

# **The Political Economy of Petro Populism and Reform, 1997-2011**

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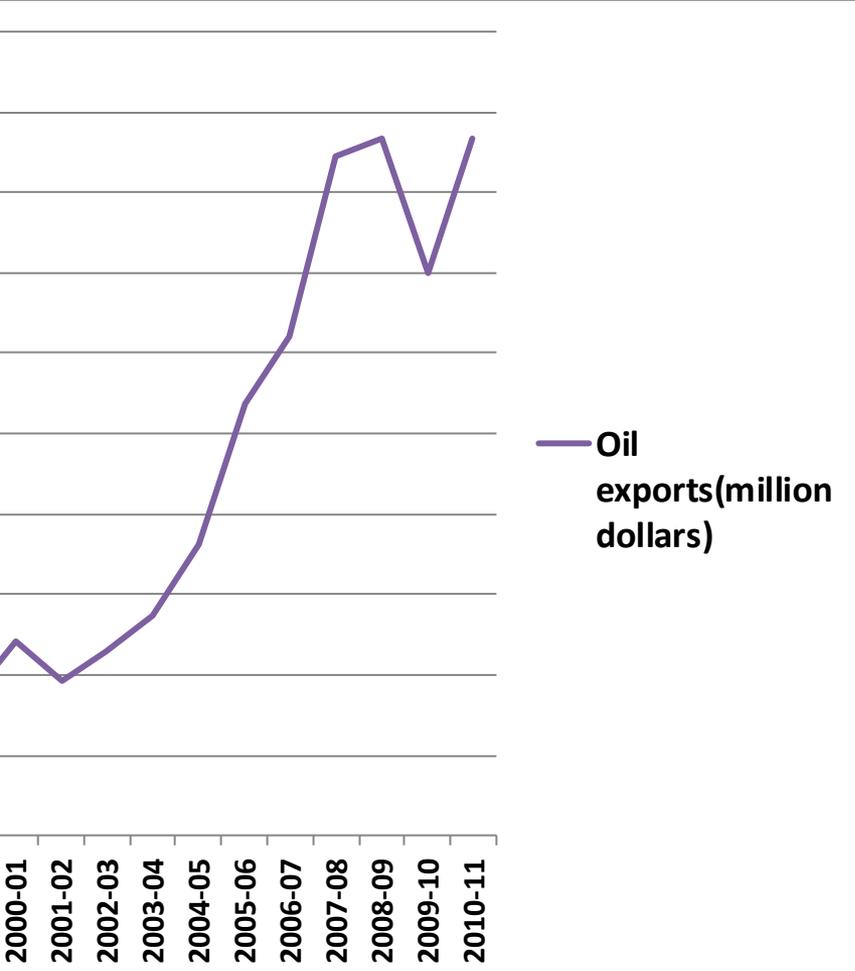
# Summary

- This study provides a broad analysis of comparative economic performance over two sub-periods of reform (1997-2005 ) and populism( 2005/6-11)in Iran
- In the first phase which corresponds to Mr Khatami's Presidency (1997-2005), Iran witnessed a sustained drive for economic reform.
- In the second phase of 2005/6-11 strong populist policies and tendencies had detrimental consequences for the economy.

