the cease-fire with Iraq, production increased to some 3.2–3.4 million b/d but was still less than the peak volume in the 1970s. As a result, the share of the oil sector in GDP declined sharply from 30–40 percent in the mid-1970s to only 9–17 percent in the 1980s. Several diverse factors were responsible for the decline in petroleum production, exports, and oil revenues: the initial decision to save oil reserves by cutting output, damage suffered from the war, gyrations in world prices of crude petroleum, and poor maintenance of oil wells because of capital and other shortages. Oil income continued to account for about 90 percent of total foreign exchange receipts each year, and according to some estimates, no more than $50 billion of the $200 billion oil income received thus far since the revolution has been spent on fixed capital formation.[6]

The industrial sector experienced equally unfavorable developments after 1979. The political climate of the early years and revolutionary excesses led to a massive exodus of industrial entrepreneurs, managers, and skilled workers, as well as large-scale capital flight. The freezing of Iranian assets abroad, Western economic sanctions, and negative government policies toward multinational corporations resulted in the departure of foreign specialists and the cessation of foreign investment. Inexperienced new managers, labor disputes, and disruptive meddling by members of revolutionary *komitehs,* established in each factory, further reduced output. The situation was aggravated by the Iran-Iraq War, which damaged or destroyed production facilities. Reductions in oil revenues sharply cut into the import of industrial parts, raw materials, and processed goods. Added to the industrial sector's problems were the wholesale nationalization of hundreds of

6. See Majlis debates on the 1992/93 national budget, *Kayhan Havai,* January 22, 1992, p. 24.

privately owned enterprises, regulations impeding growth, and lack of coordination among government ministries and agencies in charge of industrial development. Uncertainty regarding the state's treatment of private property rights, lack of incentives, and the limited profitability of short-term commercial transactions discouraged new long-term investment by the private sector. In 6 of the 13 years in the postrevolutionary period, this sector experienced negative growth. Capacity utilization near the end of the decade was below 40 percent in many industries before it picked up after the cease-fire, thanks to a number of incentives and the availability of foreign exchange.

The service sector had a mixed record. While it was somewhat positively affected in terms of both output and employment shares in GDP, this sector also registered negative growth in 5 of the 13 years. The output share rose from 36 percent to 46 percent of GDP between 1979 and 1990. In terms of employment, the services' share went up from 33 percent to 46 percent of total employment. The sector was particularly noteworthy in absorbing the lion's share of new entrants into the job market. Positive growth was achieved in the trading subsector, but the picture was flat in banking, public services, and tourism.

The economy was also beset by a number of other adverse developments. All major indicators were negatively affected by unfavorable domestic and foreign events. Under the pressure of war, slow economic growth, and rising public expenditures, the central government has experienced a budget deficit every year since the revolution. The gap ranged from a huge 15 percent of GDP in 1980/81 to about 3 percent of GDP in 1991/92, with an average of about 7 percent. In some years, the deficit was larger than the government's total regular revenues. Since the budget shortfalls were almost totally financed by credit from the central bank, the money supply rose nearly 10 times during the period. This liquidity explosion pushed retail and wholesale prices upward year after year. With many items in the consumers basket subject to price ceilings, rationing, or subsidies, the true rate of inflation is not easy to determine. According to government statistics, the consumer price index rose by 637.5 percent between 1979 and 1991, or at an average annual rate of about 18 percent (compounded).[7] Unofficial estimates point to much larger figures. Official statistics show a steady decline in real wages and compensations in large-scale industrial establishments after 1980. There are other indications of similar reductions in the real incomes of middle- and lower-class workers.[8] The rising prices of goods and services, perennial shortages, and demands of war combined to cause an increase in the balance of payments deficit. The official external balance figures on current account show a deficit for 10 out of the 13 years.

Finally, despite the regime's declared policy of improving the lot of the poor (*mostazafan*), for whom the revolution itself was ostensibly launched, the

7. *Kayhan Havai*, January 15, 1992, p. 24.
8. For price and wage indices see Bank Markazi's annual reports each year from 1978/79 to 1989/90.

evidence suggests little or no measurable success. Data on wages and salaries are not adequate or reliable. Figures on family disposable incomes and rural-urban disparities are also frequently murky and unilluminating.[9] Based on all indications, however, nominal wages and salaries have persistently lagged behind inflation. According to a Majlis deputy, government employees' salaries and bonuses went up by only 142 percent between the revolution and 1991, while the cost-of-living soared more than six times, leaving "more than 90 percent of public servants below the poverty line."[10] In the absence of relevant and detailed information on wages and salaries, such claims cannot be easily verified or denied.

