Chapter IV: The Status of Economy of Iran

Section I:
General Land Use Pattern

In this chapter, the attempt has been made to give past & present status and general overview of economy of Iran. It is observed that the economy is always influenced by various economic, non-economic and foreign policy interventions. In following paragraphs, every attempt has been made to give the status of economy of I.R of Iran by giving the data, evidences, discussion, analysis and evaluation. The present chapter has been classified into four sections namely resources & land use, sector wise performance of economy, overall performance of economy and the present status & development planning.

1. Natural Resources:

According to a resource-based analysis of economic performance, Iran has the potential of being the world’s 20th strongest economy. Rich in hydrocarbons as well as other natural resources alongside the country’s geo-strategic position make the country a unique economy in the region. The Iranian economy has undergone various political upheavals that extremely affected & hit the programs of nation by which the country has still unsolved problems. Revolution, war and reconstruction were the major issues in the initial period of 1980s. However, the country has been trying its best to overcome all problems, and place itself at strongest position in the region.

According to statistical review of world energy, the country holds the world's third largest oil reserves after Saudi Arabia and Canada with proven reserves of 137.5 bn bbl in 2006 and produced 4.3mn barrels of crude oil per day (b/d) in 2006. Though they

1 Resource-based theory proposes that resources determine a firm’s strategic advantages and firm performance (Wernerfelt, 1984; Mahoney & Pandian, 1992; Barney, 1991). In this view, the concept of resources includes attributes of firms that affect the formulation and implementation of strategy (Barney, 1991; 2001). There is a progression of value creation, starting with Generic Resources, and passing through capabilities, Distinctive Competencies, Strategic Resources, and finally to Strategic Advantage (Brush, et al., 2001). Because resources are critical to the firm’s success, the type, amount, and timing of resources accumulated are vital. Joann C. Carland, Academy of entrepreneurship Journal, an official journal of the academy of entrepreneurship @Inc. Editor, Western Carolina University, Vol 9, N.1,2.
2 Salehkhou, Ramin, “The Islamic Republic of Iran, your partner in trade”, the commerce printing & publication house, affiliated to the institute for trade studies & research, 1997, P.2.
3 OPEC database bulletins, 2008.
have been producing the crude oil, the country’s existing refinery capacity is unable to keep pace with domestic demand. Therefore, country could not refine the ‘finished products’ from ‘crude products’ and the country depends on the imported refined petroleum products, which are costly; in order to meet the domestic demand of finished products.

The country estimated that natural gas reserves are more than 32 trillion cubic meters (second in the world behind Russia). It shows that the country has huge reserves of natural crude oil & gas, which are important for the various uses.

Mineral resources currently exploited include bauxite, chromium, coal, copper, gold, iron ore, limestone, red oxide, salt, strontium, sulfur, turquoise, and uranium; however, these are limited source of income. The tables of oil production and availability have been discussed in energy sector.

The economic and political power are now consolidated on the basis of natural resources that Iran having. If the country uses judicially and intelligently, the country may prove its power in the region.

2. Land Use pattern

According to agriculture census of Iran 2003, the country has surface area 174,515,000 square kilometer out of which land area is 162,855,000 sq kms. Out of land area, 29 percent is agricultural land with an area of 47,631,000 sq. kms. Two well known deserts namely “Lot” and “Kavir” field are also located in the centre of Iran plateau.

As per Bureau of Information and Statistics and Agricultural Statistics Yearbook 1993, about 11 percent of country’s land surface is classified as arable with area around 16,533,000 hectares. The most productive agricultural land, bordering the Caspian Sea, makes up about 5.5 percent of the country’s total land area. And only 6.8 percent of country’s total land classified as forest area which mostly located on north and west borders of Alborz and Zagros range of mountains. Approximately 47.34 percent of total

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Refining (also called affining) is the process of purification of a substance. The term is usually used of a natural resource that is almost in a usable form, but which is more useful in its pure form. For instance, most types of natural petroleum will burn straight from the ground, but it will burn poorly and quickly clog an engine with residues and by-products. The term is broad, and may include more drastic transformations, such as the reduction of ore to metal (for which see Refining (metallurgy)). [http://en.wikipedia.org/wiki/Refining]

OPEC data base bulletins, 2008
Cropland area is irrigated land which are most qualified and favorable agricultural land in terms of farming. Though close to 30 percent of land area is agriculture land but only less than one percent of total land area is permanent cropland. According to agriculture census of Iran at 2003, 8.3 percent of cropland area is land under permanent crops or in other words less than one percent of country's total land is permanent cropland, which is under the world average among other countries.

Section II: Sector wise Performance of Economy
1. Agriculture

The agriculture is one of the important sectors in economy, which covers 29.24% of land use area of the country. After Islamic revolution, the country adopted the new constitution which stated about the development of economy and how it is to be guided to the country. The constitution article 43, under section 9, the constitution stated:

"... emphasis on increase of agricultural, livestock, and industrial production in order to satisfy public needs and to make the country self-sufficient and free from dependence."

Therefore, the long-term objective of the government is to achieve self-sufficiency in agriculture sector, because rapidly increasing population has raised its demand for agricultural products. After revolution, the agricultural sector had to face sustain losses during the war (1980-1988) and even in subsequent years, number of natural disasters hit the country badly. On account of such problems, still Iran has to make agricultural sector more strong and vibrant sector among all sectors.

Diversity of terrain and climate enable to cultivate a variety of crops, but during 1998–2000 severe droughts caused to affect agricultural production. Output has recovered slowly since then, although many villages in eastern part of Iran have been abandoned, and consequently the area under cultivation has decreased since 2000. In the early 2000s, about 20 percent of Iran’s arable land remained

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9 Salehkhou, Ramin, "The Islamic Republic of Iran, your partner in trade", the commerce printing &publication house, affiliated to the institute for trade studies & research, 1997.
uncultivated. Indeed, the government desires to have self-sufficiency in food is proving more elusive but yet, the country still is a net importer of grains, especially rice and wheat, and a net exporter of fruits, nuts, and various other important crops.

Farmers grow a variety of crops, most notably wheat, barley, rice, pistachio nuts, cotton, sugar beets, and sugarcane. However, the country is the world's largest producer and exporter of pistachios, which account 54% of global sales. Agriculture statistics reported that about one-third of agricultural income comes from livestock, chiefly chickens, sheep, beef cattle, and dairy cows. With the exception of sheep and goats, which graze on open rangeland, most livestock is raised in fenced pastures.

According to data released by the Ministry of Agriculture Jihad, production of farming crops in an area of 13 million hectares of land (the land under crops at the time), was 70 million tons in the farming year of 2005. Out of total farming products, 89.6 percent (62.7 million tons) were produced in irrigated land and the remaining were rain fed crops. The horticultural produce in an area of 2056.6 thousand hectares of land and produced 14.9 million tons. Grain production (wheat, barley, rice and corn) of the country in 2005 was 21897 thousand tons. Eventually the trend of Gross National Product of agriculture sector at constant prices of 1997 was as following table:

<table>
<thead>
<tr>
<th>Year</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture sector, GNP</td>
<td>49818</td>
<td>53362</td>
<td>54521</td>
<td>59602</td>
<td>62386</td>
</tr>
</tbody>
</table>

Table 4-1 - Yearly trend of Agricultural sector output (Billion Rial)

As per table 4-1 in 2002, the agriculture sector GNP was 49818 and it is added by 25.23 percent in 2006. From above data, it is observed that the country has an average growth rate of agriculture sector GNP is 5.05 percent.

As per figure 4-1, it is noticed from the figure that agriculture sector value added percentage share of GDP is gradually decreasing during 1990 to 2005. The annual growth rate of agriculture sector value added has been fluctuating and it is observed that it was negative in 1999. It is also observed that the share of agriculture

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10 Aggregate agriculture sector product annually that is share of agriculture sector from total country's GDP.
sector value added from GDP during 1980 to 2006 gradually decreasing which reveals the average growth rate of agriculture sector with comparison to other economic sectors of country decreased. On the other hand, the value added data of agriculture sector shows that the sector has no sustained growth rate and it is affected by rainfall volume as well as agriculture sector infrastructure and technology used and finally unstable government’s foreign trade tax policy and protectionism policies and regulations.

Figure 4-1 - Agriculture Sector Value Added 1970-2006

Agriculture Sector Value Added

<table>
<thead>
<tr>
<th>Year</th>
<th>Value Added (annual % growth)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1970</td>
<td>10</td>
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<tr>
<td>1971</td>
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<td>1972</td>
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<td>20</td>
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<tr>
<td>2005</td>
<td>30</td>
</tr>
<tr>
<td>2006</td>
<td>10</td>
</tr>
</tbody>
</table>


i. Guaranteed Purchase of Agricultural Product

The government of Iran framed the policy package of Guaranteed Purchase of agricultural products in 1989 to support & protect farmers in the production of basic agricultural crops, to establish equilibrium in the production system, and to maintain farmers’ income level. Initially the policy was started by government for wheat only. The government also tries to protect the agriculture sector from different ways by charging 3-5 percent less interest rate than commercial sector for financial sources by state banks.

