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FINDINGS, CONCLUSION AND POLICY IMPLICATIONS
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Findings, Conclusions and Policy Implications

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Prior-to Revolution (1960s, 70s, & 80s):

Particularly during 60s and 70s Iran was a high growth performing economy. The state had substantial autonomy form social groups and pursued policies that were conductive to the development of the private sector. Moreover, as with other military dictators, the Shah had a strong commitment to growth, which he saw as the way to lifting the country out of a century of poverty and underdevelopment. To achieve this, he implemented a wide-ranging program of social and economic reforms from above in the 1960s, and pursued an active import-substitution industrialization policy to accelerate capital accumulation in the 1960s and 1970s. Steadily growing oil incomes and sizeable domestic market offered Iran more of an opportunity to emerge as a semi-industrialized country by the 1970s. The advent of the oil boom in this decade, in particular, fostered this vision as it now seemed feasible to use the underground wealth to catapult Iran into a regional economic and military power. The dictatorship of Shah was overthrown by the strong religious group of Shiite Clergy.

However in actual practice, growth has suffered setbacks and endured heightened volatility for much of the period since the late 1970s. Whereas real GDP growth had averaged 5.3 percent per year for the four and a half decades since 1960, there has been a gross discrepancy between growth performance before and after the Revolution. Prior to 1979, Iran’s economy grew at 9 percent per year in real terms—that is, more than three and a half times faster on average than after 1979-2004; Where as growth averaged 10.6 percent per year in the period 1960-72, the fastest growth rates ever attained were during the heyday of the oil boom in the 1970s, with growth hitting an all time high of about 17 percent in 1972 and 1976.

Three general phases are readily evident form this long-term trajectory of Iran’s real income and its evolution over time. The rapid rise in two decades prior to the Revolution (the 1960s and the first half of the 1970s); the collapse...
and contraction period of the 1980s; and the resumption of growth after the early 1990s. This rather clear-cut and well-differentiated pattern of the GDP growth phases punctuated by one (long) collapse period (the 1980s) may lead one to conclude that—barring an exceptional period of stagnation and decline itself occasioned by revolutionary upheaval and war with Iraq in the 1980s—Iran has been a high performer during most of the last four and a half decades and is now back on its “sustainable growth”.

9.2 Iran-Iraq War Period (1980-88)

It is immediately after the end of Iran-Iraq war in 1988, Mr. Rafsanjani was elected, government had to face the tremendous downfall in the economy. Over the period 1978-88, the real output and investment fell by average annual rates of 1.8% and 6.6% respectively, while the total real consumption expenditures had remained largely stagnant, with population growing at around 3.2% to 3.9% per annum. As a result the share of investment in aggregate output declined substantially from 22.2% in 1978-79 to 10.8 in 1988-89, while over the same period the share of consumption in aggregate output in fact rose from 66.0% to 71.1%, largely reflecting the populist economic policies of the regime.

The unprecedented falls in output and investment were accompanied by a widening gap between the official and the black (or “free”) market exchange rates, and rapidly rising prices. Over the period 1978/79-1988/89 the exchange rate premium (defined as the ratio of the free to the official rate) rose by an average annual rate of 19.1%, the Retail Price Index (RPI) rose by an average annual rate of 18.2% and the money supply (the M2 measure) by an average annual rate of 20.3%.

Some authors such as Behdad (19960 and Mazreii identified this period as Islamization of economy emphasizing on social justice, redistribution and economic independence.

The Iranian economy suffered major setbacks in this period. The resource base continued to shrink as there was a massive diversion of resources for military purposes and sustain the ongoing war effort; the country suffered a significant
international brain drain; and physical and human destruction went on a massive scale. The destruction of oil production facilities and lack of investment had severely affected Iran’s oil production, which collapsed from 5.8 million barrels a day in the 1970s to about 1.4 million early on in the war (1981). The oil sector’s share of GDP too had plummeted from a peak of about 25 percent in the mid-1970s to merely 5 percent in 1981 (World Bank, 2003, Chapter 1:3).

9.3 The Period of Reconstruction: The Pragmatic Phase:

The period (1989-93) saw a major drive at economic reconstruction and economic reform under the auspices of the First Five-Year Development Plan. Hence was ushered in new, “pragmatist” phase in the Islamic Republic.