Regarding changes in the internal distribution of income, the official line is that the poor are now better off than before the revolution. This is undoubtedly true for certain groups of people who have been especially well positioned within the regime, such as most members of the Revolutionary Guards, many families of the war dead, some among the subsidized urban proletariat, a number of *basij* volunteers, and others coming from extremely low-income households. Whether or not this is true of the entire population is still an open question. In a study shortly after the revolution, it was found that in 1972 some 44 percent of the population were living "under the subsistence poverty line."[11] According to a former head of the government's Plan and Budget Organization, absolute poverty increased by 43 percent during the 1979-1985 period, and the trend was continuing.[12] Other reports indicate "absolute poverty" spreading among as many as 65–75 percent of the population in 1988.[13]

PERFORMANCE IN PROPER PERSPECTIVE

The foregoing data on Iran's postrevolution developments point to many undeniable economic shortfalls and setbacks.[14] An objective evaluation of this rather dark picture, however, must be made against the backdrop of the regime's numerous handicaps and disadvantages. The economy, in particular, must be given credit for its resilience in the face of enormous odds. As indicated earlier, immediately after its establishment, the Islamic republic faced the massive exodus of experienced businessmen and managers, thousands of leaderless enterprises bogged down for lack of working capital, a shaky banking system, flight of funds out of the country, management-labor disputes, and total chaos in intersectoral

9. Bank Markazi publishes average annual budgets of rural and urban households based on regular surveys, but the information is inadequate for a meaningful determination of disparities.

10. *Kayhan Havai,* January 15, 1992, p. 24.

11. Hossein Azimi, "Aspects of Poverty and Income Distribution in Iran, 1960–1972" (Ph.D diss., Oxford University, 1980), p. 145.

12. *Kayhan* (Tehran), March 19, 1986, p. 18.

13. See Amirahmadi, *Revolution and Economic Transition,* pp. 194–202 and 292; and *Iran Times* (Washington), 7 Aban 1367 [1987], p. 5.

14. For a candid reference to some of these failings see President Rafsanjani's Friday prayer sermon, *Kayhan Havai,* August 14, 1991, p. 9 ff.

relations. Shortly after that, the regime was confronted with a freeze on its badly needed foreign assets, a trade embargo, and harsh financial sanctions.

Before the disputes with the United States could be settled, the country was invaded by Iraqi forces in September 1980 with subsequent heavy damage to factories, power stations, oil installations, and other parts of its infrastructure—recently reported by a UN team, on the basis of official claims, to equal $97 billion (while the government puts the total at $1 trillion).[15] Meanwhile, the regime partially lost the core of its political leadership through internal uprising and terror tactics of the opposition. Finally, the oil industry, the mainstay of the economy, underwent disruptive fluctuations in output and price because of factors largely outside the regime's control.

Notwithstanding these handicaps and hardships, the economy—thanks to a continuous stream of oil export revenues—managed to avoid life-threatening shortages, runaway inflation, and mounting foreign debt. Even at the height of the Iran-Iraq War, food and other basic necessities were available for a modest level of living. There never was famine. Even "non-necessities" were adequate for those who could afford them at free-market prices. Inflation, even by outsiders' estimates, was never close to the level experienced in some developing economies in recent times. Despite the heavy cost of war, the regime avoided recourse to foreign borrowing on a large-scale, and even paid out some of its long-term debt—albeit partly from reserves inherited from the shah's regime. Public expenditures on defense were kept from rising steeply by mobilizing private financial contributions for the war effort. The budget deficit was held on average below 8 percent of GDP by cutting down on non-priority outlays, albeit at the expense of public services and investment. Adverse effects of inflation on low- and fixed-income groups were reduced through price subsidies, rationing, and direct distribution of certain essential goods, although at a reported cost of increased inefficiency and corruption.[16]