# Structural differences between the two periods

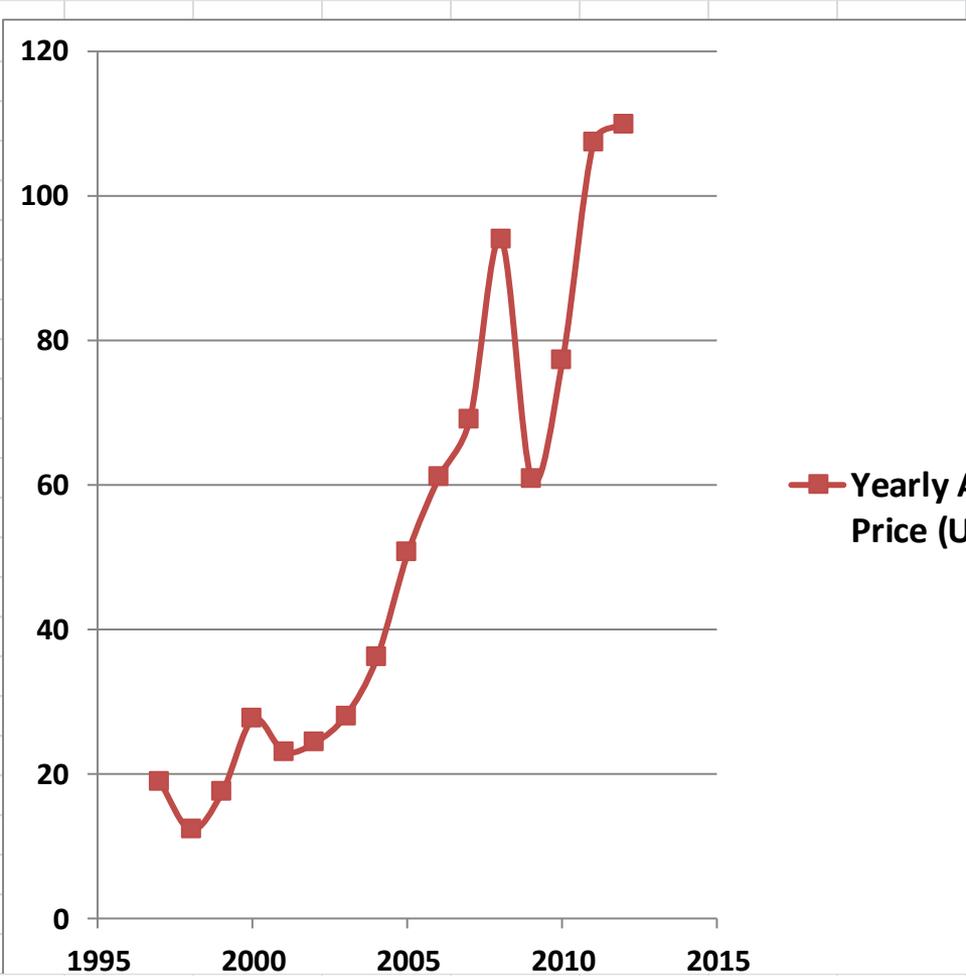
- Iran is a mature rentier state whereas both the states and their social beneficiaries in positions of mutual dependence on one another (Kamrava, 2011). What distinguishes the two periods are:
- 1) Rise in oil revenue arising from the increased oil prices over 2005-2011.
- 2) Change in the institutional composition of governance over the second period

Oil exports(Million dollars)



Graph 2

OPEC Oil Price (US Dollar)



# Rise in the oil income

Annual oil income was in the range of 17 to 36.3 billion dollars during 1999-2005 increased to 86.6 billion dollars by 2008-09.

# Institutions

- There is a consensus that political institutions shape economic institutions which in turn have a direct bearing on economic performance (Knack and Keefer, 1995; Hall and Jones, 1999; Acemoglu et al, 2004; Rodrik et al, 2004).
- Institutions determine “rules of the game” and these rules “structure incentives” in human behaviour (North 1990, Acemoglu, Simon Johnson, James Robinson 2004).

# Political institutions and governance in the Islamic Republic

- The post-revolutionary era has witnessed the emergence of a polycentric structure of governance and political institutions. This is in total contrast to the monolithic power structure in the pre-revolutionary period (Mohajer and Vahabi, 2011).
- This power structure is characterized partly by elected and partly by unelected bodies. Unelected bodies have veto power over elected institutions and are by and large extremely conservative in their interpretation of Islamic law (Beeman 2004).

# Continued

- There, has been of course a very dynamic relationship and interaction between the two, sometimes leading to the changing position of individuals within each centre of power.

# Institutional set up over (1997-2005)

- Mr Khatami that had the support of women, youth, intellectuals and the business community tried to implement political reforms in his first term (1997-2001) by emphasizing the “rule of law”, “civil society” and “dialogue among civilization”.
- He faced opposition by the unelected institutions and in particular the Guardian council.
- In his second term he submitted a bill aimed at boosting presidential power, and another curbing the role of the Guardian Council. The bills were overwhelmingly approved by parliament in April 2003 but rejected by the Council as unconstitutional in 2003.
- Instead he focused on economic reforms over 2000-2005 that mainly correspond to his second term.