Based on the data released by the ministry of economic affairs and finance and “consumers and producers protection organization”, total subsidy paid by the government (including subsidy on medicine and powdered milk and the subsidy as subject to article 46, 3rd FYDP Law) amounted to Rls. 51,840.4 billion in 2005 up by
88.2 percent. During this period, the ratio of subsidy paid by the government to GDP at basic price (including oil) reached 3.1 percent at current prices. In 2005, the share of subsidy to major agricultural crops in total subsidy paid by the government increased from 77.9 percent to 80.9 percent. Because of the subsidy policy of government, the country became self sufficient in the production of wheat.

Data released by the Customs, the country exported 2673.6 thousand tons of various agricultural products, with a value of $3,193.9 million, in 2005. Export of agricultural products constitutes 10.7 percent of weight and 30.5 percent of value of non-oil exports. The country imported 8,701.6 thousand tons of various agricultural products, valuing at $3,239 million that indicates 9.4% and 4.3% percent increase in weight and value, respectively. It is observed that imports of the mentioned goods accounted for 24.5 percent of weight and 8.3 percent of value of total imported goods.\(^{11,12}\)

In 2004 and 2005, trade balance of this sector ran a deficit in this sector in 2005; trade balance deficit reached $45 million, showing 95.7 percent reduction as compared with the previous year. This indicates an improvement in foreign trade. The remarkable growth in exports of agricultural products against imports led to the reduction in the deficit of trade balance. Among the exported agricultural products, dried fruits and agricultural processing industries products enjoyed the significant growth.

In live stock products, it is found that the production of red meat has been increasing since 1996-97. The production of milk indicates increasing. The poultry production has shown increasing trend. However the eggs production shows somewhat fluctuating trend.

Table 4-2- LIVESTOCK PRODUCTS

<table>
<thead>
<tr>
<th>Years</th>
<th>1996/97</th>
<th>1999/00</th>
<th>2002/03</th>
<th>2003/04</th>
<th>2004/05</th>
<th>2005/06</th>
<th>2006/07</th>
</tr>
</thead>
<tbody>
<tr>
<td>Red meat</td>
<td>685</td>
<td>721</td>
<td>742</td>
<td>752</td>
<td>785</td>
<td>800</td>
<td>829</td>
</tr>
<tr>
<td>Milk</td>
<td>4,705</td>
<td>5564</td>
<td>5,877</td>
<td>6,316</td>
<td>6,720</td>
<td>7,179</td>
<td>7,741</td>
</tr>
<tr>
<td>Poultry</td>
<td>676</td>
<td>725</td>
<td>942</td>
<td>1,104</td>
<td>1,152</td>
<td>1,237</td>
<td>1,360</td>
</tr>
<tr>
<td>Eggs</td>
<td>486</td>
<td>570</td>
<td>547</td>
<td>629</td>
<td>655</td>
<td>758</td>
<td>677</td>
</tr>
</tbody>
</table>

Source: Ministry of Agriculture Jihad

\(^{11}\) Annual Review, annually, Central Bank of Iran, several years,

\(^{12}\) Economic Report & Balance Sheet, Central Bank of Iran, periodical, several years
ii. Forestry:

According to the central bank of Iran classification of economic sectors, forestry is under the ministry of agriculture. The country has only about 7 percent forest cover. The major commercially useful forests are located in the Alborz Mountains in the north, especially on the southern slopes above the Caspian Sea coast. Smaller forests, principally of oak and other deciduous trees, are scattered throughout the Zagros Mountains in western and central Iran. The country is a net importer of timber products. Illegal clear-cutting and clearing for agriculture have depleted forests in the Alborz, and illegal harvesting of trees has hindered government replanting programs. In 2003, the timber industry produced about 13 million cubic meters of wood products, of which about 37 percent was pulpwood and 24 percent logs.

iii. Fishing

The country has a long tradition of fishing in the Caspian Sea, in the Persian Gulf, and on inland rivers. The government company Sheelat establishes fishing quotas and buys fish for processing. Most of the actual fishing is undertaken by small-scale, private fishermen. The most economically important product of the fishing industry is caviar from Caspian Sea sturgeon. In the 1990s, the sturgeon catch declined as a result of over-fishing and poaching. The country has an aggressive fish nurseries program aimed at reversing the decline in Caspian fish stocks. Other products of the fishing industry are tuna, the sardine-like kilka, trout, and shrimp. In 2004 catches totaled more than 330,000 tons of fish.

iv. Enhancement of Productivity:

One of the key problems in enhancing efficiency and productivity in the agricultural sector stems from the fact that most farming is undertaken by peasant households. One of the key efforts of *The Five Year Development Plans* has been to provide better infrastructural facilities, mechanized farm production and improvement distribution.

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24 Salehkhoo, Ramin, "The Islamic Republic of Iran, your partner in trade", the commerce printing & publication house, affiliated to the institute for trade studies & research, 1997, P.72
25 ibid-P.73
26 We will discuss on the five year development plans in the next part of this chapter after introducing all economic sectors.
As a result, agricultural output and productivity (as measured by the ratio of the agricultural sector value added to population) has had a secular upward trend and with the recent reduction in population growth rate combining with growing output in this sector, it is estimated that Iran’s agricultural trade balance can turn into a surplus within the coming decade. Additional productivity as well as export revenue can be earned by increases in the output of agricultural processing industries. The Five Year Development Plans stresses the importance of the expansion of agricultural processing industries and already some $624.1 million of hard currency\(^{17}\) and Rls. 33303.3 billion in second plan has been expended in the fields of canneries, animal feed, slaughterhouses and potato and fish powder factories. These new expenditures supplement Iran’s vast existing conversion industries ranging from dairies to cereal conversion industries such as flour, macaroni, biscuits and starch making.

2. Energy Sector:
   
i. Importance of Energy Sector and contribution to national Economy
   
   Since the pre-Islamic revolution period the oil and gas industries play a key role in the country’s economy, particularly under the Prime Minister-ship of Mohammed Mossadegh's who attempted to nationalize oil & gas industries, which were controlled by British Petroleum, in 1951-3.\(^{18}\) The sector has been providing majority share of foreign exchange in GNP. The industry also played and is playing crucial role in Iran’s political economy. After Islamic revolution, the National Iranian Oil Company (NIOC) took over all the operations of the oil and gas industries. By the time of the 1979 revolution, Iran’s production capacity had reached 6.5 million b/d. The export of crude oil which was around 1 million b/d in 1963 increased to a peak of 5.4 million b/d in 1974 and was 4.5 million b/d in 1978, making Iran the second largest exporter in OPEC after Saudi Arabia. So country’s key macroeconomic items comprehensively depended on single product of oil. In spite of decreasing trend of oil export from national export to almost 80% during 2000-2008, but still the oil refined products have the considerable share in non-oil export. And government budget still depended on oil revenue fluctuations.

\(^{17}\) Foreign Currency which is used by international business

\(^{18}\) Mahvash Alerassool, "IRAN; towards a new economy", Middle East Economic Digest, 1993.
ii. Energy reserves & productions

According to OPEC statistical bulletin 2006, the country has the second largest reserves of oil after Saudi Arabia among 11 OPEC member countries. The reserve of oil of Saudi Arabia is estimated 264.2 billion barrels and of Iran is estimated 137.5 billion barrels. These two countries are followed by Iraq and Kuwait by 115.0 and 101.5 billion barrels, respectively. In natural gas reserves, the country possesses abundant fuels from which to generate energy, ranking second in the world in natural gas reserves after Russia. Iran possesses 29.6 trillion cubic meters of natural gas. According to the data published by OPEC, Iran has produced 3.999, 4.081, 4.049 million barrel of crude oil in 2003, 2004 and 2005 respectively. And oil products consumption at this time period was 1.512, 1.574, 1.658 billion barrels in 2003, 2004 and 2005 respectively.

According to the national accounts published by the central bank of Iran (table 4-3), the country’s average crude oil production, in compliance with the production quota, was set at 4,268 thousand b/d in 2005 (=1384, Iranian Solar Calendar starting from 20 March). Crude oil export grew by 2.1 percent to 2,661 thousand b/d in 2005 but growth rate at 2006 was 0.48% only.

While export of oil products fell by 6.1 percent to 245 thousand b/d, the total oil export (including crude oil and oil products) reached 2.8 million b/d showing a rise of 1.4 percent compared with the 2004.

The share of crude oil export is 85 percent of total oil exports in 2004. The country’s crude oil proven reserves, production, and consumption and export figures illustrated in table 4-3 complicated.

<table>
<thead>
<tr>
<th>Table 4-3- The present status of Iran Crude oil</th>
</tr>
</thead>
<tbody>
<tr>
<td>Iran.I.R.</td>
</tr>
<tr>
<td>2005</td>
</tr>
<tr>
<td>crude oil proven reserves (billion barrels)</td>
</tr>
<tr>
<td>137.5</td>
</tr>
</tbody>
</table>

Source: national accounts, central bank of Iran

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20 Iran Economic Report and Balance Sheet in 2005/2006, the central bank of Iran,
Though other sectors of economy are growing and made substantial contribution to the GDP, oil still remains Iran’s financial backbone. Domestic consumption of oil products reached 1,669 thousand b/d in 2006. Consumption of gas oil and Petrol (gasoline), with 29.9 and 26.8 percent share in total consumption of oil products, amounted to 417 and 373 thousand b/d.