The 1994-2004 decade of development plan faced initially the twin challenges of managing an external debt crisis at the beginning of the Second Development Plan (1994-99) and restring equilibrium in Iran’s external accounts. Having emerged through this crisis, the task was then to resume macroeconomic reforms and achieve greater macro stability during; the Third Plan (2000-04). The road from crisis to reform and growth in this long decade was paved with much uncertainty over the direction of economic policy in general; and it was a time in which Iran’s political economy scene was rocked by intense political strife and factional politics.

Indeed, following the revolutionary upheavals of the late 1970s and a long and destructive war with Iraq, the economy contracted by 1.3 percent per year in the real terms during much of the 1980s (Table 9.1). However, even period form the growth picture; it is true that Iran’s growth rate has underperformed compared to the period before the Revolution: the growth rate for the post-war period (1989-2004) is still only 5.1 percent, which is just over half the rate for the Shah’s years (9 percent for 1960-78).

Two further features of the Iranian Revolution have continued to play important roles in shaping the institutional landscape in this period: the twin promises of bringing about “social justice” and achieving “economic independence.” Both were strong ideals of the Revolution and have made an important impact on both the vision and practice of economic policy ever
since. The strong anti-imperialist, anti-western stance reflected a rejection of dependency on external powers in general and the United States in particular. Powerful aspirations were thus in force from the start to turn Iran into an "independent" economy.

Another development of lasting significance was a major surge in Iran's population growth during the first decade after the Revolution. Reaching an average annual growth rate of almost 4 percent in the mid-1980s, Iran's population was by now one of the fastest growing in the world. In the intercensal period 1976-86, Iran's population thus expanded by nearly 50 percent to just under 50 million people. This implied a (net) total addition of about 16 million on a population base of just below 34 million in 1976 (shortly before the Revolution). Measured by child-woman ratio (CWR), fertility rose 17 percent during this period (reaching almost 860 children per thousand women of reproductive age-up from 732 a decade earlier).

Soon after the Revolution, the government introduced strong pro-natalist measures, leading to what was arguably a "reversal" of Iran's earlier demographic transition. These included shutting down family planning clinics, promoting early marriage, (to 9 for girls and 14 for men), and discouraging birth control. These were further reinforced by new "Islamizing" measures, which aimed to reshape the regulatory and socioeconomic environment affecting women's position. In general, these aimed to redefine their role in the economy and to encourage their retreat into the family and the domestic domain. It was in this context that the baby boom of the 1980s was officially hailed as an important indicator of "success."
Table 9.1: An Overview of Iran’s Growth by Sub-period, 1960-2004

<table>
<thead>
<tr>
<th>Average annual real GDP growth rate (%)</th>
<th>Mean</th>
<th>STD</th>
</tr>
</thead>
<tbody>
<tr>
<td>Before the Revolutions</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1960-72</td>
<td>10.6</td>
<td>3.5</td>
</tr>
<tr>
<td>1973-77</td>
<td>8.0</td>
<td>7.6</td>
</tr>
<tr>
<td>1960-78</td>
<td>9.0</td>
<td>6.2</td>
</tr>
<tr>
<td>After the Revolution</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1980-88</td>
<td>-1.3</td>
<td>8.9</td>
</tr>
<tr>
<td>1989-93</td>
<td>7.5</td>
<td>5.4</td>
</tr>
<tr>
<td>1994-99</td>
<td>2.8</td>
<td>1.9</td>
</tr>
<tr>
<td>2000-2004</td>
<td>5.4</td>
<td>1.7</td>
</tr>
<tr>
<td>1989-2004</td>
<td>5.1</td>
<td>3.7</td>
</tr>
<tr>
<td>1979-2004</td>
<td>2.5</td>
<td>6.7</td>
</tr>
<tr>
<td>1960-2004</td>
<td>5.3</td>
<td>5.3</td>
</tr>
</tbody>
</table>

Source: Central Bank of Iran.

At constant 1997/98 prices.