- What distinguishes the period of *2006-2011* from the earlier period is the relative political harmony between the elected and the unelected institutions at least up until 2011 (Mr Ahmadi-Nejad lost its support in response to the dire consequences of populist policies). This support was manifested in unchallenged implementation of populist reforms by Mr Ahmadi-Nejad's administration during his first term of office as well as his re-election in the second term in 2009 despite widespread allegations of election fraud. This is in contrast to the earlier period, when the administration of Mr Khatami was continuously challenged by conservative political institutions during his reign (1997-2005).
- The support of unelected political institutions particularly during the first term of Mr Ahmadi-Nejad's government created an 'unrestrained executive' that undermined the relative independence of economic institutions including the Central Bank and the Management and Plan Organization as mentioned above. In other words attempt at de-politicization of economic institutions and the creation of 'rational' rather than 'ideological' economic institutions by the earlier reformist administrations were totally reversed over this period.

# Mr Khatami's market-oriented reforms, 2000-2005

- Exchange rate unification
- the setting up of an Oil Stabilization Fund (OSF)
- trade reform, tax reforms, ratification of the law on foreign investment, and the licensing of four private banks.
- Exchange rate unification(EXU) in 2002
- EXU and the OSF in 2000 had a significant potential impact on improving the 'transparency' and 'accountability' of the state.

# Nature of the reforms

- These reforms are considered as the first generation of structural adjustment reforms.
- A logical sequence to these reforms would have been the deepening of the reforms for the removal of explicit subsidies, trade liberalization, promotion of private investment and also invigoration of political and social institutions to improve public accountability, transparency and efficiency of the governance structure.

# Petro-populism, 2005-2011

- Mr, Ahmadinejad who came to office in August 2005 won the presidential election with the campaign slogan of 'taking the oil money to people's table'.
- This slogan combined with Mr Ahmadinejad's emphasis on the centrality of 'piety and simplicity' by the President and members of his cabinet struck a chord with lower social strata of the population.
- Mr Ahmadinejad's economic populism combined with his conservative political agenda won the outright support of a coalition of conservative political forces and institutions as well as lower economic classes.

- More over the liberal composition of the parliament had changed by 2004 to pave the way for conservative forces.
- This led to a win by the conservatives of at least 70% of the seats.

- In other words Mr Ahmadinejad had the support of both unelected and elected political institution at least until 2010.

# Expansionary populist policies

- This political landscape combined with the unprecedented rise on the oil income facilitated the implementation of populist expansionary economic policies by Mr Ahmadinejad.
- The two main components of populist policies were: 1) the reduction of interest rate below the rate of inflation and provision of cheap credit to low income groups and religious organizations and, 2) Mass scale privatization through distribution of "*justic share*".
- The stated objectives for the implementation of the first policy were to facilitate entrepreneurial activities and self-employment as well as to improve the wellbeing of the poor through subsidization of marriage's expenditures for low income population(Farzanegan 2009).
- Reform in subsidies that had started during Mr Khatami's presidency was postponed until the December 2010 when the Iranian Parliament passed the bill known as '*subsidy reform*' in response to severe budget deficit that was crippling the government (IMF, 2011).

# Opposition to populist policies

- The forced reduction of interest rates below the rate of inflation faced opposition from two governors of the Central Bank who later resigned (Forohhar, 2009).
- The populist policies were not welcomed by the Management and Planning Organization of Iran (MPO) either. In 2007, MPO was dissolved after a direct order from the President. Subsequently, Mr Ahmadi-Nejad established a new budget planning body that was directly under his control.

# Cont

- Despite the unprecedented rise of oil income, the government faced a budget deficit arising from its over commitment to spending. Hence as early as in 2007 it resorted to drawing from the Oil Stabilization Fund to finance its budget deficit.