Nevertheless, in 2005 Iran spent US$4 billion dollars on fuel imports, mainly because of dramatic growth of domestic demand and inefficient domestic use. Oil industry output averaged almost 4 million barrels per day in 2005 and 2006, compared with the peak output of 6.6 million barrels per day in 1976. In the early 2000s, industry infrastructure was increasingly inefficient because of technological lags, limited investment, sanctions and high rate of natural decline in country’s mature oil fields. According to fifth five-year development plan submitted to the Parliament in January 2010, government plans to increase oil production capacity to 5.1 million by 2015, but foreign assistance will likely be necessary.

![Figure 4-2 Total Energy Consumption in Iran, by Type (2007)](image)

Source: EIA International Energy Annual 2007

<table>
<thead>
<tr>
<th>Table-4-4 Domestic Consumption of Oil Products (thousand b/d)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percentage change</td>
</tr>
<tr>
<td>-------------------</td>
</tr>
<tr>
<td>2005</td>
</tr>
<tr>
<td>Gas oil</td>
</tr>
<tr>
<td>Fuel oil</td>
</tr>
<tr>
<td>Gasoline</td>
</tr>
<tr>
<td>Kerosene</td>
</tr>
<tr>
<td>LPG</td>
</tr>
</tbody>
</table>

Other Products | 115 | ... | 127 | 153 | 143 | 20.5 | -6.5 | 11.0 | 9.6 |

Total | 1,049 | 1,216 | 1,394 | 1,492 | 14.6 | 7.0 | 100 | 100 |

Source: Ministry of Petroleum
According to data published by OPEC, country’s estimated proven gas reserves stand at 29.61 trillion cubic meters (Tcm), second only to Russia. Over two-thirds of country’s natural gas reserves are located in non-associated fields, and have not been developed. Major natural gas fields include: South and North Pars, Kish and Kangan-Nar. In 2008, country produced an estimated 116.06 (million cubic meters) of natural gas and consumed an estimated 112.06; the difference made up by imports from Turkmenistan. Natural gas consumption is expected to grow by 7 percent annually for the 2020s. In 2008, country became the world’s fourth largest gas producer and third largest consumer of natural gas.

Both production and consumption of natural gas have grown rapidly over the past 20 years, and natural gas is often used for re-injection into mature oilfields in country.

According to FACTS Global Energy, country’s natural gas exports will be minimal due to rising domestic demand even with future expansion and production from the massive South Pars project. In 2008, roughly 70 percent of country’s natural gas was marketed production, approximately 16 percent was for enhanced oil recovery gas re-injection, and shrinkage, loss and flaring accounted for about 14 percent. As with the oil industry, natural gas prices in country are heavily subsidized by the government.

### iii. Energy export and import

According to the data, the country is one of the largest oil exporters in the world. In 1384 (20/03/2005-20/03/2006), the country exported crude oil to various regions of the world. Out of total crude oil exported (2.66 – 2.67 million barrel), 59.4 percent was exported to Asia and share of Japan is 20 percentage, the share of Western Europe is 33.5 percent and share of Africa is 7.1 percent.

![Table 4-5 Iran Oil Export](source: OPEC Annual Bulletins-2008)
The share of crude oil in total oil export is 90.1 percent and the share of oil products is 9.9 percent.

Indeed, Iran endowed with the second largest natural gas reserve of the world, should have already been the main exporter of natural gas to the global markets. This has yet to happen. The reasons for not yet achieving such a status in the world markets are many. They include insufficient investment resources, strong demand at the domestic market for fuel, rapid depressurizing of some oil reservoirs, domestic environmental policies pertaining to substitution of fuel oil and petrol with natural gas and the inability of some potential buyers in separating politics from business or resolving long festering disputes such as the India-Pakistan dispute over the status of Kashmir.

The country imports natural gas from its northern neighbor Turkmenistan. Due to pricing disagreements, supply is irregular, but in 2008 up to 0.8 Bcf per day was imported from Turkmenistan.

iv. Development and Planning

The energy sector being the one of large contributor to the GDP, the government has been planning to develop the crude oil refinery and petroleum products. Though the government has other sources of revenue this sector is highly motivated and recognized as priority sector on development agenda. Iran’s Oil Ministry is attempting to bolster production and increase the added value of hydrocarbon resources by more part of crude oil should be refining and do not
exporting as a raw material (crude oil) but oil products like petrol, gas oil, fuel oil, kerosene, LPG & LNG and other products and petrochemical products.

The oil industry post-Islamic revolution faced a number of problems resulting from the war, economic sanctions, lack of maintenance and the departure of specialized expatriates. However, because of its developed structure and infrastructure, its performance has been remarkable. Government is planning to divert revenue of crude oil exports for increasing the value-added resources to the hydrocarbon and the rapid industrialization of the country.

One of successful government plans in oil sector was by establishing the Oil Stabilization Fund to cushion the economy and the government budget against fluctuations in oil proceeds.

Stabilization Fund was created to ensure the sustainability and preservation of national wealth. Since its inception in 2000, the Oil Stabilization Fund has received around US$29.1 billion from oil revenue and about US$1.2 billion from other sources. About US$16.7 billion has been used for budget purposes and around US$4 billion has been allocated to private sector investors as facilities during third five year development plan.

Iranian natural gas field exploration occurs in the Fars province including the Varavi, Shanol, and Homa fields, and in the Persian Gulf Salman gas field. In November of 2008, NIGC announced it was partnering with Indian firm Oil and Natural Gas Corp to produce recoverable gas reserves estimated at 12.8 Tcf from the Farsi Block. In April of 2008, NIOC announced the discovery of a field containing an estimated 740 Bcf of recoverable sour gas in the southwestern province of Khuzestan.

In April 2008, Oman and Iran signed an agreement to develop Iran’s offshore Kish field. With estimated reserves of 50 Tcf, Oman will invest $7 billion in developing Kish in the hopes of producing 3 Bcf/d of natural gas. Phase I of the project, tentatively scheduled for first delivery to Oman by 2013, will produce approximately 2 Bcf/d; 65% of production will remain in Iran, the remaining 35% goes to Oman. Phase II of the project will produce 1 Bcf/d to be used for Iranian purposes.
The most significant energy development project in Iran is the offshore South Pars field (called the North Field in Qatar), which is estimated to have 450 Tcf of natural gas reserves, or around 47 percent of Iran’s total natural gas reserves. Discovered in 1990, and located 62 miles offshore in the Persian Gulf, South Pars has a 25 phase development scheme spanning 20 years. The entire project is managed by Pars Oil & Gas Company, a subsidiary of the National Iranian Oil Company. Each phase has a combination of natural gas with condensate and or natural gas liquids production. Phases 1-10 are online. The majority of South Pars natural gas development will be allocated to the domestic market for consumption and gas re-injection. The remainder will either be exported to South Asia or Europe, used for LNG production, and or used for gas to liquids (GTL) projects.

**Pipelines**

Developments in the Iranian Gas Trunkline (IGAT) pipeline series, all fed by South Pars development phases, are important to Iran’s natural gas transport. IGAT-7 (2011) will transport up to 3 Bcf/d of gas along southern Iran, between Assaluyeh and Iranshahr. IGAT-8 (2012) will run nearly 650 miles to Iran’s northern consumption centers, including Tehran. IGAT-9 is an estimated $8 billion pipeline proposed to run from Assaluyeh to the northwestern city of Bazargan. IGAT-9 is unique in that for the first time, Iran is offering a build-own-operate contract for construction of its pipelines.

The 745 mile Iran-Turkey pipeline, completed in 2001, can transport up to 1.4 Bcf/d of natural gas. The 87-mile long Iran-Armenia pipeline will transport 86 Mcf/d to Armenia in exchange for 3.3 billion kilowatt hours of electricity.

Iran’s participation in the Nabucco gas pipeline project remains unresolved. Plans call for a 2050 mile pipeline connecting Iran and other Caspian states to Austria and the EU through Turkey. Construction is slated to start in 2010, and the entire project will cost an estimated $12.2 billion with a capacity to transport 3 Bcf/d.

