CHAPTER IV

MISSED OPPORTUNITIES AND THE EMERGING CRISIS
INTRODUCTION

The period on the eve of the fifth plan in Iran was characterised by an accelerated private expenditure and a more rapid growth in government consumption. These were the cumulative effect of the growth process during the third and fourth plans. This growth process also had its impact on investment in the economy. These trends are indicated in Table 1 which is based on data from Bank Markazi's reports for various years. Average annual growth in private expenditure which stood at 5.8% during 1959-63 period rose to 11.3% per annum between 1963-72. Similarly, government consumption expenditure rose by about 15% from 7.2% to 22.6% during the respective periods. Annual average growth in government investment during 1959-63 period was -0.5% which rose to 24.2% annually between 1963-72. Private investment growth averaged annually -0.6% during 1959-63 but moved to an annual figure of 18.6% between 1963-72. While thus both private and government investments rose considerably during the period 1963-72, Robert Looney, based on incremental capital output ratio measures (ICORs) shows that in the early 1960s relatively high ICORs were observed as a result of excess capacity that existed due to government's stabilisation programme; again ICORs declined until the late 1960s and began to increase during the 1970s. Robert Looney suggested that in the late 1960s and early 1970s increase in
Table 1: Patterns of consumption and investment 1959-72
(in percent)

<table>
<thead>
<tr>
<th></th>
<th>Average Annual Growth</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1959-63</td>
</tr>
<tr>
<td>Private consumption (current price)</td>
<td>5.8</td>
</tr>
<tr>
<td>Government consumption (current price)</td>
<td>7.2</td>
</tr>
<tr>
<td>Total private investment (current price)</td>
<td>-0.6</td>
</tr>
<tr>
<td>Total Government Investment (current price)</td>
<td>-0.5</td>
</tr>
</tbody>
</table>


the quantity of factors of production generated a smaller output increase. As most production units tended to use additional variable factors with fixed factors even beyond the optimal level since such fixed factors were in scarce supply, input costs rose while productivity declined. Finally, the author shows how results of 1959-77 study of ICORs indicated that government expenditure had a strong negative impact on the productivity of capital in the economy, no positive economies or positive linkages being created during the period by government expenditure. Additionally, there was a strong positive indication of the ratio of government to private expenditure, the implication of which was the government's bidding away of productive resources which otherwise would have entered private channel.
Robert Looney's attempts to study ICOR showed that certain variables employed such as growth of real nonoil GDP, growth of real domestic product, growth of aggregate income etc., would all be greater when capital employed would be more and more productive. But the final picture that emerged indicated that the impact of capital employed between 1959 and 1977 on these variables was negative. Similarly, variables such as the ratio of total real government to total real private expenditure, the level and growth of real government expenditure, etc., were also employed; the exercise for ICOR in this direction showed that ratio of government to private expenditure was positive indicating shift of resources from the productive private sector and the positive sign which was associated with total investment indicated diminishing returns to investment (see Looney Robert, 1982, p. 136).

While these observations are intended to help us to know the direction in which the economy was moving at the end of four plans, they enable us to have a better perspective of the operation of the fifth plan was that designed to run from March 1973 to March 1978.

The fifth plan:

On October 27, 1976, about three and half years after the fifth plan was launched, the Shah of Iran, in an interview with Kayhan said that if the government continued to increase its investments in the economic affairs of the state "all Iranians would perish". In so saying the Shah had
not only openly made an admission of the wrong policies that were pursued by the government, but in fact drew the attention of the people to the gravity of the situation.

The fifth plan began on March 21, 1973. But the plan had to be revised because in the last quarter of 1973, oil prices quadrupled and the original plan had lost its relevance as the Shah intended to immediately put additional funds into development channel and expenditure stream of the economy. There was a dramatic increase in the revenues of the country because on December 23, 1973, market price of crude oil rose to $8.73 per barrel as against a price of $2.70 just three months earlier. This huge rise in 1973 oil revenues as also that in 1974 was to have its implications in respect of domestic spending and allocation of resources, balance of payments, etc. As table 2 indicates, there was a near doubling of total development expenditure. The original plan had a total outlay of 2486.7 billion rials which rose to 4697.5 billion rials under the revised plan submitted to the parliament in the winter of 1974. The original plan had its own distinct characteristics as against its predecessors not only in respect of its size but in the inclusion, for the first time, of Iran's military and defence expenditure. Of the total outlay of 2486.7 billion rials under the original plan, 1548.7 billion rials was under the public sector while the private sector accounted for 912.4 billion rials. The basic objectives of the plan as set forth in the
Table 2: Fixed investment by sector, 1973-77, original and revised fifth plan

<table>
<thead>
<tr>
<th>Sectors</th>
<th>Original</th>
<th>Share %</th>
<th>Revised</th>
<th>Share %</th>
<th>Revised as % original</th>
</tr>
</thead>
<tbody>
<tr>
<td>Industry &amp; mines</td>
<td>552.2</td>
<td>22.2</td>
<td>845.8</td>
<td>18.0</td>
<td>153.2</td>
</tr>
<tr>
<td>Agriculture</td>
<td>180.2</td>
<td>7.2</td>
<td>309.2</td>
<td>6.6</td>
<td>171.5</td>
</tr>
<tr>
<td>Transport</td>
<td>188.3</td>
<td>7.6</td>
<td>492.1</td>
<td>10.5</td>
<td>261.3</td>
</tr>
<tr>
<td>Housing</td>
<td>402.3</td>
<td>16.2</td>
<td>924.8</td>
<td>19.7</td>
<td>229.9</td>
</tr>
<tr>
<td>Oil &amp; gas</td>
<td>461.0</td>
<td>18.5</td>
<td>791.1</td>
<td>16.8</td>
<td>171.6</td>
</tr>
<tr>
<td>Others</td>
<td>702.7</td>
<td>28.3</td>
<td>1,334.5</td>
<td>28.4</td>
<td>189.9</td>
</tr>
<tr>
<td>Total</td>
<td>2,486.7</td>
<td>100.0</td>
<td>4,697.5</td>
<td>100.0</td>
<td>189.9</td>
</tr>
</tbody>
</table>