# Populism was not a response to the rise of inequality

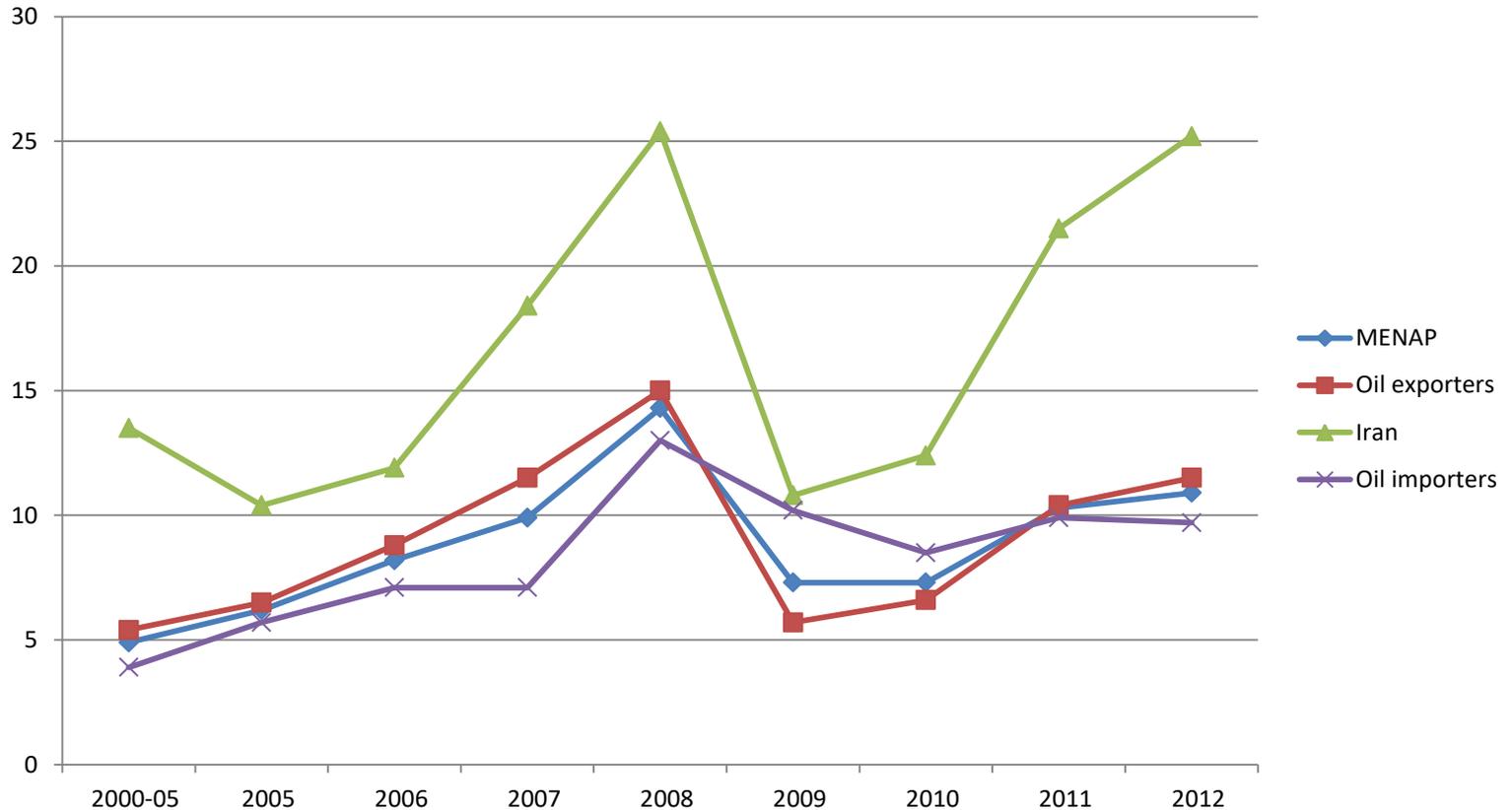
- Empirical evidence does not support the proposition that the victory of Mr Ahmadinejad in election for his first term was the rise in inequality during the previous administration.
- “inequality has been relatively constant in the post-revolutionary period, after its initial decline immediately after the Revolution. The Gini index of inequality in 2005 was about the same as it was in the early 1970s’ (Salehi-Isfahani, 2009: 24).