A controversial pipeline proposal is the $7.4-billion Iran-Pakistan-India (IPI) line which would transport Iranian natural gas south to the Asian subcontinent. With a
proposed 1724 miles and a 5.4 Bcf/d capacity, the pipeline has been stalled in the past due in part to disputes over the cost of the shipments. Iran and Pakistan have finalized gas sales and purchase agreements, but without India’s participation in the negotiations. It is probable that Iran would extend its domestic IGAT-7 pipeline into Pakistan, avoiding the creation of a new, parallel pipeline.\(^{21}\)

3. **Industry (Manufacturing and Mining, Construction and housing)**

   i. **Importance of Industry Sector**

   According to data published by the central bank of Iran, the share of industry sector value added from GDP during 1980-2006 was between 20% to 45%, which indicates the large share of industry sector in gross domestic product. It is noticed from the data that during 1980 to 1988, the share of industry value added was showing decreasing trend. This might be because of the war between Iran and Iraq during this period, whereas exactly after peace agreement between two countries, the share of industry in GDP started increasing. Actually during the war (1980-1989), many petrochemical refineries and other manufacturing companies suffered and also most of them were

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\(^{21}\) www.EIA.doe.gov
underutilized because of unavailability of inputs and raw materials. After 1990, the share of industry sector in GDP gradually started increasing and it reached to 45% percent of GDP in 2006 as compared to 1988. This positive growth in industry sector was achieved because of the government's restructuring policy for the industry and government started investment in various chemical and petrochemical and other manufacturing sectors.

The data indicate that the annual growth rate of industry was between -35% to +45%. After 1999 the industrial growth rate is found positive and it was in an average more than 7% percent. It has indicated that the country has moved through the negative growth rate to positive growth rate. It happened because of capital outflow from the country during Islamic revolution and unstable economy and volatile situation in the country during the war period.

Uncertain oil revenue and foreign exchange reserves problem created havoc in industrial development. Due to shortage of foreign exchange reserves the industrial sector failed to import capital goods, modern technology and services into the country.

Figure 4-5 Share of Industry sector Value-added from GDP$^{22}$

The data observed in this figure included oil industry value added.

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$^{22}$ Data observed in this figure included oil industry value added.
ii. Present status of industry sector

The aim of five year development plans was to develop the industrial sector by renovation of the existing industries; giving priority to the capital and intermediate goods industries; emphasizing industries that use domestic resources; encouraging private and foreign investment; and improving the management and industrial technology. The first place in value-added of industrial sector in the Iranian industrial plants belongs to the chemical & petrochemical products and material production. The investment in petrochemical section and its downstream industries was seriously impeded but is relatively improving after year 2000 and some development plans have been designed for this industry. In the petrochemical sector, the state-owned National Petrochemical Company is undertaking an expansion program aimed at the construction of some 30 petrochemical plants by 2013. In May 2001, NPC officials estimated that total installed capacity had reached 12 million tons per year. By the end of 2001, petrochemicals overtook carpets as Iran's leading non-oil export.

\[ \text{Th}^{12.364} \]

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23 The central bank of I.R.I, Annual Bulletin, different years,
Second to the petrochemical industries, the highest value-added of industrial sector is motor vehicles and production of basic metals.

According to the data available for manufacturing sector it is found that the share of manufacturing sector in GDP is an average more than 11%.

The growth rate of manufacturing sector is found between -5% to +26%. Since 1999 it is found that the average growth rate for manufacturing sector around 10%.

Restructuring of economic enterprises and enhancing competitiveness through creating linkages among small, medium and large enterprises, removing impediments
to growth and expanding small and medium enterprises to large and competitive ones were among the objectives set in the 4th FYDP for the improvement of the manufacturing sector. Among the measures taken and approvals in 1384 were: approval of the executive by-law for the expansion of SMEs; allocation of banking facilities to the SMEs; approval of Articles of Association for Investment Guarantee Fund of small industries; extension of exemption period of small manufacturing establishments with less than 10 employees from Labor Law for 3 years; prohibition of purchase of consumer durables by the government's administrative organizations, which are produced in local market, from abroad; establishment of Iran Small Industries and Industrial Parks Organization (ISIPO); rescheduling of debts and providing debt relief to manufacturing enterprises on the basis of Article 138 of the Constitution; transferring some part of industrial companies' shares and utilization of administered funds.

Figure 4-9 Annual growth rate of value added of manufacturing sector (%)

Manufacturing, value added (annual % growth)

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Iran has invested heavily in the steel sector during the 1990s. This investment has seen production rise to 6.9 million tons per year making Iran the largest producer in the Middle East. Iran also produces aluminum (131,000 tons in 2000 and 148,000 tons in 2001) and has a reasonably well-developed agro-industrial base. The automotive sector is insulated from competition by high tariffs and quotas, which has stifled domestic innovation. The country's textiles industry is largely based on the
domestic supply of cotton although comparatively high labor costs and inflexible labor laws mean that the price of Iranian produced textiles is higher than that of its regional competitors.

A Comparison of Sector wise Shares of GDP in last decades:

During 10-years period (1979–1989) the country adopted the closed economic system because country went through the Islamic Revolution, war between Iran-Iraq and economic sanctions by US. Due to closed economy in the country the various sectors had gone through the home borne problems and the share of these sectors to GDP decreased. According to the national accounts published by the central bank of I.R.Iran, the role of oil in gross domestic production greatly decreased and the share of industry, mines and construction sectors also decreased, but the share of agriculture and servicing sectors increased. During this problematic period, the government could not frame the proper economic planning and policy that affected the external markets particularly for the oil export market as well as other industrial sector. The disordered status of economy can be seen in the 8% negative growth of gross domestic production in 1986. After end of war in 1988, the economy of the country was revived. Between years 1989 and 2000, the country had positive growth rates in oil sector, industries, mines, water, power and gas but the share of agriculture, servicing and construction in GDP decreased. This change of share in structure of gross domestic production is the outcome of restoration of oil establishments and increased extraction and export of oil from the Iranian oil fields bordering Iraq and the consequent increased oil revenues as well as step by step operation of the damaged industries.

The industry sector with an increased share of 18.5% from 17.8% reached maximum share of 20.7% in some years but the share of service sector declined and reached to 34.6% from 50% and in some years even reduced to 23.9% which is a reflection of the investments in industry sector through the oil revenues.
Section III: Overall Performance of Economy

1. Gross Domestic Product (GDP)

According to the World Development Indicators (the World Bank -2008) in 2006 Iran’s GDP in terms of purchasing power parity (PPP) was US$ 694.4 billion and GDP per capita was US$ 9,906. The estimated GDP growth rate was 5 percent. Industry contributed 45.3% percent of GDP, services 43.7% percent, and agriculture 11% percent of GDP.\(^{24}\)

Figure 4-11 GDP PPP (current, International Dollar $) 1980 – 2006

According to national accounts data of Iran, GDP growth rate of country was fluctuating since 1980 to 1990 but after this period the country had positive annual growth rate ranging from 2% to 8%. Since 2005 it is around 4.5 percent.

2. Public Sector (expenditure and revenue)

In Articles 43 and 44 from chapter IV of Constitutional law of Iran, principal framework of Economy and Financial affairs in Iran is declared:

In the Iran constitutional law government responsibility defined completely regarding providing an active economic atmosphere, social safeguard, education, health and job creation. Complete survey of government responsibility on Islam and I.R. of Iran constitutional law attached to appendix no.III.
i. Government Budget:

During 1979–88, Iran suffered substantial economic and financial losses in its war with Iraq. This war, coupled with mismanagement and capital outflows after the 1979 revolution, resulted in income losses, significant government budget deficits (which were mainly financed through central bank resources), and multiple exchange rates. Liquidity and prices grew at average annual growth rates of 20 percent and 18.7 percent, respectively. Country’s population also grew rapidly and reached 53 million by 1988, with 55.6 percent of the people residing in urban areas at that time. As a result the unemployment rate rose significantly in this decade. Budget deficits, largely caused by extensive state subsidies of commodities such as food and fuel, have been a major problem. Iran’s 2005 budget included a deficit of US$11.6 billion based on revenues of US$48.8 billion and expenditures of US$60.4 billion, including US$7.6 billion of capital expenditures. Backed by increased oil prices, announced outlays in the 2006 budget were about 50 percent more than those in 2005.\(^2\)

ii. External Debt:

According to world development indicators data, in 1991, the country had external debt at US$23 billion. It is found that in 2001 the external debt came down to US$7.86. But in subsequent years, it is found that debt increased. It reached US$18.6 billion in 2006 and came down to US$13.8 in 2007.

Figure 4-14- the present status of country’s external debts

\(^2\) Economic Report & Balance sheets, the central bank of Iran, 1979-2007

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World Bank Assistance

According to the World Bank's official article of association:

"The overarching objective of the World Bank's partnership with Iran is to support the country's economic transition and structural reform agenda towards a more open economy, sustainable growth with improved income distribution. Bank's analytical work focuses on sectoral reform strategies, public expenditure reform and on an integrated reform of Iran's oversized, inefficient and untargeted subsidies system to reach its objectives of growth and social justice."

Before 1979 Islamic revolution, Iran was an active borrower from the World Bank and after revolution the World Bank stopped lending until 1991. Between 1991 and 1993, seven World Bank projects\(^26\) were approved despite the United States voting against these projects. The current portfolio of approved loans for Iran, which total approximately $847.4 million, are for projects\(^27\).

Between 1993 and 2000, the United States was able to sustain a coalition of G-7 countries that voted against World Bank lending to Iran. In May 2000, however, the United States proved unsuccessful in keeping the coalition together and lending resumed as the other G-7 countries voted to approve $232 million in loans for health and sewerage projects\(^28\).