9.4 Assessment of Iran’s Performance of FYDPS:

The 20 years Economic development plan approved by Shah Regime practically failed. Economic, political, social and cultural nonconformities and heterogeneities of the government of Mullahs are similar elements which make achieving the set goals difficult. Economically speaking, the Achilles' heel of the Islamic government is its heavy dependence on oil revenues as before and reduction of foreign currency revenues from oil export can seriously impair the national economy and leave a major part of the plans unaccomplished. Furthermore, serious challenges exist on the issue of industrial strategy of the country, manner of its implementation, position and status of Iran in the process of economic globalization, function of government and the developing trend of private sector and the opposing view of some economists in Iran in disagreement with economic orientation of statesmen in the fourth economic development plan shows theses ambiguities.
The major role of government in the economy of Iran should be underlined. According to present assessments, the government has control over about 75% of the entire economy. The volume of government costs to the gross domestic production has reached 80% during the Third Economic Plan while most of the experts recommend that it should change and reach 15 to 30 percent. Thus, in spite of plans and forecasts, only 45% of the projects for assigning government companies to the private sector were implemented in 2003.

Increase of oil price during recent years and higher foreign currency revenues from oil exports and the consequent new investments in different economic fields especially industry sector with huge investment costs, has not reduced the major role of government sector in the entire economy of Iran, in spite of efforts towards privatization and accelerated rate of assigning economic units to capitalists.

Even the privatization process is under government control in the form of new concessions, new exclusions. For example some government companies like Khuzestan Cement factory was sold to private company to attract private capital. The oriental despotism is still in existence in Iran. Accordingly the Iranian statesmen, bureaucrats and theoreticians of whom Nezamolmolk, the powerful vizier of Seljuk kings was a distinguished representative, knew centralized control over economic affairs by the government as a determining factor to guarantee national consistency and protect royal dynasties against domestic opposition and foreign neighbors. Iranian despotism which is a special form of oriental despotism has not yet changed much in its nature.

Both named specifications, i.e. dependence of economy on oil and the determining role of government in economic structure, are remarkable in both regimes of Shah and the Islamic Republic, but in different forms.

The fact that Iranian economy is still under full control of the Central government of Mulas orthodoxy, all the efforts of developing private sector and of attracting foreign capital to enhance investment rate could be operationally defined as Economic Liberalism with Mulas. However since nearly 80% of the economic activities in Iran are under government control and especially the oil and gas sector is mainly controlled by the leadership
system and the Ministry of Petroleum, it can be said that most of the major foreign economic contracts in near future will pass through this canal.

9.5 Foreign Trade Outcomes:

Iran's real growth in trade was 8.4% in 2007, making it the 62nd best performer among 160 countries. However, this represents a decline from its 2005-06 growth of 27.9% that made Iran the 2nd best performer (of 152 countries) for the period. It also was high real growth in trade in the early 2000s. The result of such robust growth, coupled with the recent increases in world oil prices, is that Iran's trade share in GDP increased substantially from 56.4% in the early 2000s to 82.1% in 2007, an integration ratio still quite a bit below the comparators'. However, imports have grown much faster than exports since early 2000, and in fact Iran had one of the lowest export growth rates (1.3 percent) in the world in 2007. Oil represented 79 percent of Iran's product exports in 2005, and was followed by gas, nuts, and metallurgical products. Iran's main destination markets were Japan, China, Italy, the Republic of Korea, and South Africa. Iran imports a variety of merchandise including industrial raw materials and intermediate goods, capital goods, food products and other consumer goods, technical services, and military supplies. Imports were predominantly obtained from Germany, the United Arab Emirates, China, Italy, and France. Services Exports contributed just 6.8 percent to total exports in 2007.

Iran faces relatively low barriers to its exports. Its latest Market Access TTRI (including preference) score was 1.6 percent, much lower than the average MENA regional and lower middle income group mean. The rest-of-world applied tariffs weighted average (1.4) it faces is comparable to the MENA regional means and below the lower-middle income group mean. MFN duty-free exports are 71.4 percent of the total, higher than the regional and income group average, but they are mainly oil and gas. Its EU preference utilization rate is 75.8 percent (2008), yet the value of such preferences is close to nil. Regionally, it is a member of the Economic Cooperation Organization (ECO). Iran has applied for membership to the World Trade Organization (WTO), but the accession process has not proceeded far.
9.6 Trade Policy:
Trade Tariff Restrictiveness Index (TTRI) score is 13.1 percent. The tariff protection in the Islamic Republic of Iran is one of the most restrictive, substantially higher than an average, Middle East and North Africa (MENA) and lower-middle-income country. Both the MFN applied and the import-weighted average tariffs (26.2 percent and 19.2 percent respectively) are above the regional and income group comparator means. MFN duty-free imports accounted for only 8.4 percent of all imports in the early 2000s. A number of non-tariff barriers recently have been replaced by their tariff equivalents. Characterized by an active public sector, the country has made limited progress with the market reforms plans put forth by preceding administrations since the early 1990s. The government provides large energy subsidies to domestic businesses. Efforts are ongoing to diversify the country's export sector through investments in non-oil sectors, including in free trade zones (Chabahar and the Qeshm and Kish Islands in the Persian Gulf). Chabhahr is being developed as an Indian Ocean entrepot for Central Asian countries and is competing with the port of Gwadar in neighboring Pakistan.