Original Fifth Plan Document in order of priority were as follow (Fifth Plan, 1973).

a. To raise levels of knowledge, culture, health and social welfare to the greatest extent possible.

b. To ensure a more equitable distribution of national income emphasising in particular - a rapid rise in standards of living and welfare among low income groups.

c. To maintain a rapid and sustained rate of economic growth accompanied by relative price stability and a healthy balance of payments.
d. To ensure productive employment in all regions of the country so as to absorb all new entrants to the labour market and achieve a considerable decrease in disguised and seasonal unemployment.

e. To create greater social and economic balance between the various regions of the country.

f. To utilise fully the productive capacity established in previous development plans and raise productivity in the manufacturing marketing and service activities of both the public and the private sector.

g. To raise Iran's share in international market, improve general administration and natural environment.

The fifth plan envisaged that gross national product would rise at an average annual rate of 15.3% from about 1149 billion rials at the end of the fourth plan to about 2345 billion rials at the end of the fifth plan. GNP per capita was expected to rise from 36,800 rials to 65,100 rials during the plan. GDP was expected to rise at an annual average rate of 11.4%. Foreign exchange earnings on current account were expected to be $30.7 billion, two and half times that during the previous plan. Of this $24.6 billion or 80% was to flow from the oil sector under the original plan, nearly 50% of the total public sector allocation of 1548.7 billion rials was to be earmarked for agriculture and social sectors. Thus, compared to the previous plan, this
plan granted explicit priority to improvement of low income classes. However, about half the total planned allocation was to go into infrastructure development thus assigning it the highest priority.

Radical change in oil price, however made this original version of the fifth plan obsolete. The qualitative objectives remained almost the same under the revised plan as earlier. Of the total projected expenditure of 4697.5 billion rials, 3118.6 billion rials was allocated to the public sector and 1580.3 billion rials to the private sector (Planned Budget Organization, Revised Fifth Plan). Those industries of strategic importance like oil, natural gas and petrochemicals had been accorded highest priority. Under infrastructure, ports and communications were assigned priority.

Having noted that allocations were almost doubled in respect of the fifth plan, on account of this revision we take up a critical examination of the plan's achievements; it would be worthwhile to start with an aggregate picture.

The rate of growth in GNP from 1231.5 billion rials in 1972 to 5342.6 billion rials in 1977 indicated that Iran was one of the fastest growing countries in the world. In other words, GNP rose from an annual average of 14.6% during 1963-72 to 30.7% annually during 1973-77. Rising oil revenues had the effect of reducing the share of non-oil GDP in gross national product from 70% in 1973 to 66% in 1977.
By 1976, the rural sector that accounted for 56.0% of total population was contributing 9.6% to the country's GNP. The urban sector, on the other hand, with 44% of population produced 53.6% of the GNP, the petroleum sector separately, accounting for 37.0% of the GNP, although with an insignificant proportion of the labour force. Both private and government expenditure registered increase during 1973-77. While the former rose from 11.3% to 25.2% between 1973-77, the latter rose from 22.6% to 34.8% during the period. Government investment which stood at 143.4 billion rials in 1972 rose to 1055.1 billion rials in 1977. Its ratio to GNP was 14.5% during 1977. With the same ratio of 14.5% to GNP, private investment rose to 776.8 billion rials by 1977 from 144.0 billion rials in 1972. It is noteworthy that the ratio of private to public investment that stood at 1.00 in 1972 declined to 0.74 in 1977. More significantly, the ratio of machinery to construction investment that stood at 0.65 in 1972, fell to 0.54 by 1977. Rate of growth of exports which at current prices stood at 16.2% during 1963-72 actually declined to 12.0% during 1973-77. Whereas imports which registered a rate of growth of 7.8% during 1963-72 rose to 9.4% during 1973-77. The rate of growth of intermediate and capital goods that stood at 1.3 and 2.3% during 1963-72 period actually declined to -1.3% and -3.0% respectively during the 1973-77 period. Meanwhile the share of consumer goods imports in GNP which was 2% in 1967 registered a marginal increase and stood at 2.5% in 1973.
The ratio, however, rose to 4% in 1977 (Looney Robert, p. 65-67, 1982).

Agriculture under the plan:

More revealing would be an analysis of the sectoral pattern of growth during the fifth plan period. As Table 3 indicates, agriculture/GNP ratio which stood at an annual average rate of -5.5% during 1963-72 further declined to an average of -8.2% per annum during 1973-77. At the same time, manufacturing/GNP ratio which averaged annually at 1.1% during 1963-72 also declined by -1.6% per annum between 1973-77. Construction, on the other hand, moved from 15.8% per annum during 1963-72 to 58.2% per annum during 1973-77.

Table 3: Sectoral Patterns of Growth, 1963-77 (percentage)

(billions of rials)

<table>
<thead>
<tr>
<th></th>
<th>Average Annual Growth</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1963-72</td>
</tr>
<tr>
<td>Construction (current price)</td>
<td>15.8</td>
</tr>
<tr>
<td>Agriculture/GNP</td>
<td>-5.5</td>
</tr>
<tr>
<td>Manufacturing/GNP</td>
<td>1.1</td>
</tr>
</tbody>
</table>

SOURCE: Computed on the basis of data from Robert Looney.