World Bank lending to Iran resumed in 2000 and started two operations: Health and Sewerage. This coincided with the beginning of the Government's large reconstruction effort.

According to the World Bank latest reports on country's lending from the World Bank, the current portfolio consists of six active operations - Tehran Sewerage Project, Second Primary Health Care and Nutrition Project, Environmental Management, Earthquake Emergency Project, the Ahwaz and Shiraz Water Supply and Sanitation Project, and the Urban Upgrading and Housing Reform Project for a total commitment of 833US$ million. The undistributed but approved loans are

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\(^{26}\) Projects such as: primary health, earthquake recovery assistance, drainage and irrigation projects, and power sector improvements


409.80 US$ million. The main part of the lending was in water supply and sanitation projects in urban areas by 71% and remain allocated to earthquake reconstruction and recovery projects by 20%, urban development and environmental management projects.

Section IV: Present status and Planning

1. Domestic saving

Gross savings are the difference between gross national income and public and private consumption, plus net current transfers. The country’s data discovers that figure is in average around 40 to 45% percent of GNI, which is high with compare to other countries. Though in the most of developed countries this figure is around 25 percent it can illustrate that country tries to ensure the national production by higher rate of saving. On the other hand it will reveal the inefficient utilization of national resources which high rate of them is stock. The sharp decrease of net national saving figure from 1996 to 2001 is high rate of capital amortization and consumption of fixed capital.

Figure 4-15 National Saving (% of GNI)


2. Foreign Investment:

According to article 43 and 44 of post-Islamic Revolution constitution, the granting of concession to foreigners for operating in the fields of trade, industry, agriculture, mines and services are prohibited. Therefore, attracting the foreign direct

29 World Bank Operation in Iran, The World bank, 2009,
investment as a means of spurring growth and economic development had not been a priority with the exception of the oil, gas and petrochemical industries. However, the reform on foreign investment law by the expediency council in May 2002 turned the countries interests in the issue of attracting foreign investment. The new law along with reforms & modification on article 43 and 44 of constitution deal with reduction of the political risk of investing and allows repatriation of principal and earnings.

Foreign investment has been hindered by unfavorable or complex operating requirements in Iran and by international sanctions, although in the early 2000s the Iranian government liberalized investment regulations. In the early 2000s, foreign investors have concentrated their activity in a few sectors of the economy: the oil and gas industry, vehicle manufacture, copper mining, petrochemicals, foods, and pharmaceuticals. Iran’s constitution prohibits direct concession of petroleum rights to foreign investors. In the 1990s and early 2000s, some indirect oilfield development agreements were made with foreign firms. The most active investors have been British, French, Japanese, South Korean, Swedish, and Swiss companies.

According to the World Bank Group data base, the FDI inflows to Iran had sharp increase after 2001 whereas, it has reached to 900 million $US in 2006, from less than 100 million $US in earlier 2001.

3. Human Capital

a. Employment and job creation

Against the backdrop of socioeconomic condition, according to the statistical centre of Iran (SCI), population age group of 10 years and over is regarded as labor force supply. Labor force supply is affected by this age group and also labor force participation.

In Iran, from 1956 to 1996 the population of Iranians aged 10 years and over grew at an average annual rate of 2.9%, 3.1%, 3.6% and 3.3% respectively, while the economically active population grew 2.6%, 2.2%, 2.7% and 2.3% respectively. The difference in the growth rates of these two population groups resulted in a decline in the labor participation rate from 47.5% in 1956 to 35.3% in 1996. According to Iranian Census of population and housing, in 1996 the labor participation rate in Iran among the population aged 10 and over was 35.3%. This compares very poorly with labor
participation rates in the industrialized countries which range from a low of 58.5% in Spain to a high of 77.1% in the U.S.A. Table 4-6 shows the active population and participation rate in Iran. One of the important factors to decline participation rate in Iran is that high percentage of women who are housewives. Another factor is that number of students in secondary and tertiary (higher education) levels increased. The table 4-7 shows the various categories of inactive population in Iran.

Source: statistical center of Iran

According to figure 4-15, tendency of Iranian women to find job and shift to active population and young Iranian to continue their education increased from 1956 to 1996. The table 4-9 shows that distribution of active population between employment and unemployment. The table 14 has shown that distribution of employment between males and females, rural and urban and employment between different economic sectors. According to table 14 the employment ratio in the agriculture sector decreased from 56.3% of labor force in 1956 to 23% in 1996. In the same period the employment ratio in the industry and services sectors increased from 20.1% and 23.6% to 30.7% and 46.3% respectively.

According to the statistical center of Iran, the population age group of 10 years and over grew by an annual average rate of 2.7 percent during 1996-2006 to reach 59,507 thousand in 2006. Participation rate was 39.4 percent in 2006. Therefore, active population reached 23,466 thousand, up by 3.9 percent compared with 116,027 thousand in 1996. Higher participation rate in tandem with lower demand for labor force (3.4 percent demand against 3.9 percent supply of labor force), added to the number of unemployed. Thus the unemployed numbered 2,991 thousand, against 1,455
thousand in 1996, and unemployment rate trended upward from 9.1 percent in 1996 to 12.1 percent in 2006. However, high unemployment rate among female population during the recent years was mainly attributable to the rise in potentially active population and rate of women’s participation in socioeconomic activities on the one hand and the imbalance between the huge number of job seekers and the availability of jobs on the other.

Table 4-6 Active population and participation rate, 1956 - 1996

<table>
<thead>
<tr>
<th>Year</th>
<th>Population aged 10 years and over (1000)</th>
<th>Active population (1000)</th>
<th>Participation rate (%)</th>
<th>Unemployment (%</th>
<th>Unemployment Male (%)</th>
<th>Unemployment Female (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1956</td>
<td>12,784</td>
<td>6,067</td>
<td>47.5</td>
<td>2.6</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1966</td>
<td>17,000</td>
<td>7,842</td>
<td>46.1</td>
<td>6.3</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1976</td>
<td>23,002</td>
<td>9,796</td>
<td>42.6</td>
<td>10.2</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1986</td>
<td>32,874</td>
<td>12,820</td>
<td>39</td>
<td>14.2</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1991</td>
<td>38,655</td>
<td>14,737</td>
<td>38.1</td>
<td>11.1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1996</td>
<td>45,401</td>
<td>16,027</td>
<td>35.3</td>
<td>9.1</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

2000

<table>
<thead>
<tr>
<th>Year</th>
<th>Population aged 10 years and over (1000)</th>
<th>Active population (1000)</th>
<th>Participation rate (%)</th>
<th>Unemployment (%</th>
<th>Unemployment Male (%)</th>
<th>Unemployment Female (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>16</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2001</td>
<td>18,241</td>
<td>9,160</td>
<td>47</td>
<td>13.9</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2002</td>
<td>21,000</td>
<td>10,120</td>
<td>48.1</td>
<td>10.9</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2003</td>
<td>21,600</td>
<td>10,720</td>
<td>49.7</td>
<td>10.1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2004</td>
<td>21,900</td>
<td>10,940</td>
<td>49.7</td>
<td>9.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2005</td>
<td>22,000</td>
<td>11,000</td>
<td>50.0</td>
<td>9.4</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2006</td>
<td>23,466</td>
<td>11,730</td>
<td>50.0</td>
<td>16.7</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: The Population and Housing Census, statistical center of Iran

However for recent years data are available from different sources which are not consistent with census.

Table 4-7 Population, Active population rate by gender

<table>
<thead>
<tr>
<th>Year</th>
<th>Total population (age 15+)</th>
<th>Total Active population (age 15+)</th>
<th>Total activity rate (age 15+)</th>
<th>Men activity rate (age 15+)</th>
<th>Women activity rate (age 15+)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1976</td>
<td>18,699.38</td>
<td>9160.564</td>
<td>49</td>
<td>83.2</td>
<td>13.4</td>
</tr>
<tr>
<td>1986</td>
<td>26947.28</td>
<td>12338.346</td>
<td>45.8</td>
<td>81</td>
<td>9</td>
</tr>
<tr>
<td>1991</td>
<td>31054.92</td>
<td>14319.651</td>
<td>46.1</td>
<td>79.9</td>
<td>9.9</td>
</tr>
<tr>
<td>1996</td>
<td>36,297.59</td>
<td>15,651.131</td>
<td>43.1</td>
<td>74.8</td>
<td>10.6</td>
</tr>
<tr>
<td>2005</td>
<td>47,121</td>
<td>21980</td>
<td>46.6</td>
<td>73.8</td>
<td>19.2</td>
</tr>
<tr>
<td>2007</td>
<td>52,681.45</td>
<td>233,746.57</td>
<td>44.4</td>
<td>71.2</td>
<td>17.3</td>
</tr>
<tr>
<td>2008</td>
<td>54,091</td>
<td>22729</td>
<td>42</td>
<td>68.8</td>
<td>14.9</td>
</tr>
</tbody>
</table>

Source: Statistical Center of Iran
Table 4-8 Employment and unemployment population, 1956 - 1996