9.7 Growth and Income Scenario:
The constitution of Islamic Republic of Iran embodies the role of Government, through its systematic fiscal management, as an legitimate machinery to enhance and improve the distribution of increase and welfare of the people. Accordingly Government should design its budgets to ensure political and economic independence. In this context, the tax revenues mainly accrued for oil exports play an important role to impact the overall development of the country.
In 1976, before the revolution, government expenditure was 37 percent of GDP while its revenue was about 39 percent (See Table 9.2). However, after the revolution, even though the government was at war, its total expenditure, including that earmarked for war purposes, constituted a much smaller percentage of real GDP than that during the pre-revolutionary years (Fiscal Management). Real government expenditure as a percentage of real GDP
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decreased to a low of 16 percent in 1991-2 and then rose to a high of 23 percent in 1994-5. Ratios of government revenues to real GDP followed the same pattern during the same period. This decline is mainly due to the decreased in oil revenue, which was both international and incidental. Oil revenue decrease due to the ravages of the eight-year Iran-Iraq war and its ramifications, and secondly due to the national policy of economic independence and self-sufficiency.

Table 9.2 : Government revenue and expenditure in relation to GDP (billion rials), 1976-95

<table>
<thead>
<tr>
<th>Year</th>
<th>Revenue</th>
<th>Expenditure</th>
<th>GDP</th>
<th>Revenue/ GDP</th>
<th>Expenditure/ GDP</th>
<th>Def/sur</th>
</tr>
</thead>
<tbody>
<tr>
<td>1976</td>
<td>1790</td>
<td>1675</td>
<td>4548</td>
<td>39</td>
<td>37</td>
<td>3%</td>
</tr>
<tr>
<td>1980</td>
<td>1453</td>
<td>2249</td>
<td>6632</td>
<td>22</td>
<td>34</td>
<td>-12%</td>
</tr>
<tr>
<td>1981</td>
<td>1975</td>
<td>2707</td>
<td>8009</td>
<td>25</td>
<td>34</td>
<td>-9%</td>
</tr>
<tr>
<td>1985</td>
<td>2993</td>
<td>3313</td>
<td>15775</td>
<td>19</td>
<td>21</td>
<td>-2%</td>
</tr>
<tr>
<td>1988</td>
<td>2513</td>
<td>4210</td>
<td>22304</td>
<td>11</td>
<td>19</td>
<td>-8%</td>
</tr>
<tr>
<td>1990</td>
<td>6266</td>
<td>6051</td>
<td>36644</td>
<td>17</td>
<td>17</td>
<td>1%</td>
</tr>
<tr>
<td>1991</td>
<td>7920</td>
<td>8090</td>
<td>50107</td>
<td>16</td>
<td>16</td>
<td>0%</td>
</tr>
<tr>
<td>1992</td>
<td>11183</td>
<td>10756</td>
<td>66462</td>
<td>17</td>
<td>16</td>
<td>1%</td>
</tr>
<tr>
<td>1993</td>
<td>22124</td>
<td>20886</td>
<td>93609</td>
<td>24</td>
<td>22</td>
<td>1%</td>
</tr>
<tr>
<td>1994</td>
<td>31137</td>
<td>29593</td>
<td>128381</td>
<td>24</td>
<td>23</td>
<td>1%</td>
</tr>
<tr>
<td>1995</td>
<td>45432</td>
<td>41961</td>
<td>184185</td>
<td>25</td>
<td>23</td>
<td>2%</td>
</tr>
</tbody>
</table>

Source: Economic and Social Time Series, Planning & Budget Organization, Table 3 & 14.