Apart from these statistical indicators a deeper insight into the growth pattern may now be attempted. This, in effect is an extension of what we have already seen in
respect of productivity, etc. in an earlier discussion as regards the primary sector. In doing this, we rely on studies made during the fifth plan period.

A 1977 study indicated that large farm units with 100 hectares and above made up about 2% of total land and produced 6% of agricultural output (Business International, "Operating in Iran", 1977, quoted by Robert Looney). Medium size units of 10 to 100 hectares comprised less than 50% of the land but produced three fourth of the output (Looney, 1982, p. 53).

The study cited above shows that while cooperatives were handicapped with inadequate funds, ill trained staff and absence of market incentives and when the large farms failed to achieve a breakthrough in farm production, it was largely this flourishing segment of medium to large size farmers with 400,000 holdings who had improved by the mid 1970s. They were largely producing for an expanding market in the country. Several of them with assured water supply, showed positive response to increasing demand for foodstuffs by adopting new techniques of production. On the other hand, the agribusiness, of which four major ones covered a total area of 68,000 hectares in Khuzestan province were accorded preferential treatment. About 18% of total government disbursement to agriculture went to agribusinesses during 1968-76. On the other hand, the share of cooperatives and farm corporations, that accounted for 90% of rural
households, witnessed a declining share from 16 to 9% in 1973 and 1974 reaching 8% by 1978. They were owned by foreign agencies and enjoyed assured water supply, subsidies, etc. They were also to act as a catalyst for modernisation in rural areas and as a source of employment and output generation. But agribusiness scheme had to be abandoned in 1976 on the ground that they were unsuited to local conditions, and were costly and complex.

Farm corporations again were very large units that arose out of an amalgamation of small units. Small landholders were expected to give up their right to cultivate their land in lieu of shares allotted to them in the corporation. Further, they were to work as wage labourers and were also eligible to have a share in profits. By 1976, about 90 farm corporations existed with a total membership of 33,663 (which was about 1% of all rural households). These corporations existed in districts with good soil and water supply. Even though they were supposed to employ owners as labourers, in reality, as many of them tended to adopt modern techniques, they were instrumental in creating unemployment in the first instances and for reasons already seen (Chapter III, p. ) those corporations had very little profit to distribute among shareholders.

The process of land reforms came to an end by 1974. Two groups of people were not in any way affected by land reforms - one group was that of landlords who remained large
farmers as they lost very little due to various saving clauses under the reform law the second group being those who did not gain anything from the law. However, by 1974, about 8.6 million hectares had been distributed among 3.6 million farmers. Out of this about 150,000 hectares was under 320 large agribusinesses, farm corporations, government projects, production cooperatives and large farmers. There were about 1 million small farmers and around 800,000 landless people. The middle order farming units numbered 645,000 or 18% of production units. They accounted for 58% of all irrigated land and 52% of cultivated land in Iran. Between 1968 and 76 agribusiness received about 18% of loans disbursements to agriculture. But farm cooperatives and farm corporations that accounted for 90% of peasant households had a continuously declining share with 16% in 1973, 9% in 1974 and 8% in 1978 (Looney, 1982, p. 55).

**Industrial development during the fifth plan:**

On the industrial front, the contribution of the sector to GDP, which was 20.1% in 1972, slightly declined and was 17.3% by 1975. The total number of industries which was 112,000 in 1966 rose to 235,000 in 1976; the number of major factories rose from 3,500 in 1966 to 6,200 in 1976 (Amuzegar, 1977, p. 78-79). The total value added in mining and manufacturing which grew at 12.7% over the 1962-72 period registered a 17% growth rate over the 1972-76 period. The fastest growing industries were chemicals and
petrochemicals followed by machinery, vehicles and basic metals. The manufacturing sector registered good progress during the fifth plan period. Thus, automobile industry which was engaged till 1972 only in assembling began thereafter production of a variety of vehicles such as station wagons, vans, etc. By 1978, besides Iran Jeep, which was the first company to enter the field of automobiles, there were about five more important ones. Even though this industry had gradually expanded by the mid 1970s, it was able to meet only about 2/3 of the demand for cars and two wheelers.

Ten cement factories were operating in Iran by 1973. There was a rapid rise in demand for cement during the period which the domestic units were not able to cope with. Imports were therefore necessitated and by 1977-78 cement imports reached 3.4 million tonnes from a mere 100,000 tonnes per annum during the fourth plan.

Textile industry that accounted for the largest number of employed people i.e., about 290,000 persons in 1975-76 underwent a process of expansion and modernisation during the period. The result was a rise in import of textile machinery from $108 million in 1974 to $212 million in 1975. Between 1973-75, imports of machinery and equipment grew by about 46% per annum.

While Iran's requirements of steel by 1972 were of the order of 1938 thousand tonnes, domestic production stood
at just 484,000 tonnes. While domestic demand by 1977 rose to 5253.7 thousand tonnes, the country was able to produce 1,306,000 tonnes. Iran took to steel production only by 1966. The first integrated steel mill which was established in Esfahan in collaboration with U.S.S.R. could not begin production by 1972 due to many problems and even by 1976 the target of 6,00,000 tones could not be reached due to not only technical problems but also to unsuitability of locally available raw material.

It must be said that notwithstanding these statistical aggregates in respect of these and other industries, on an average, Iranian industries were working at about 60% of their capacity by 1977. Industrywise breakup shows that textiles utilised 61%; 51% of capacity was utilised in the car industry while it was about 32% in respect of two wheelers and 46% in brick making. However, cement and sugar industries utilised about 90% of capacity (Graham, 1979, p. 120). As well shall see in the following paragraphs, inadequate infrastructure facilities, shortage of building materials like cement, etc., contributed to underutilisation of capacity.