<table>
<thead>
<tr>
<th>Year</th>
<th>Active population (1000)</th>
<th>Employment</th>
<th>Unemployment</th>
<th>Unemployment rate (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1956</td>
<td>6,067</td>
<td>5,908</td>
<td>159</td>
<td>2.6</td>
</tr>
<tr>
<td>1966</td>
<td>7,842</td>
<td>7,116</td>
<td>726</td>
<td>6.3</td>
</tr>
<tr>
<td>1976</td>
<td>9,796</td>
<td>8,799</td>
<td>997</td>
<td>10.2</td>
</tr>
<tr>
<td>1986</td>
<td>12,820</td>
<td>11,002</td>
<td>1,819</td>
<td>14.2</td>
</tr>
<tr>
<td>1991</td>
<td>14,737</td>
<td>13,097</td>
<td>1,640</td>
<td>11.1</td>
</tr>
<tr>
<td>1996</td>
<td>16,027</td>
<td>14,572</td>
<td>1,456</td>
<td>9.1</td>
</tr>
</tbody>
</table>

Source: statistical center of Iran

Dr. A. Valadkhani (2006), examined the major causes of Iran’s unemployment conundrum by using a simultaneous-equation model and annual time series data from 1968 to 2000. Finally he concluded:

“empirical results clearly indicate that the following five factors determine the significant variations in the unemployment rate: inflation, output gap, economic uncertainty associated with an unstable currency, the real growth of investment, and a dummy variable capturing the devastating impact of Iraqi war. It is also declared that there are exists a trade-off between inflation and unemployment for the post-1979 era. However, it should be borne in mind that persistent and soaring inflation can easily lead to the depreciation of the domestic currency, which in turn exacerbates unemployment.”31

4. Inflation Scenario in Economy (WDI, CPI)

The country has been facing the serious problem of inflation. Presently country is going through double digit inflation rate scenario. In 2006 the inflation rate was 15.8 percent however the inflation further increased to 17 percent in 2007. Having 17 percent inflation rate in any country in the world is the matter of serious concern. It requires immediate intervention of the government as well as the central bank of country.

Over the period 1979/80-1988/89 the period after the revolution and before the start of First Plan, money supply (M₂) and the index of retail prices grew by average annual rates of 20.1% and 19.0%, respectively. The smaller rate of increase in the real

money balances (the difference between money supply growth and inflation rate) over this period is largely explained by the negative output growth experienced during the period.

Dr. H. Pesaran by his monetary model for economy of Iran remarks:

"Consequently the same rates of expansion in private and public sectors liquidity are likely to have more inflationary consequences after than before the revolution. In other words, there is a much closer association between growth of money supply and inflation over the post-revolutionary period as compared to that which existed before the revolution. As a result relatively more stringent restrictions on credit expansion are required if the authorities are to succeed in controlling inflation.

The first FYDP for period 1989-1994 was aimed to limit the rate of expansion of the local private sector liquidity (namely, the M$_2$ measure of money supply) to an average annual rate of 9.4%, and the rate of increase of the index of retail prices to an average annual rate of 15.7%. However, according figures revealed by the central bank, money supply (the M$_2$ measure) grew by 25.2%, thus substantially exceeding the plan's target. The M$_1$ measure of money supply grew slightly less at around 23.8%mainly reflecting the move from cash and non-interest bearing deposits to term-investment deposits paying returns of between 7 to 1 per annum. The retail Price Index rose by an average annual rate of 18.7% during the plan, which was much closer to the plan’s target 15.7%.

Dr. Bahmanee by employing monetarist model of inflation investigated the main determinants of inflation in country. By using annual data over the 1959-1990 concluded:

"It was shown that inflation in Iran is not only a monetary phenomenon; it is also a result of the depreciation of the Iranian rial in the black market (now the free market) and of imported inflation. The first major implication of our finding is that, if the Iranian government is to fight inflation, it should not finance budget deficits by printing money. rather, the government should rely
upon fiscal policy such as removing subsidies, raising taxes, increasing the effectiveness of government-owned industries, and making the Iranian central bank independent of the central government, etc. the second implication is that, because inflation is due in part, to depreciation of rial, the Iranian central bank should not allow the rial to depreciate further.”  

Whereas, Dr. Mohammad Ali Moradi, the head of macroeconomic modeling group in management and planning organization in his paper “Nonlinear modeling of inflation in Iran” investigated the main determinants of inflation in Iran over 1959-1996 and has been concluded that:

“inflation in Iran was affected by both domestic factors through excess money supply, and external factors through deviations from PPP. The results do not support the output gap as a proxy for excess demand and the inflation-inertia hypotheses for Iran. This finding suggests the possibility that the government could attempt to control inflation through monetary or exchange rate policies by reducing inflation and maintaining an environment of low inflation and price stability. However, the slow adjustment coefficients imply that monetary or exchange rate policies to control inflation are unlikely to be more effective.”

The inflation rate in 2000, showed a marked change against the previous years and declined to a low of 12.6 percent, while in the 3rd FYDP Law it was forecasted at 19.9 percent in 2000. The fall in inflation rate was due to the positive impact of the increase in foreign exchange revenues on government’s fiscal position and improvement in BOP during 1999-2000, limitation of price increases to no more than 10 percent annually for goods and services provided by public corporations and institutions in accordance with the Third Plan Law, and a decline in inflationary expectations. According to the central bank annual economic reports, the major portion of the rise in the Consumer price index (CPI) i.e. 36 percent was due to an

34 Sometimes calls retail price index
increase in the price index under the heading of “housing, fuel and lighting”, which in turn, was due to the increase in the price index for “housing”. The increase in the price of housing was due to the relatively mild upturn of this sector from recession”.

According to quantitative targets of the 4th FYDP, the average rate of inflation and liquidity growth are set at 9.9 and 20.0 percent, respectively, over the Plan’s period, therefore the inflation rate and liquidity growth for the first year of the Plan are set at 14.6 and 24.0 percent, respectively.

The increasing trend of inflation has been reversed since the beginning of 2003. This rate which was 11.4 and 15.8 percent in 2001 and 2002, with a slight decrease, was limited to 15.6 and 15.2 percent in 2003 and 2004, respectively. This declining trend continued in 2005 to 12.1 percent, showing 3.1 percentage points reduction\(^{15}\). In 2006 the inflation rate was 15.8 percent however the inflation further increased to 17 percent in 2007\(^{36}\). The following diagram gives the clear picture of inflation scenario of based on CPI and WPI indices.

![Figure 4-17 Inflation rate trend (CPI,WPI)](image)

Source: Macroeconomic time-series data base, The central bank of I.R. Iran\(^{37}\)

Whereas given the adverse effects of the inflation on the economy, the key objectives of the government are to reduce inflation rate to a single digit and to maintain price stability. High liquidity growth is largely responsible for pushing

\(^{25}\) Economic Report & balance sheet, the central bank of I.R. Iran-2003/04/05

\(^{36}\) Ibid -2006/07

\(^{37}\) www.cbi.ir
inflation up. Other factors are also responsible for changes in the general price level. Increase in wages and price of production inputs (domestic and imported) are among other factors responsible for cost-push inflation. Changes in the prices of imported goods lead to change in inflation rate as well. This is attributable to the high dependence of various sectors of economy on intermediate goods and imported raw materials. High dependence of government budget on oil revenues, the monetary and fiscal policies oriented toward job-creation, and inflexibility of wages are among structural factors causing inflation.

Despite high liquidity growth, factors such as relatively stable exchange rate, recessionary housing market condition which led to reduction in rentals, decrease in the velocity of circulation of money, surge in imports of consumer goods, decrease in import tariffs of several fruits resulting in the rise of their imports and fall of their prices, in conjunction with benign climatic conditions of recent years which led to rise in the supply of agricultural products, resulted in the deceleration of inflation rate as compared with the previous years.

High inflation rates are the main cause of economic instability. The economy works best when the price level is stable and predictable. If the inflation rate fluctuates unpredictably, money becomes less useful as a measuring rod for conducting transactions. Borrowers, lenders, employers, and workers must take on extra risks.

While Iran’s inflationary environment has worsened due to external circumstances, it is nonetheless mainly a domestic creation. The economic problems are not cyclical but structural and ideological. These inflation levels have been partially associated with government’s efforts to restrain the interest rate.

High levels of inflation have also been associated with a growth in Iran’s money supply. The Central Bank’s data suggest that the money supply growth has been about 40% annually. The rapid growth of money supply came from high demands for borrowing capital at the rate of 12% the banks offer. This rate is lower than the inflation rate, which makes the cost of borrowing less than the free market cost of
borrowing that would have been determined by free market supply and demand based on the inflation rate and risk. In countries that prices or rates (such as the 12% lending rate) are not determined by free market supply and demand, even if the borrowers are destined to use the low rate borrowed funds in production, the effects of lowering inflation because of lower production costs due to lower borrowing costs would be much less if the rates were determined in a free market. This is due to the fact that the allocation of resources in a free banking system would be much more optimally and efficiently done.