Before the revolution, Iran was exporting upwards of 5 million barrels of oil a day. The war destroyed the country's ability to extract and ship oil at a level near this magnitude. In the meantime, Iranian policy-makers were determined
to limit oil and gas exports to expand non-oil exports in order to pay for imports. While oil exports were effectively limited, there was no corresponding increase in non-oil exports.

Expansion of non-oil exports has not materialized yet. In actuality, such exports declined to about 2 percent of total imports. As a result, total government revenue and expenditure declined. Although the direction of this trend seems to have shifted upward in 1993, revenue and expenditure as a percentage of GDP remain much lower than the 1976 levels. It seems unbelievable that the government has been running a growing surplus rising to as much as 2 percent of the GDP in the first half of the 1990s, despite the high rate of unemployment, both open and disguised, and the obvious need for growth and development.

9.8 On Investment:
Another notable area of weakness has been Iran’s inability to attract Foreign Direct Investment (FDI). Iran’s current FDI inflows are abysmal both in absolute size and by any comparative measure. Total net FDI amounted to $32 million only in 2001, amounting to only 0.34 percent of all FDI inflows into the MENA region. Since this region is severely underrepresented in its share of global FDI flows (accounting only 1.3 percent of the total), it is not surprising that Iran’s share in the global FDI inflows is also a paltry 0.003 percent.

9.9 An Evaluation:
Some observers have characterized Iran’s failure to achieve structural transformation since 1980 as a stage of ‘structural trap’. This is defined as the situation ‘in which political and economic obstacles avert the reallocation of capital from low-productivity firms and sectors to high-productivity ones’.

Accordingly, Iran’s economy remains dominated by inefficient, subsidized and loss-making state-owned enterprises (SOEs), as well as the unregulated and unclear para-governmental organizations (bonyads or foundations): conglomerates which benefit substantially from both implicit and explicit government subsidies.
The introduction of the Third Five Year Plan in March 2000 ushered in a new direction in official policy-making. After several years of hesitancy, this Plan finally seemed to address the overarching question of economic reform by increasing the role and diversity of the private sector, reducing obstacles to foreign and domestic investment, initiating privatization supporting export-led growth, and developing the non-oil sector. The Plan set out a series of ambitious targets, including an average GDP growth of 6 percent per year, average annual non-oil GDP growth of 6.8, and average annual inflation of 15.9 percent. Job creation was also targeted to reach three-quarters of a million new jobs annually.

Some of the toughest structural changes that could transform the competitiveness of the economy have yet to be tackled. Effective reform of SOEs through privatization has not yet materialized, even though the legislative and regulatory environment governing the process has been established. So far, privatization has been confined to sales of government equity shares to private investors and bonyads, with the majority control retained by the government. Given that SOEs are politicized institutions in which both workers and managers strive to prolong subsidies and perpetuate their redistributive function, this was perhaps largely predictable. Moreover, large-scale privatization would inevitably entail mass redundancies, which are not politically feasible, particularly in an era of high unemployment.

One of the most significant areas of reform was the successful unification of the exchange-rate system in March 2002. Although the new system still entails significant budgetary costs for the government, because these implicit costs have had to be replaced with explicit subsidies, the new system is more transparent, and has signaled to international investors the seriousness of Iran’s reform effort.

The oil-driven growth, however, is by its very nature, not sustainable in the long run. Each episode of oil price increases moves the economy to a higher plateau in terms of foreign exchange requirements to sustain the pattern of oil-dependent economic growth. Oil prices are subject to sharp fluctuations, and even if the country can smoothen the impact of such fluctuations through the operation of the Oil Stabilization Fund, without a continuous upward trend in
Without fundamental structural reform to substantially improve export diversification, the recent reforms, as in the past, will sooner or later be reversed.

However, in a developing economy like Iran with a young and rapidly growing labour force and with a huge technological gap and an aging capital stock, oil exports can, under the right economic policies, be a complement to diversification into other export activities. A comparison with the case of Malaysia can shed light on this issue.