The fifth plan that began in 1973 was to end in 1977. The rate of growth of the economy was more rapid under the fifth plan compared to that during the fourth plan. Not only were many new projects initiated at that time but large investments made in economic activities especially in the
industrial and construction sectors resulted in a growth rate of 17.2% over the period. Many existing activities saw a two or even three fold increase in expenditure. Iran also witnessed major defence purchases such as nuclear power reactors, sophisticated and technologically advanced type of weaponry, arms, etc., largely from the United States and the U.K. During 1974-76, the country participated in equity investments in many developed countries and extended aid facilities to many less developed nations in Africa and Asia. As Robert Looney observes, in less than two years after the 1973-74 oil boom, Iran had spent, invested or loaned most of its excess oil revenues. And the major question, as the author put it, was not any more whether Iran could spend or absorb its new found wealth but "how to do so efficiently". This was because many of the policy makers expressed the view that Iran was quickly being pushed into a situation where the public sector and banks were compelled to borrow short term funds in the international market. Even by mid 1975, there were signs of a deficit in the 1975-76 budget. Foreign reserves that rose by about 800% stabilised at $9 billion contrary to expectations of continuous rise beyond $20 billion at the end of 1974 (Looney, 1982, p. 99).

The following analysis of the course of events that led to an early termination of the fifth plan is based extensively on an analytical discussion by Robert Looney of several important developments that took place in Iran during the post-1973 period.
Inflation And Government Reaction:

Throughout the 1960s, Iran enjoyed a large measure of economic stability. But from 1972, the country was under inflationary pressure. The average annual increase in consumer prices over the fourth plan period, stood between and 6%. Over the fifth plan period, however, the rate was in excess of 10%, it being as much as 27% in the year 1977. The situation indicated that supply of complementary factors such as human skills, infrastructure, raw materials, etc., failed to move in step with increased financial resources of the country. Higher inflationary pressures built up as a result of uncontrolled pumping in of money beyond the absorptive capacity of the economy. Not only was it true that Iran was trying to do "too much in too short a time" as observed by Firouz Vakil (1977, p. 722) but the problem of inflation was reinforced by international transmission of inflationary trend during 1973-74. At any rate, studies relating to the overall pattern of domestic inflation suggest that 75% of such inflation was due to internal factors which is true of Iran also. Apart from a doubling of investments for the remaining plan period when the fifth plan was revised in 1974 where social welfare and subsidies were allocated heavy outlays, the government's expenditure for 1974 was there times as much as it was in 1973. However, out of a total budget of 1,254 billion rials for 1974, just 28% went towards fixed capital formation, 58% went into current expenditure directly while the remaining 14% that
was spent towards other kinds of payments effectively added to current expenditure.

The initial transformation of unprecedented oil revenue flow was an expansion in liquidity. This resulted in increased demand for goods and services that escalated into demand for primary and intermediate goods. Producers quickly responded by working at full capacity while traders did so by shipping in more imports to balance demand with supply.

The housing and construction sector was the first one where inflationary pressure showed up. Rapid increase in demand for urban housing aided by rural migration quickly transmitted inflationary pressure to other sectors. There was a steep rise in demand for construction materials, land price went up on an unprecedented scale and construction labour that was in great demand earned very high wages. Bottlenecks began to develop when there was a cascading effect of this initial inflationary trend in construction over the other sectors. Sufficient time elapsed before financial spending was transformed into availability or supply of goods and services in different sectors. It was also a fact that many projects on which the entire amount allocated were spent remained incomplete. Additionally, imports ordered failed to reach the market in time.

Apart from the intersectoral implications that these inflationary pressures had, in terms of intertemporal dimensions, they meant loss of real resources. In other
words, the economy dissipated oil resources in the form of higher domestic product and factor prices at a time when its absorptive capacity was very limited while the same resources could otherwise have been put to more efficient use in future when constraints on absorptive capacity would have been reduced.

During the fifth plan period, returns on investments were quickly eroded as continuously rising application of financial resources tended to go with not only shortage in the supply of complementary factors but because funds that went initially into more productive uses tended later to move into marginal projects where inferior technologies were resorted to resulting in inefficiency. Simultaneously, while labour costs rose three or even four times, as reported by the Industrial and Mining Development Bank in its 1976-77 report, per worker production rose only by 10%. The report noted that labour cost increases estimated on a conservative basis indicated an upward trend of about 30% which played a significant role in domestic price rise.

Improper Investment Planning:

It is significant to note that between 1974 and 1977, Iranian economy witnessed rise in real investments in the public sector. Government investment in machinery as Table 4 indicates, rose at the rate of 38.7, 11.8, 33.8 and 16.5% for the years 1974, 1975, 1976 and 1977. This was coupled with similar rise in public sector construction
Table 4: Growth in Investment

(Constant Prices)

<table>
<thead>
<tr>
<th>Year</th>
<th>Private Sector</th>
<th>Government Investment</th>
<th>Total Investment</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Machinery</td>
<td>Construction</td>
<td>Total</td>
</tr>
<tr>
<td>1974</td>
<td>13.3</td>
<td>20.1</td>
<td>16.7</td>
</tr>
<tr>
<td>1975</td>
<td>63.4</td>
<td>35.7</td>
<td>53.4</td>
</tr>
<tr>
<td>1976</td>
<td>-1.7</td>
<td>32.6</td>
<td>14.2</td>
</tr>
<tr>
<td>1977</td>
<td>-17.9</td>
<td>14.9</td>
<td>0.0</td>
</tr>
</tbody>
</table>

SOURCE: Computed from Bank Markazi, Iran, Annual Report, various issues.
investment which stood at 25.2, 40.1, 24.8 and 9.0\% during the respective years. Normally, this should have induced investment in the private sector as well. However, real private investment in machinery declined from 63.4\% in 1975 to -1.7\% in 1976 and -17.9\% in 1977. At the same time, the sector's investment in construction showed a positive trend with 35.7\% for 1975, 32.6\% for 1976 and 14.9\% for 1977. While in accordance with its sub-sectoral priorities government tended to allocate large resources to petro-chemicals, steel, etc., private investors concentrated on or confined themselves to quick yield construction activities. Both the sectors hence were characterised by investment behaviour that was unidirectional.