5. Export – Import, Trade Surplus/ Deficit, Balance of Payments

The Iran Sanctions Act, in existence since 1996 and until 2006 known as the Iran–Libya Sanctions Act, is a full U.S. trade embargo against Iran, although the embargo was relaxed in 2000 to permit U.S. companies to import Iranian carpets, caviar, and pistachio nuts. Other countries, including members of the European Union, have continued to trade with Iran, but western countries have blocked the export to Iran of dual-use items, such as computer equipment, with potential military applications. In the early 2000s, China emerged as an important trade partner in both imports and exports. Japan retained the position that it assumed in the mid-1990s as Iran's best export customer. In order of volume, the main purchasers of Iran's exports in 2006 were Japan, China, Turkey, Italy, South Korea, and the Netherlands. In order of volume, the main source countries for Iran's imports in 2006 were Germany, China, the United Arab Emirates, France, Italy, South Korea, and Russia. The main commodities imported are basic manufactures, chemicals, food (chiefly rice and wheat), and machinery and transport equipment. The main commodities exported are petroleum, carpets, chemical and petrochemical products, fruit and nuts, iron and steel, natural gas, and copper.

a. Trade Balance:

In 2007 Iran's estimated income from exports was US$76.5 billion (free on board—f.o.b.), 85 percent of which came from petroleum and natural gas. The estimated
Payment for imports in 2007 was US$61.3 billion (f.o.b.), yielding a trade surplus of US$15.2 billion.\textsuperscript{38}

Figure 4-18 time trend of Foreign trade in Iran

\begin{figure}
\centering
\includegraphics[width=\textwidth]{figure.png}
\caption{Time trend of Foreign trade in Iran}
\end{figure}

b. Balance of Payment

In 2007 Iran's current account balance, determined mainly by its merchandise trade surplus and its smaller services trade deficit, was US$19 billion. Its foreign exchange reserves, determined primarily by oil prices, were estimated at US$69.2 billion in 2007. Records on portfolio investment are not available. Foreign direct investment has remained relatively small.

c. Currency and Exchange Rate:

The value of the rial, Iran's unit of currency, declined substantially between 2002 and 2005. In 2002 a multiple exchange rate was replaced by a single floating rate. The average exchange rate per US$1 was 9,227.1 rials in 2006 and 9,407.5 rials in 2007. In mid-May 2008, the exchange rate was approximately 9,255 rials to the U.S. dollar. The tuman, which is worth 10 rials, is the preferred unit of currency in commerce.

\textsuperscript{38} Economic Reports & balance sheet of Central bank of I.R.Iran
6. Millennium Development Goals

The millennium Development Goals (MDG’s) represent a global partnership that has grown from the comments and targets established at the world summits of the 1990’s. Responding to the world’s main development challenges and to the calls of civil society, the MDG’s promote poverty reduction, education, maternal health, gender equality, and aims at combating child mortality, AIDS and other diseases, environmental sustainability and global partnership. Set for the year 2015, the MDG’s are an agreed set of goals that can be achieved if all actors work together and do their part. Poor countries have pledged to govern better and to invest in their people through health care and education. Rich countries have pledged to support poor countries though aid, debt relief and fairer trade. According to the country’s last MDG report in 2005, MDG progress in I.R. Iran reveals that:

**Goal 1: (Eradicate Poverty and Hunger):** The percentage of the population with an income of under $1 (PPP) per day has fallen sharply to 0.62 percent in 2002 from 2.24 in 1995. More than 6 percent of the population remained in a situation of extreme poverty in 2002, creating a challenge for poverty alleviation. Even so, a more important challenge concerning poverty in I.R. Iran is to reduce the food poverty line, known as national poverty line. According to the latest data, the food poverty line has significantly decreased from 12.75 percent in 1995 to 8.99 in 2002.

**Goal 2: (Achieving Universal Primary Education):** The net enrolment ratio expressed as the ratio of children in the 6-10 age group enrolled in primary schools to the total population of official school-age children steadily rose to 97 percent in 2002 from 85 in 1999. In addition, the literacy rate for the 15-24 age group for both sexes has progressively enhanced. The rate for men has risen from 92.2 percent to 97.6, while that of women soared from 81.1 percent to 94.7 (1990-2002).

**Goal 3: (Promote gender equality):** The ratio of female students in primary, secondary and tertiary education rose remarkably to 93.1 percent in 2002 from 79.2 in 1990, and the ratio of women to men in tertiary education has shot up to 110.5 percent in 2002 from 37.4 in 1990. Furthermore, the ratio of literate women to men in the 15-24 age group has increased by 9.1 percent, rising from 87.9 in 1990 to 97 in 2002.
Goal 4: (Reduce Child Mortality), the country has made remarkable progress in decreasing child mortality rate from 68 in 1000 live births in 1990 to 36 in 2000. In addition, substantial progress in relation to the infant mortality rate, decreasing the rate by over 54 percent, from 52.5 in 1000 live birth in 1990 to 28.6 in 1000 in 2000 all of above indices indicating the improved situation in health care. 

Goal 5: (Improving Maternal Health in the Context of Reproductive health), the maternal mortality ratio per 100,000 live births has dropped sharply to 37.4 deaths in 1997 from 91 in 1989 in I.R.Iran. Likewise, the proportion of births assisted by skilled attendants has increased from 70 percent in 1989 to about 90 in 2000. Five major reasons directly affecting the shrinkage in maternal mortality include a decreased fertility rate, an increase in late marriages and childbirths, improved rural women’s literacy, better access to emergency health (especially obstetric) services and broadened provision of maternal and childbirth care due to expanded health networks and centers.

Goal 6: (Combat HIV/ AIDs, Malaria and other Diseases): While prevalence of HIV/ AIDs among 15-24 year old pregnant women reported cases was zero in 2003, the prevalence of the condom use rate by married women (15-49) was 9.3 percent in urban and 5.4 in rural areas in 2000. The total number of registered HIV/AIDS infected cases was calculated as 7,510 late September 2004, of which 95.1 percent were men. I.R.Iran is among those countries of the region showing low/moderate malaria endemicity.

Goal 7: (Ensure Environmental Sustainability): The ratio of the area protected for maintaining biological diversity to total surface area of the country has jumped to 7.11 percent in 2002 from 4.58 in 1997, energy use (kilogram oil equivalent) per $1 GDP (PPP) has increased slightly from 0.309 kilogram in 1990 to 0.338 in 2001. Carbon dioxide emissions per capita have jumped up to 4,681 kg in 2001 from 4,002 in 1996. Similarly, consumption of ozone-depleting CFCs has increased from 4,500 tons in 1995 to about 6,179 in 2001. The proportion of the population with sustainable access to an improved water source has increased slowly from 89.9 percent in 1990 up to 93 in 2000.
Goal 8: (Develop a Global Partnership for development): Number of telephone lines has soared from 4.04 per 100 population in 1990 to 23.2 in 2002, similarly number of personal computers per 100 population has more than doubled from 1.96 in 2000 to 4.80 in 2002. The number of internet uses per 100 population was 8.3 persons in 2003.

As noted earlier, goal 8 is seeking ways of facilitating development cooperation in order to provide better access to the other seven goals. Accordingly, the major challenges faced can be categorized as follow: (1) Institutionalizing international development cooperation in order to meet the Millennium Development Goals. (2) Placing an emphasis on knowledge-based assistance in the international development cooperation mentioned above. In response to these challenges, there are two major national priorities for international development cooperation. These are as follow: (1) Granting assistance to the MDG Focal Point in order to institutionalize the international development assistance for achieving the MDGs, and setting up an information system for Official Development Assistance (ODA). (2) Discovering new methods for transferring knowledge-based development assistance in order to realize the MDGs in I.R.Iran. Following the guidelines and goals of MDGs the country’s senior decision-makers & law- makers started to adopt the long-term and mid-term development planning a FYDPs to implement the government commitment on this regard.

7. The Planning and Development

a. Five Year Development Planning

When Iran emerged from the 8-year war with Iraq in 1988 with a highly centralized economy, then initiated an ambitious reconstruction program of Five-Year Economic, Social, and Cultural Development Plans (FYDPs).

According to a report by a UN team published 24 December 1991, assessing war damage in Iran, the total cost of upstream reconstruction would amount to IR 795 500 million and $18 999 million. This includes the cost of current and future reconstruction.

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40 Five Year Development Plans
The macroeconomic situation during the post revolution period of 1979–88 was mainly determined by the second oil shock of 1979 and its 8-year war with Iraq. The government adopted direct administrative policies to deal with the exigencies of war. Such policies included “import substitution”, “strict foreign-exchange control”, an “industrial policy supported by explicit and implicit subsidies”, and “direct allocation of bank credits” (primarily to the public sector).

1989-93: First Five-Year Development Plan

After the end of the war with Iraq in 1988, Iran initiated an ambitious reconstruction program to deal with the highly centralized economy created during the war. The First Five-Year Economic, Social, and Cultural Development Plan (FYDP) focused on the development of infrastructure and the marketization of the economy. In the last year of the plan (1993), the central bank unified the exchange rate, but then a significant drop in oil prices weakened the external payments position and created a growing stock of external payment arrears. The system of multiple exchange rates was re-instituted. Nevertheless, the first FYDP was marked by real GDP growth at an average annual rate of 7.5 percent, with considerable improvement in social indicators.