In contrast to the case of Iran, being an oil economy has not prevented Malaysia from increasing its manufacturing export share from low level in the mid-1960s to over 80 percent in recent years. Whereas in the case of Iran in the post-revolution period the contribution of the foreign direct investment to capital formation has fallen to negligible levels, Malaysia in the same period has attracted foreign direct investment to the tune of 10 to over 25 percent of its gross capital formation. More importantly, in addition to its financial contribution, foreign investment in the case of Malaysia has been instrumental in the transfer of modern technology and in building up a competitive edge in export-oriented activities.

The World Bank cites the example of China in implying that in Iran a similar lack of democratic and transparent government may not be essential for the growth of the market economy. A small detail which is missing in this analysis is that Iran is not quite China. Given the huge oil surpluses in the hands of government, which with the new price reform policies oil price will be substantially increased, the driving force of the Iranian economy will be state-centered, oil-financed activities. As long as the state remains undemocratic, and hence non-transparent, in an oil economy such as Iran, government policy will be dominated by particular rent-seeking interests that will inhibit the growth of an independent and competitive private sector-based economy.
9.10 Challenges and Policy Implications:

The Islamic Regime is in power and the process of connecting economy of Iran to the global economy and change in economic structure or "economic liberalism" continues with the same existing parameters. This process started step by step since the presidency of Hashemi Rafsanjani and continued with some changes during the presidency of Khatami. The assessment is based on the assumption and the possibility that the conservative forces led by Rafsanjani or Khamenei, "Velayat-e-Faqih", or other ruling authorities may preserve the most important political and economic tools of power the same as now by relying on non-democratic institutions such as the "Council of Guardians" and "the Expediency Council" and so on and prevent the reformists to take power.

The clashes during the past few years have shown that the conservatives led by "Velayat-e-Faqih" who have all the suppressive organizations under their control, are not willing to leave their unlimited powers easily. The problems facing the opposition is currently as follows: On the one hand, the non-reformist opposition forces have been severely suppressed during the past 25 years and their publications have been banned and therefore, they lack considerable practical power in Iran. On the other hand an extensive unity between the wide spectrum of forces opposing the Velayat-e- Faqih Regime is lacking inside and outside Iran and the different groups are mainly wasting their energy on disputes over assessment of the present conditions and their role in the future government of Iran rather than reaching a unity so urgently needed. In case of coordination between opposition forces inside and outside Iran, victory over the police-military regime of Velayat-e-Faqih seems possible in the short run, because of the extensive disagreement of the people and their opposition to the Mullahs. The other factor which may increase the possibility of tension is related to the American foreign policy and the possibility of military attack on Iran. The following policies could be recommended:

1. The government has had a privatization programme since the First Development Plan (1988-92) that has been carried on into second and third development plans. However, the actual number of companies privatized has
fallen short of the quantitative targets set by the government in each of the above plans.

2. To reach higher growth rates, the Iranian economy needs to save and invest a significant fraction of its GDP. For instance, to have a growth rate of 8 percent, the investment rate should be between 3 percent of GDP. To encourage investment on this scale, the legal and political uncertainties for non-government entities and the private sector should be reduced. Transparency in investment laws and regulations, legal protection to domestic private investors and reduction of bureaucratic impediments and transaction costs to encourage FDI, are the type of non-price policies that should be implemented to encourage greater participation by non-government entities in the economy.

3. High investment rate requires high saving rate. The government can raise the saving rate though fiscal discipline and more efficient tax collection. Control on the growth rate of government expenditure, more financial discipline on public enterprises, and overhauling the tax collection are the kind of fiscal measures to boost government saving rate. In this connection, privatization of public enterprises in economic spheres, where the government has no special knowledge, expertise or advantage, should proceed at a speedier pace.

4. The recent tax reforms have reduced the marginal tax rates on corporations and individuals, particularly individuals with below middle-income earnings. The lower tax rates must be compensated with a better tax administration/collection system; otherwise a persistently low tax/GDP ratio will give rise to a situation where either the oil revenues or the inflation tax will have to be relied upon to finance a higher proportion of current expenditures. This can potentially reduce investment in infrastructure and capacity creation in a number of economic sectors where the public sector has a large presence, and therefore result in a lower rate of economic growth and employment creation.