Government authorities were confused about this trend in private investment, particularly because it was thought that government investment and expenditure programme would induce private investments. Growth in economic activity in different sectors and the easy availability of foreign exchange notwithstanding, by 1975 private investors showed signs of subdued activity. By 1976, private sector was not only anxious to complete their projects on hand but had little enthusiasm to undertake new ones. Many entrepreneurs diverted their resources to ventures outside the country, those inside the country did so by investing funds in the most profitable and quick yielding projects such as construction or real estate. In nine months during
1976-77 alone, construction, etc., accounted for $2.5 billion which was a 62% increase.

Conflicting Policies:

It has to be noted that while government expected a positive response from private entrepreneurs to its own investment policies, there were countervailing forces emerging from other governmental policies that thwarted private initiative and created a strong suspicion about the intentions of authorities. It can even be said that the pursuance of these policies was more in the realm of political authoritarianism than fulfilling the immediate economic imperatives. The sudden decision, in 1975 of the government to enforce the share participation scheme that was legislated during the 1960s under the White Revolution, the obnoxious character and coverage of price controls open trial of innocent officials for maladministration, harassment of even petty businessman are some cases in point.

By July 1975, the authorities enforced the share participation scheme which was a part of the Shah's White Revolution. Uncertainties crept in among private entrepreneurs because the government insisted that 49% of the shares of private companies be made over to their respective employees and the general public. With the idea of enlarging the ownership base and in order to give incentives to labour, the scheme was extended originally to 320 selected companies. Indigenous entrepreneurs felt that
the price of shares fixed did not represent the real worth and that there would be loss of control over management. Foreign entrepreneurs were, in addition to the second one above, under an apprehension that it would affect their overall efficiency and returns. However, by mid 1977, about 150 companies had distributed 20% of their shares since the scheme was to work in phases. But even this limited application of the scheme had eroded business confidence all over the economy. Simultaneously, profit margins gradually declined, several companies even incurring losses, as land prices rose by 60%, wages by 35% and import prices by over 20% during the years.

That economic measures followed during the time had political overtones can increasingly be perceived on examining anti-inflationary or price control measures that went into operation on grounds of economic imperatives but ended up with political reprisals. Additionally, they tended to undermine the very economic environment.

Under price control measures upto the year 1973, the government simply resorted to publication of prices of goods at which its various departments made purchase in the domestic market. In October 1973 itself, the government established a price commission to curb inflationary trend. The task of this commission was not only to advise on price fixation but to see that wherever justification lacked, prices were to revert to the June 1973 level. Though till
1974, the commission played a minimal role due to lack of adequate staff, during that year, it effected price reductions in the case of 966 items and was instrumental in fixing the price of 2,236 items. While in the former case price reductions were possible due to reduction in import taxes and in costs of raw materials used in their production, in the latter case, prices were stabilised so that further increases were ruled out. Also in the direction of price control were other measures adopted by the government. During 1974-75, government introduced or expanded direct and indirect subsidies on a large number of goods and services, reduced several taxes and abolished charges paid towards education, health, etc., provided by it.

During 1973-74, government investment and large scale credit facilities provided to the private sector were both instrumental in raising levels of income and effective demand for goods and services. Private sector liquidity grew by 35% in August 1974 and by 57% during March 1975, finally liquidity reached 59% in June 1975.

It is worth mentioning that aggregate supply of domestically produced and available goods in the economy during 1975 rose by 27.5% as against the rise of 18.9% during 1974, this increase of 27.5% including within itself a 61.0% increase in imports. Thus, the share of imports to aggregate supply had increased to 25% by 1975. During 1975
again, government freezed the prices of manufactured goods, restricted profit margins and imposed prior governmental permission for upward revision of prices. During August 1975, the authorities incorporated their intention to fight inflation as the fourteenth programme of White Revolution. Besides, the Price Intelligence Centre had been established in 1975 to monitor prices of imports and major indigenous products; it was invested with increasing powers during the course of 1975. The Price Intelligence Centre produced a list of companies or business establishments whose prices were to revert to their January 1974 level. The government published the price of many articles of daily use through the Commodity Price Centre during 1976 including about 160 basic products or raw materials that were being imported.

The Price Commission was to investigate all cases where the business people deviated from the norms prescribed by the authorities. A separate Committee that comprised students, the National Commission for Consumer Protection and the guild chambers was to assist the Price Commission. The guilty could be fined, sent to jail or their establishments closed down. They could even be tried by a military tribunal and could suffer imprisonment or deportation. By the end of the year, administered prices were applicable to around 16,000 items in all.