# Real GDP Growth, 2000-11

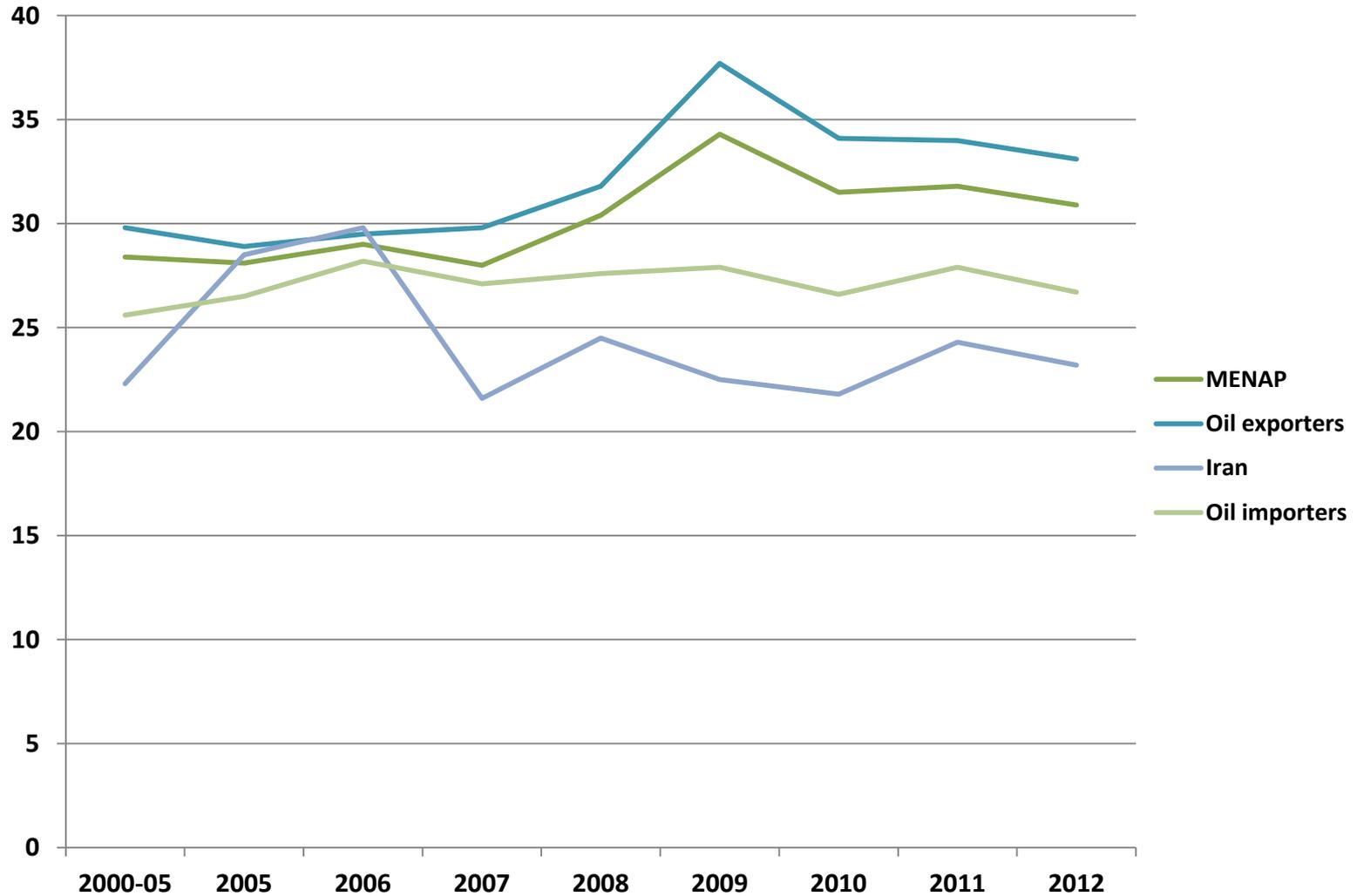
Table 2:										
	Average 2000-05	Average 2006-11	2005	2006	2007	2008	2009	2010	2011	
Middle East and North Africa (MENAP)	5.2	4.5	5.8	5.9	5.8	4.5	2.7	4.8	3.4	
Oil exporters	5.6	4.4	6	5.7	5.4	4.1	2	5	4	
Iran	5.5	4.1	4.7	5.8	6.4	0.6	3.9	5.9	2	
Oil importers	4.4	4.8	5.4	6.3	6.5	5.5	4.2	4.3	2.2	
Notes:	IMF classifications: MENAP region includes countries in the Middle East and north Africa plus Pakistan and Afghanistan. Oil exporters and importers refer to those in the MENAP region.									
Source:	IMF.									