At the same time, it should be noted that while some of the adverse elements were beyond the government's control, other factors responsible for keeping both output and income down were of the regime's own making. Specifically, two policy decisions stand out. First, the regime's self-appointed mission as exporter of Islamic revolution throughout the Muslim world (and beyond) was clearly an overly ambitious and unrealistic objective for which the country was politically, financially, and technically ill-prepared. Not only was most of the world against such adventurism but, as the nearly universal support for the Baghdad government after its imminent collapse in 1982 made apparent, Tehran's own Muslim allies in Damascus, Tripoli, and Algiers were not ready to embrace Ayatollah Khomeini's brand of Islam and thus risk destabilization of their own regimes.

15. See UN Security Council, S/23322, December 24, 1991.

16. See Dilip Hiro, "War Unsettles Iran's Economy," *Washington Post*, January 9, 1986; see also, "A Teheran Spring," *New Yorker*, June 22, 1992.

Preoccupation with this unrealistic mission sapped a great deal of the country's energy and increased the government's diplomatic isolation.

The second policy decision that hampered economic growth was the choice of an old (and already discredited) Marxist economic model, long practiced in India and also in parts of Latin America with disastrous results. Largely under pressure from its radical faction, and partly due to war requirements and exigencies, the Islamic republic during 1982–88 resorted to public ownership, price control, industrial regulation, import substitution, and overall economic regimentation designed to produce an elusive self-sufficiency. Using wartime conditions as an excuse to harness the economy, the government tried everything to expand government ownership and operations. By 1987, an estimated 60–70 percent of the entire domestic economy and 90 percent of foreign trade were directly or indirectly in state hands. Although public expenditures by the central government as a percentage of GDP (at current market prices) fell from 42 percent in 1977/78 to 22 percent in 1990/91, the share of the general government (including public enterprises and parastatal "foundations") increased progressively.[17] The regime's foreign exchange system was, up to 1989, highly restrictive, complex, and arbitrary. There were a multitude of exchange rates for different transactions. The direction of trade was shifted deliberately from the United States and the West in favor of neighboring countries, the Eastern bloc, the Third World, and smaller partners. The result has been a mushrooming bureaucracy, which now employs twice as many people as there were in the shah's time, sheer inefficiency, lower per capita output, and related problems.

THE ROAD AHEAD

The period of "postwar reconstruction" began in earnest after the cease-fire with Iraq, the revision of the constitution, and the election of Rafsanjani to the presidency. A five-year plan has been underway since 1989. It targets 8 percent annual real growth for GDP, with promises of increased employment, and higher per capita income. Planned outlays are to be financed mainly from domestic resources and owned foreign income (i.e., earnings from oil and gas). Total gross fixed capital investment from central government sources is estimated at about 27 percent of total government expenditures.[18] While slightly larger than the last ten years' average, this share is measurably smaller than similar ratios in the prerevolution plans.

17. In the fiscal year 1992/93, the budget of public enterprises was one and one-half times the national budget. The budget of parastatal "foundations" was also an additional 50 percent. See *Kayhan Havai*, February 19, 1992, pp. 24–6.

18. See *A Summarized Version of the First Five-Year Economic, Social, and Cultural Development Plan of the Islamic Republic of Iran, 1989–1993* (Tehran: Plan and Budget Organization, 1990).

In a major policy shift from the past, the government and its top spokesmen now clearly admit that regulation and regimentation have been harmful to the economy.[19] Through a series of Majlis laws and cabinet decisions, the private sector is now asked to participate in non-strategic manufacturing, social services, transportation, tourism, and trade. One-fourth of state-owned enterprises have become candidates for privatization. Free trade zones have been established at Qeshm and Kish islands. The new strategy of "economic adjustment and reforms" aims at the establishment of a market mechanism for determining the prices of goods, foreign exchange, and money; privatization of non-strategic industries now under government control; deregulation of cumbersome bureaucratic rules; and reorganization of state machinery in the service of marketization. The policies designed to achieve some of these objectives relate to tax laws, import-export regulations, accounting procedures, exchange system, and monetary and banking guidelines. The ultimate goal is to enhance people's participation in economic activities and decision making, and reduce state controls.