5. Reform of the financial sector for mobilization of a greater volume of financial savings and a more efficient allocation of social capital should focus on terminating sustained financial repression and improve the quality of financial intermediation. Reducing the extent of private sector credit rationing,
redirecting more credit to the private sector and limiting the control and share of government in the banking system credit should continue as the main elements of credit policy. Empirical studies show that higher credit flows to the private sector are positively correlated with growth. On the other hand, growth in lending to the government sector did not significantly influence economic growth.

6. Policies in the banking sector should focus on increasing the quality of financial intermediation and a gradual reduction in the extent of the government's quasi-fiscal activities. Institutional development, greater specialization, increased competition and creation of transparency, improved supervision and regulation by monetary authorities, and implementation of better accounting and risk-control standards are the recommended policies to raise the quality of financial intermediation. These measures should improve credit allocation and result in a higher average efficiency of the investments financed by the banking system.

7. Directed-lending programmes should focus more on small firms and sectors with high risk and high social rate of return (e.g. agriculture) and must find ways of linking lending to performance indices. Enhanced credit access by small firms and lower transaction costs of obtaining credit by small firms- whose growth is essential for significant employment creation - should be adopted. One way to achieve this is to lend to firms in sectors where competition disciplines borrowers (e.g. the export markets) or where subsidized loans are linked to indices of productivity and efficiency.

8. Promotion of non-oil export is one way of raising sustainable economic growth in Iran, particularly in light of the fact that it is expected that per-capita oil-revenues will decline in real terms in the future. To raise the growth rate of non-oil exports, exchange rate misalignment in favour of tradable goods should be avoided. Moreover, the domestic market structure should be more competitive. By limiting the extent of domestic protection and rent-seeking opportunities, the authorities can send stronger signals to the local firms to seek more profits through innovation, efficiency and higher international competitiveness.
In the last 27 years, given that the public sector is not able to significantly increase employment, policy makers need to implement macroeconomic policies friendly to growth and the greater private sector participation. The ‘appropriate’ economic policies have a much higher probability of being effective when a social and economic environment conducive to economic transparency, stability, efficiency and wider participations by private individuals exists.

The hard economic facts facing Iran in the early 21st century are a rapid increase in the number of young and educated entrants into the labour market who want well paid jobs, while the old want higher pensions and better health care. To generate higher incomes for the average household and to create a sufficient number of jobs to keep the rate of unemployment steady, the economy must grow at about 8 percent per year.

Presently Iran's GDP (PPP) estimated at more than 695 (million dollars) with 5.8 percent annual growth rate, the country's per capita income comes to 9906 (US dollars). However, unemployment rate is 12 percent and inflation rate (CPI) still is at high level (17 percent).

Mohammad Ahmadinejad, who became president in 2005, provided checks to privatization of the economy and strengthened state-dominated economy. He has greatly expanded government spending. High world oil prices have significantly boosted oil export revenues which provide about 85 percent of government revenues, but Iran's economy remains burdened by high unemployment, rising inflation, corruption, costly subsidies and an increasingly bloated and inefficient public sector.

Iran's economy, once of the most advanced in the Middle East, was crippled by the 1979 Islamic revolution and the Iran-Iraq war, and the country continues to suffer from chronic economic mismanagement and corruption. International concern about its nuclear development activities remains high and has resulted in economic sanctions against the country. Iran's self-defeating protectionism and price controls have led to double-digit inflation. The economy has no strong economic institutions and scores better than the world average only in terms of fiscal freedom and government size. According to World Bank, Iran's economic freedom score is 44.6, making its economy
the 168th freest in the 2009 index. Its score decreased by 0.4 point from last
year (2008), partially reflecting improvements in business freedom offset by
slippage in five other components of economic freedom. Iran is ranked 16th
out of 17 countries in the Middle East and North Africa (MENA) region, and
its overall score is below the world average. Trade Freedom, monetary
freedom, investment freedom, financial freedom, property rights, and freedom
from corruption are all weak. Business licensing and closure are regulated
heavily by an intrusive and highly inefficient bureaucracy. High Tariff rates
and non-Tariff barriers impede. Property rights in a court of law cannot be
guaranteed. Resistance to privatization is high. The oil sector, the most
important part of Iran's economy, accounts for nearly 50 percent the
government budget and remains almost entirely state-owned.

Under these circumstances if Iran has to grow at about 8 percent per year we
should expect another revolution - of course it should be economic revolution
only - this itself is a challenge before the Iranian government.