The high growth achieved during the first half of the plan largely reflected the initial effects of trade and foreign exchange liberalization and the utilization of used capacity in the economy, and was accompanied by an unprecedented surge in private consumption expenditures.

The huge increase in real private consumption expenditure during the years immediately following the Iran-Iraq war can be explained, at least partly, in relation to the pent up demand created over the war years. However, the government failure to moderate the rate of consumption growth during 1990/92 played a significant role in bringing about the exchange rate crisis that in fact followed41.

1995-99: Second Five-Year Development Plan

The Second FYDP focused on the promotion of non-oil exports to lower Iran’s dependence on oil. The period of the second FYDP was characterized largely by low economic growth and macroeconomic instability, mainly because of low oil prices in 1997-99. The government responded by increasing direct control of economic activities. A significant success of this period was in regulating and managing the external debt arrears, which were largely amortized by mid-1999.

2000-2004: Third Five-Year Development Plan

The Third FYDP sought to restore market-based prices, reduce the size of the public sector, and encourage private sector investment. The main objective of the plan was the following:

- Liquidate, privatize, merge, and restructure Iran’s state-owned enterprises
- Raise the efficiency of the tax system and eliminate organizational bottlenecks
- Establish the Oil Stabilization Fund to cushion the economy and the government budget against fluctuations in oil proceeds
- Adjust certain regulations to promote foreign trade
- Introduce flexibility into the banking industry

On the positive side, Iran experienced growth of capital formation, improvement of the balance of payment, and reduction of the unemployment rate. On the negative side, the economy suffered from high liquidity growth, a high inflation rate, a large government sector, and unsuccessful privatization of SOEs. It should be noted that during the third FYDP, Iran’s international relations were rendered unstable by the U.S. occupation of Iraq and the resulting internal war in Iraq and by issues related to Iran’s nuclear energy industry.

Table 4-9 Trends of macroeconomic indices During 3rd Five-Year Development Plan

<table>
<thead>
<tr>
<th>Third FYDP</th>
<th>Target</th>
<th>2000/01</th>
<th>2001/02</th>
<th>2002/03</th>
<th>2003/04</th>
<th>2004/005</th>
<th>average growth(%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP</td>
<td>6.0</td>
<td>5.0</td>
<td>3.3</td>
<td>7.5</td>
<td>6.7</td>
<td>4.8</td>
<td>5.5</td>
</tr>
<tr>
<td>Oil</td>
<td>---</td>
<td>8.3</td>
<td>-11.1</td>
<td>3.6</td>
<td>12.9</td>
<td>2.6</td>
<td>3.3</td>
</tr>
<tr>
<td>Agriculture</td>
<td>---</td>
<td>3.5</td>
<td>-2.3</td>
<td>11.4</td>
<td>7.1</td>
<td>2.2</td>
<td>4.4</td>
</tr>
<tr>
<td>Mining</td>
<td>---</td>
<td>9.5</td>
<td>10.2</td>
<td>12.3</td>
<td>7.4</td>
<td>8.1</td>
<td>9.5</td>
</tr>
<tr>
<td>Unemployment rate</td>
<td>---</td>
<td>2.9</td>
<td>5.7</td>
<td>5.5</td>
<td>5.1</td>
<td>4.8</td>
<td>4.8</td>
</tr>
</tbody>
</table>

Source: Economic Reports & Balance Sheets, the central bank of I.R. Iran
In a different way from the previous plans, Iran’s 3rd development plan (2000-2004) aimed for structural reforms in Iran’s economy. Partial privatization of financial markets, balanced government budget, foreign exchange reserve fund/account (to stabilize the economy from oil price fluctuations), unification of exchange rate, and movement from fixed to managed float exchange rate system, revision of direct tax law to lower tax rates and indirect levies integration, revising foreign investment protection and inducement law, abolition of export surrender requirement, removing some non-tariff foreign trade barriers and changing the government budget booking to GFS standards, strengthening the capital market (Tehran Stock Exchange), expansion of financial sector, taking some steps in privatization of government's companies are the main reforms of the 3rd development plan. However, high oil price put the economy in a stable and surplus position of income receipts.

The economic performance and macroeconomic policies during the third FYDP are reviewed below: During the third FYDP, the economy grew at an average annual rate of 5.5 percent, which was lower than the plan’s target rate of 6 percent. The growth rate was around 7 percent in the middle years of the plan, but it slowed to 4.8 percent in 2004. The industries and mining sector had the highest average annual growth rate (9.5 percent). The high rate of growth in this sector can be attributed to the adequacy of foreign exchange to the manufacturing sector because of high foreign-exchange revenue, adoption of foreign-exchange deregulation, and the sector’s access to credit from the banking system. The average gross fixed-capital formation was around 9.3 percent, which exceeded the plan’s target of 7.1 percent. Growth of fixed capital formation was 16.4 percent in 2001, but after that year it slowed down, reaching 6.4 percent in 2004. Another achievement was the reduction of unemployment rate, which fell from 13.5 percent at the end of the second FYDP to 10.3 percent in the third quarter of 2004. External sector (balance of Payment) data, shows that Iran’s non-oil exports grew significantly in each year of the plan. This outcome was a result of implementing broad-based deregulation of foreign trade, converting non-tariff barriers to tariff barriers, increasing domestic financing of foreign trade, and giving non-oil exporters more freedom to manage their foreign-exchange proceeds. Combining this with the high earnings of gas and oil exports and
the improvement in the capital accounts balance, the overall balance enjoyed a significant surplus during the whole period of Third FYDP. In last year (2004/2005), the balance of payments surplus reached US$8.282 billion. Iran's external debt was US$15.7 billion at the end of February 2005, with 58 percent of the debt being related to short-term debts.42

Government sector and budget performance: Revenue from crude oil exports constituted a major part of government revenue. During the Third FYDP, the Oil Stabilization Fund was created to ensure the sustainability and preservation of national wealth. Since its inception, the Oil Stabilization Fund has received around US$29.1 billion from oil revenue and about US$ 1.2 billion from other sources. About US$16.7 billion has been used for budget purposes and around US$4 billion has been allocated to private sector investors as facilities.

Monetary Sector: Monetary policy was aimed at curbing inflation while providing for the financial requirements of the economic sectors. At the beginning of the third FYDP, the central bank introduced Central Bank Participation Papers (CBPP) as a monetary policy instrument to absorb excess liquidity. Iran's monetary base experienced a high average growth rate (16.4%) during the third FYDP, mainly because of a significant increase in the central bank’s net foreign assets, which was a result of a continuous surplus in the overall balance of payments account in the Third FYDP period. Liquidity grew by an annual average rate of 28.9 percent, which exceeded the plan’s target (16.4%). Facilities extended by banks and non-bank credit institutions to the non-public sector grew by an annual average rate of 35.9 percent, which is the main reason behind the high growth of liquidity. In the last year of the plan (which ended in March 2005), the authorities' monetary program was aimed at containing liquidity growth within a range of 20-24 percent, but liquidity actually grew 30.2 percent.43

43 In this period the average annual growth rate of net claims of banking system on the public sector was 8.9 percent.
2005-2009: Fourth Five Year Development Plan

The Fourth FYDP is a continuation of the Third FYDP in objectives, policies, and perspectives, and is designed to meet the ongoing challenges facing Iran. In the Fourth FYDP there is special emphasis on the following issues:

- A more open economy based on competitiveness
- Privatization and a smaller role for the government in the economy
- More autonomy for the central bank in monetary policy design and implementation
- Greater independence for the national Iranian Oil Company (based on a royalty scheme)
- Implementation of a clear legal framework for foreign investment in Iran
- Achievement of an annual growth rate of 8 percent, with 2.5 percentage points from growth in total factor productivity

The privatization program in the Fourth FYDP is likely to be more successful than the one in the Third FYDP because there is a new interpretation (likewise modification by expediency council) of Article 44 of the Constitution. This new reading of Article 44 will likely pave the way for the privatization of state industries such as banking, insurance, and aviation.

The prospects for the Iranian economy are promising. The commitment of the government to fulfill the broad-based reform package in the Fourth FYDP will create conditions more favorable for economic growth. As the world becomes increasingly integrated both economically and financially, economic progress in any single country is not only in that country’s national interest, but also in the collective international interest. This is why it is important that the forces working for reform and liberalization should be engaged constructively. Iran has embarked upon an ambitious program of reform and liberalization, and the country will take advantage of economic globalization to advance its program.

Major Challenges ahead

The main challenges Iran faces are the following:

- A double-digit inflation rate.

• Low productivity growth.
• High dependency of state revenue on oil revenue.
• High unemployment.
• A government sector that is too large.
• Low share of non-oil exports in total exports, even though this share has grown in recent years.
• Unstable political situation in the region, and somewhat difficult international relations because of issues related to Iran's nuclear energy industry.
• High rate of liquidity growth caused by increases in the foreign reserves of the central bank as a result of increased oil exports and weak sterilization policy.