Price control measures as outlined above tended ultimately to be counterproductive. For, essential
foodstuffs such as sugar, bread, egg, chicken, meat, etc., were under severely short supply or supplies were partially blocked. A black market was thriving where prices were ten times as high as the official rates. While on the one hand, these measures acted as disincentives to private businessmen in general, on the other hand, they provided a conducive environment for hoarders and black marketeers. It is significant to note that government's involvement in price control measures were so tendentious or bore all the characteristics of excessive rationalisation that even articles like wedding dresses had been brought under their purview. Though these measures were intended to demonstrate to the business community the terrible consequences of noncompliance plus to impress the common man with the idea that it could safeguard his interest, the fact that the task of the authorities had reached beyond manageable proportion was clear because even special courts established to decide cases of noncompliance were, as per a Commerce Ministry's report of January, 1977, just able to dispose of 300 cases per day out of 1500 cases registered daily. Finally, there was very little justification in law for enforcement of antiprofiteering measures that restricted profit to 10 to 15%. The fixation of this profit margin was arbitrary in general and the law itself was extensively put to use against retailers selling food articles and other daily necessities.
Despite these measures, the initial months of 1976 witnessed huge increase in prices of all commodities. Average consumer price index rose by 16.6% during 1976; the wholesale price index rose by 15.5% while the price of food rose by 13%. The construction sector registered a 36% rise, this being 50% of the overall aggregate price rise in 1976.

An aftermath of all this was that by October, 1976, the revised fifth plan had lost its significance. The country witnessed attempts at formulating the sixth development plan that was to run between 1978 and 1983. Since the formulation of this plan involved besides the Plan and Budget Organisation, the users of funds in various ministries, consultants, etc., there were more than 100 agencies preparing expenditure proposals. However, it was easy to discover by 1977 that this exercise in decentralised planning was futile as total demands from different ministeries, etc., amounted to about $500 billion whereas all sources of funds put together would have yielded a mere $120 billion.

**Demand Supply Disequilibrium:**

Policy disincentives apart, structural imbalances that surfaced during this period hastened the process of economic decline. Structural weaknesses were pronounced in transportation, port and power sub-sectors. Apart from the long gestation period associated with their provision which would cause considerable hardships during normal periods, in Iran infrastructural inadequacies were exacerbated in the
face of continuously rising demand for goods and services after 1973, bottlenecks appeared in power supply adversely affecting many firms which depended on electricity for their production operations. There was regular curtailment of power supply resulting in a loss of four hours of work per day. Electricity consumption rose by about 20% a year. Official sources said that by 1977, the country faced an absolute shortage of 600 MW of power, unofficial sources put it at 1600 MW. There was an acute shortage of power leading to blackouts, slow production, etc. In the country's aluminium plant at Arak, production declined by 43% as it could have access to 35 MW instead of 115 MW required to operate at full capacity. The problem was not unique to this plant alone and all over the country it began intensifying by the beginning of 1974. Most firms, relied on government's assurance of power supply at low rates and hence failed to provide for their own source of supply.

While internal production failed to keep pace with ever increasing demand for goods and services, attempts at balancing supply demand inequalities which manifested in the form of imports were frustrated largely because of inadequate port faciliteis and of means of transport and communication. That port congestion assumed enormous proportions during 1974 becomes clear when it is realised that despite a rise in cargo handling capacity from 132% in 1973 to 185% in 1974, demurrage charges which the country was required to pay was of the order of over $1 billion.
Transportation bottlenecks meant that a large part of the domestically produced and imported goods could not reach the market in time. These structural inadequacies not only therefore pushed up costs of production but were the most vital sources of a spiralling inflation during fifth plan.

Supply demand equilibrating mechanism was again rendered ineffective largely due to increase in wages paid to labourers. Rise in wages itself occurred in the fifth plan period mainly because of shortage of labour. A 1976 Ministry of Labour Report estimated that there was a total labour shortage of 6,00,000. Earlier, in 1975, shortages estimated stood at 64,000 in respect of skilled and unskilled labour in addition to a shortage of 6,500 technicians, 3,740 engineers and 1,820 doctors. The Ministry pointed out that Iran needed 7,00,000 foreigners for effective implementation of the fifth plan.

A large contingent of 35,000 foreigners was working in Iran in addition to foreign consultants numbering between 15,000 and 20,000. Foreign labour was expected to rise to 55,000 by the late 1970s. Substantial number of American technicians were working in the armed forces (Graham, 1979, p. 91). Several Indian doctors who were willing to work for lower remuneration than what Iranians doctors expected and who showed greater willingness to work in conditions that were considered unsuitable by the natives were recruited along with thousands of labourers from other Asian
countries. At the same time, private industries competed with each other by offering higher wages to attract the best skills. Construction sector tended to overtake all others where wages are reported to have risen by 35% as per official estimation but by as much as 60 to 70% as reported by people in the business.

A 1977 report of the Plan and Budget Organisation revealed that employment expanded more rapidly in the industrial sector compared with the construction sector. Notwithstanding increases in consumer price index the period witnessed rise in nominal as also in real wages since there was a delayed downward adjustment of wages in response to slackening economic activity after 1976, as firms were to pay under rules, two to three months pay to employees in advance even if the companies were under loss and because while output per worker rose by 10%, wages increased on an average by 30%.

That the Iranian economy was on full throttle throughout the 1973-77 period is clear from the issues we have examined so far. To this must be added the fact that inefficiency in the use of resources came close on the heels of the boom in oil prices in 1973-74 that manifested in the form of overpayment for imports and possibly in other fields as well. Overpayments on imports amounted to about $500 million upto 1974. Loss of precious foreign exchange on this count was attributed to insufficient knowledge about prevalent market prices, higher prices paid to ensure quick
deliveries, old contracts that failed to reflect the actual price situation, supply by agencies of multiproduct firms who were obliged to secure orders for all or most of the products of the firms, etc.