# Graph 3-Consumer price inflation(average Annual %)



Source: IMF MENAP region includes countries in the Middle East and North Africa

# Graph 4-Government expenditure as % of GDP



# Graph 5-Broad money growth

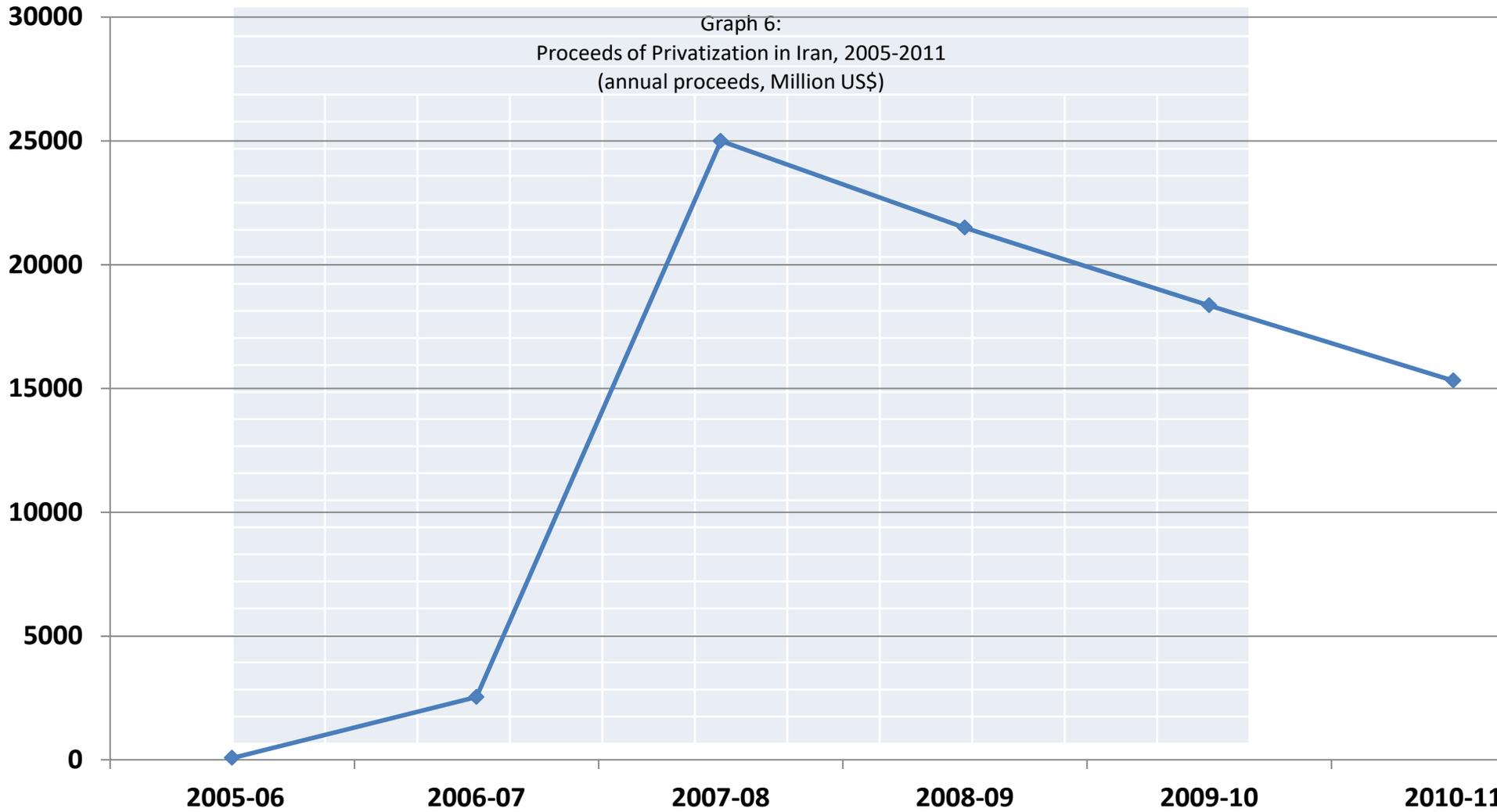


- Another important component of populist policies over the period of 2006-2011 was the mass distribution of shares through the so-called Justice Shares scheme.
- Privatization policy acquired momentum in response to 1) the unsustainable financial burdens posed by SOEs on government finances, 2) concerns for efficiency of major industries and 3) concern to boost political legitimacy through 'share distribution'.
- The objectives of privatization were reflected in the amendment of Article 44 in 2004, which was concerned with the promotion of efficiency, equity and reduction public sector expenditure.
- The privatization policy required the government to privatize around 80 per cent of its assets in 'mother industries' or major sectors including heavy industry, downstream oil and gas, financial sector, energy and communications and foreign trade (Ehsani; IPO). Half of this was to be allocated to 'Justice Shares' (JS) for low-income families with another 40 per cent to be tendered through the Tehran Stock Exchange (TSE); the remaining 20 per cent was expected to be kept by the government.

- In distributing Justice Shares the highest priority was given to the two lowest income deciles of the population ‘who were offered 50 per cent discount on stock prices to be paid through 10-year instalments (Atashbar, 2011:7). Those who obtained JS were also entitled to receive dividends.
- For distribution of JS a complex web of state-controlled ‘cooperative companies’ were created in all provinces under the supervision of the government, parastatal organizations (Imam Khomeini Charity Committee), and the State Welfare Organization. Table 3 provides data on the prioritization of targeted groups. The highest priorities were given to those identified by parastatal charitable organizations, followed by villagers and nomads, employees of the state companies and retirees and finally the war veterans. More than 36 million people, or nearly half of the total population, were considered entitled to JS and its benefits.
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# Privatization: Justice share

Targeted groups	Number of people enrolled in cooperatives following entitlement to JS*	Share of targeted groups in the distribution of Justice Shares* (%)
1 <sup>st</sup> group	6,993,860	19.3