Prospects for these new policies remain somewhat uncertain due to strong resistance from powerful vested interests already entrenched at the various levels of the bureaucracy and the economy as a whole. Apart from hurdles involved in the resolution of conflicting philosophies and approaches among various clerical factions to many essential policy issues, some of the targets of the 1989–1993 plan relating to inflation, balance-of-payments, budget deficit, housing, non-oil exports, job creation, and private investment seem rather ambitious. The government's reported determination to rebuild its shattered military, expand its regional assistance, and support Islamic groups in Afghanistan, Algeria, Lebanon, and Sudan may make the domestic task even more difficult.[20] The plan's performance in its first two and one-half years of operation is far from reassuring. Scattered information filtering through government offices and agencies indicate shortfalls from target goals in many areas.[21]

The plan's overall success will require in addition to the peaceful resolution of internal and external conflict, a series of sustained structural adjustment measures including the gradual unification of exchange rates; stringent fiscal reforms aimed at eliminating perennial budget deficits; speedy removal of price controls, rationing and subsidies; a serious demand management strategy to harness inflation; the dismantling of the regulatory mechanisms on credit, trade, and private enterprise; restoration of the accountability of the parastatal organizations; streamlining of public administration; and the adoption of clear long-term policies on energy, agriculture, industry, and foreign trade. Without such a substantial restructuring of the economy,

19. See *New York Times*, May 28, 1991, and July 2, 1991; *Iran Focus*, May 1990; and MEED, November 15, 1991, p. 4.

20. David Hoffman, "Iran's Rebuilding Seen as Challenge to West," *Washington Post*, February 2, 1992.

21. *Arzyabi amalkard barnameh aval dar salhaye, 1368 va 1369* (Performance evaluation of the first development plan for 1989/90–1990/91) (Tehran: The Plan and Budget Organization [1991?]).

the country is likely to face further inflation, larger fiscal deficits, reduced efficiency, a decline in output growth, a deterioration in the external account, and a possible recession. Even reasonable headway toward these objectives requires further rethinking of a number of political, ideological, and even constitutional preferences, priorities, and prescriptions.

Preparations are now being made for the second five-year economic plan (1994/95–1998/99) to be submitted to the Majlis later this year or in early 1993. Thus far, significant deviations from current plan targets have raised questions at home and abroad regarding the usefulness and relevance of the Iranian planning mechanism in helping to shape the country's economic development. These questions have become even more pertinent now that the private sector is officially mandated to serve as a main force for growth in the next plan.

The results of the April-May 1992 nationwide elections for the fourth Majlis have been widely interpreted as a confirmation of President Rafsanjani's pragmatic economic policies and a good omen for the country's sustained growth and political calm. Some Western observers have seen the hardliners' defeat as a mandate to proceed with industrial privatization, government deregulation, and the economy's integration into the global market. While this prognosis seems plausible, its optimistic undertones remain to be tested. Iran's current economic problems need much more than a friendly Majlis; they call for an improved international political image of the Tehran regime, greater private sector confidence, increased foreign exchange, newer technologies, higher labor productivity, a cleaner bureaucracy, and less income disparity. An accommodating Majlis can at best be a catalyst for change, but it cannot be an ultimate solution.

The new "moderate" Majlis may support the government in further opening the country to the West—even to the United States—streamlining the bureaucracy, shedding some money-losing enterprises and clostly regulations, and seeking foreign assistance. These reforms, however, are not without cost. If the experience of Eastern Europe and the former Soviet Union serves as a guide, Rafsanjani's *perestroika*—raising taxes, rationalizing interest rates, cutting off subsidies, unifying the exchange rate, liberalizing trade, and linking wage hikes to productivity—will have similar widely unpopular repercussions. These restructuring measures, although ultimately rewarding, are bound in the short term to produce further inflation, unemployment, bankruptcies, and deprivations unwelcome not only to opposition politicians but to an overwhelming majority of the rank and file Iranians who, after 13 years of patient waiting, would like to see the regime's promises of prosperity and plenty fulfiled. In the fluid political climate of today's Iran, it is too soon to count the new Majlis's blessings.[22]

22. For full details see Jahangir Amuzegar, *Iran's Economy under the Islamic Republic* (London: I.B. Tauris, forthcoming 1993).