Misplaced Judgement - Unproductive Spending:

It must be acknowledged, all the same, that even by 1974 when efforts were under way to revise the fifth plan, the Plan and Budget Organisation's Planning Division warned against the danger of inflation if expenditures were pursued beyond the economy's absorptive capacity because even the original allocations under the first version of the plan were perilously close to such levels. But the caution was never heeded by the division in charge of projects which advocated maximum spending. Further the IBRD, in its document dated June, 1974, dwelt upon the alternatives that were open to the authorities in using rising oil revenues. It is worth quoting IBRD's observations here. "The increase in these resources is staggering. Our projections indicate that Iran may receive about $15 billion in 1974 alone compared with a figure of about $3.7 billion expected for 1974 in September 1973". Estimating oil revenues on a conservative basis, IBRD observed that during 1974-80, Iran would receive about $170 billion as current surplus on the balance of payments. The report continued "If part of the surpluses are invested abroad, which may be necessary for reasons of domestic monetary management, surplusses could continue much further. On the other hand, rapid increases in
expenditure on such items as defence, government administration, social welfare, infrastructure investment, etc., could lead to a more rapid erosion of the surpluses, even within the next decade and could also cause serious inflationary pressure" (emphasis supplied) (I.B.R.D., Vol. I, p. 88).

In fact, Iran chose the latter course. The country's expenditure towards these items did increase substantially during the fifth plan period. According to Amin Saikal, after 1974, Iran was a leading arms purchaser in the world, not just a big military spender. Dramatic increase in defence spending may be observed from the fact that during 1972 and 1973, defence accounted for a total of $1375 million and $1525 million respectively. By 1974, when the fifth plan was being revised, the government proposed to spend a total of 1968.7 billion rials or $28 billion on defence for the plan period. This was 31% of its total allocations, just 2.7% less than the total allocations on economic development. In fact, the Government did not adhere to the revised plan allocations. Between 1974 and 1977 defence expenditure rose from $3680 million to $9400 million. The final year of the plan witnessed a budget estimate of a record $9.9 billion. By the time the plan ended, the country had spent $10 billion more than what was planned. Sources that may be considered more authentic (reports placed before the U.S. Congress and the Stockholm International Peace Research Institute) have held that
between 1973 and 1977 alone arms purchases amounted to over $15 billion. Iran was the single largest buyer of American arms in 1977, having spent $5700 million during the year. And this made up for more than half the total U.S. arms sales (Saikal Amin, 1980, p. 157-158).

In addition to huge defence expenditure which was had portentous as it had all the potentials of unproductive expenditure in the economy, Iran spent during the 1974-78 period huge sums on social welfare schemes and on general administration which led to galloping inflation. State consumption rose from 159.3 thousand million rials in 1971-72 to 354.2 thousand million rials in 1972-73 and to 786.0 thousand million rials in 1977-78 as revealed by Bank Markazi's annual reports. In about fifteen years time by 1977-78, state consumption rose twenty six times. Total current expenditure that stood at 282.2 thousand million rials in 1973 rose to 825.3 thousand million rials in 1974, to 951.8 thousand million rials in 1975, to 1154.8 thousand million rials in 1976 and 1282.5 thousand million rials in 1977 according to data available from ESCAP's Statistical Year Book of 1978. During the years 1970-74 alone, when foreign assets of the Central Bank rose from 20.5 billion rials to 487.8 billion rials and expenditure of the government's general budget, excluding government companies etc., rose from 242.4 billion rials to 1286.8 billion rials, there was a rise in money supply to the tune of 6.5 billion rials (Dadkhah M. Kamran, 1985, p. 371). That even by 1975,
the dangers of overspending were sensed by the Ministry of Finance would be clear from the following. To quote Hossein Razavi and Firouz Vakil, "the warning signals that Iran was overspending had come much earlier (than 1976), but the response had been muted. In July 1975, for example, the Finance Ministry authorised foreign borrowing by government agencies. Only seven months previously this had been thought unnecessary before 1978. At the same time, the instructions were sent to all the Ministries to observe the utmost care and economy, to be followed by an order to submit monthly accounts to the PBO for scrutiny" (Razavi and Vakil, 1984, p. 89). Again, writing in Tehran in June 1975, Firouz Vakil said the following. To quote "Oil revenues may well be a mixed blessing, depending on the size of the annual liquidity injections relative to the availability of complementary factors of production. Indeed, these revenues are on the one hand, like the blood of the economy, carrying badly needed investment resources to particular areas for purposes of expanding productive capacity, and on the other, they are capable of producing an excessive liquidity situation, if capital resources became suddenly out of line with other complementary factors of production (such as skilled labour, technology, organisation skills, natural resources or general infrastructural services). This duality renders the planning task all the more difficult under conditions of financial surplus, since it requires a shift of emphasis in the planning circles from an allocation of
resources according to financial constraints to an allocation of resources according to the real scarce factor or a combination of them." (emphasis supplied) (Razavi and Vakil, 1984, p. 66).

The foregoing was an attempt to draw an elaborate picture of the direction in which Iranian economy moved during the fifth plan period. "An overconfident Shah of the post 1973 period launched the overspending spree with his dream of a Great Civilisation" wrote Razavi and Vakil. "In doing so, he set in motion an inflation that was to topple his regime" (Ibid., p. 96).