Supported by charitable bodies		
2 <sup>nd</sup> group	16,024,806	44
Villagers and nomads		
3 <sup>rd</sup> group	12,048,685	33.2
Government employees and retirees		
4 <sup>th</sup> group	1,140,006	2.9
War veterans		
Other groups	199,962	0.6
Total	36,407,319	100
Source: Atashbar (2011: Derived from Table 1).		



- It is too early to evaluate the impact of the privatization scheme in terms of its own objectives. Nevertheless, a brief overview of the institutional set up for the distribution and operation of the Justice Shares may provide some insight into its potential impact. Similarly, we will also discuss privatizations through the TSE below.



- This 'mass privatization' however has been accompanied by heavy administration costs without reducing the role of the government in the privatized SOEs.
- In an study of JS that was undertaken by Atashbar for the Iranian Parliament it has been argued that the designers of privatization established gigantic semi-government bureaucratic institutions, which were very costly.
- Furthermore despite the privatization of a significant block of shares in SOEs 'the managing board positions are still occupied by government representatives' (2011: 10). In other words, mass privatization through JS, did not have any effect on the board of directors SOEs.
- The continued presence of government representatives on the Boards of the 'privatized' firms contradicts one of the main objectives of privatization in terms of principal-agent problem.

- Another challenge was the payment of dividends to shareholders that created a huge burden on government resources as a large number of privatized SOEs were not profitable. This have already forced the government to stop or delay paying any dividends' (Atashbar, 2010:9).

- The other form of privatization of SOEs has been through the Tehran Stock Exchange which is dominated by the IRGC, pension funds, social welfare institutions, various religious foundations and the municipalities. A study Kevan HARRIS (2010) indicates that parastatal organizations have been the main beneficiaries of these privatizations.
- Due to complete opacity, accurate information about the size, functions and actual worth of the parastatal organization is not available.
- This lack of accountability and transparency combined with their access to government resources makes it difficult if not impossible to make any evaluation of the potential efficiency and productivity of parastatal organizations.

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