Failure to modernise the economy was largely visible in the gap between promises and actual performance. Iran had a 287% increase in oil revenue which proved to be disastrous as the different social groups in the country felt they were denied the benefits while only a chosen minority reaped maximum advantages from increased oil revenues. They, therefore coalesced to openly give expression to their discontent or disenchantment. To quote Razavi and Vakil again, "... the Shah, the Prime Minister and his major ministers, who together formed the High Economic Council, made the wrong policy decisions at the wrong time and thereby progressively alienated every social group in the society. One might even say, that they did not feel the true importance of these decisions, which were taken in an almost cavalier fasion, abstracted from their potential
repercussions. The dissenting voices were always brushed aside, as if the pessimism and the caution they introduced would spoil the dream" (Razavi and Vakil, 1984, p. 96).

It is widely held that it was not just the inflationary trend that set the tone for an economic downswing. Policy makers rather tended to devise policies that could not but aggravate the situation. Policy instruments encompassed high cost emergency programmes, welfare schemes, subsidies, anti-profiteering programmes, etc., and some of which either militated against the more essential retrenchment in public spending while some others were repressive in character due to reasons already mentioned in page

The government was totally oblivious to the fact that what was essential was a set of stabilisation measures to combat inflation which had its origin not in cost push factors but in demand pull factors. Extreme forms of rigor associated with antiprofiteering law, price control, etc. only led to black marketing and further fuelled rising demand and prices. Prices of oil fell in 1975 by about 2%. Between 1975 and 1978, there were several rounds of OPEC meeting to consider the issue of oil price rise. And except in 1976, when Iranian oil secured a 10% rise in prices, possibilities of further increase were eroded as there was a price freeze on it. But the Shah's confidence was not eroded despite the fact that the 1976-77 budget had a huge deficit of 178.8 billion rials and that Iran was obliged to borrow
in the international market. It was not until October 19786, that there was a complete reversal of policy and when measures were adopted to effect economy in government spending.

The appointment of the Imperial Commission signified not so much the idea that the dangers of uncontrolled spending had dawned on the Shah but that he was determined to find a scapegoat. The Imperial Commission with eight committees was set up in November 1976 and operated in coordination with the Imperial Inspectorate (the Shah's special investigating agency), the Savak and the various ministries. The commission was empowered to deal with cases of delays, wastage and corruption in the administration of development projects. Wide publicity was given through mass media like TV etc., about the gross mismanagement by some of the ministers. It is to be acknowledged that wastage and delays or even corruption were an outcome of pressure built up on the bureaucracy that was to manage the impossible. Oil revenues were well above the country's absorptive capacity and as Vakil observed "no amount of exceptional management skills could have prevented the resulting fiasco" (Ibid., p. 73). While for all practical purposes, the Shah was personally responsible for economic adventurism during the fifth plan period, the bureaucracy, which just carried out his orders, was on trial publicly and was held answerable and to account for inefficiency in what was impossible to carry out.
That bureaucracy, even the ministers, given the autocratic power of the Shah, was thrust with tasks impossible to carry out would be clear from the following. "At Khoramshahr, the principal port, over 200 ships were waiting to unload their cargoes by mid 1975, ships were having to wait 160 days or more before entering harbour. At one point, more than one million tonnes of goods were being kept in ships' holds awaiting the opportunity to unload ... 12,000 tonnes were being unloaded per day, but only 9,000 were being removed per day. At the most congested point in September/October 1975, there were over one million tonnes of goods piled upon the jetties and around the port" (Robert Graham). What was impossible was rendered interminable because, even though measures were adopted as part of an emergency programme to ease port congestion, transport bottlenecks, etc., by purchasing two thousand trucks and six hundred trailers, the problem of finding drivers still remained. Not only trucks and trailers but even drivers were imported because Iranian drivers prepared to work in remote areas were not available. Ultimately, after a period of some months when expatriate drivers found that they were paid less than native drivers, they abandoned their jobs (Graham, 1979, p. 87-88). Hundreds of vehicles stood unused as silent witnesses to escalating poverty amidst plenty.

The persistent attitude of government to tackle the issue of widening gap between supply and demand with
policies that always tended to further widen the gap seemed not only paradoxical but endless. This was because instead of measures to tackle demand pull inflation, the authorities took recourse to those tackling cost push inflation which actually exacerbated the situation. When the Shah realised that the circle was unbreakable, he set up the Imperial Commission to lay the whole blame on those who were carrying out his orders. Public trials of high officials meant to impress the people caused just the opposite - it gave rise to a sense of disgust in them about the ruler. To quote Vakil "In a sense, the Shah had placed himself on trial; and through the media ensured that the message would go out clearly and far" (Razavi and Vakil, p. 93). As the process of trial involved not only the ministers of prime minister Hoveyda's cabinet but those of the new Prime Minister Amuzegar's cabinet through 1976 and 1977, the distance between the ruler and the people widened.

It was also clear by the end of 1977, from preliminary data on the sixth plan that was being processed, that the economy was heading towards an economic bankruptcy or even a disaster, not only because by 1978, very little financial resources seemed to be available in the economy but also because even with a 30% increase in oil totalling 8617.1 billion rials, resource constraints were thought to hold back new projects during 1978-83.

In the first half of 1977, the population was restive, frustration gripped it later with promises that
turned out hollow, shortages that intensified and hopes that were shattered. Prime Minister Amuzegar who inducted a new cabinet replacing that of Hoveyda was allowed a free hand. Deflationary measures were immediately set forth by him. They brought a sudden crash-growth in unemployment, especially among those who were unskilled or semi-skilled. As Keddie observed "... this, coming after rising expectations, helped to create a classic pre-revolutionary situation".

By the beginning of 1978, when inflation between 1974-76 and deflation during 1977-78 had the cumulative effect of shortages, reprisals, unemployment and inequity, the frustration of people transformed itself into open rebellion in January. The riots of Qom were the forerunners of a nationwide political upheaval. The result was the overthrow of the Shah a year later.
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