



Directorate of
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Iran's Economy: A Survey of Its Decline (U)

A Research Paper

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August 1991

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Iran's Economy: A Survey of Its Decline (U)

A Research Paper



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August 1991

Iran's Economy: A Survey of Its Decline (U)

Summary

Information available
as of 1 July 1991
was used in this report.

Living conditions are significantly worse for most Iranians today than they were when Ayatollah Khomeini came to power in 1979. An indication of Iran's economic descent is the fall in its GNP since the revolution. In constant terms, Iran's per capita GNP of \$1,384 in 1990 was 42 percent lower than it was in 1977. More direct indicators of living conditions also suggest a dramatic decline. Inflation has surged ahead of wages, forcing most to seek second and often third sources of income to get by.

Unemployment has worsened sharply since the Shah's era and currently hovers around 30 percent. The level of public services has deteriorated generally, and such services have become more expensive:

- Tehran's real per capita spending on education in 1990 was 71 percent lower than it was in 1980.
- Public funding for health care dropped 65 percent.
- Expenditures for housing fell 94 percent.

Iran's mortality rate has risen since the revolution, and drug addiction has become epidemic, reflecting in part increased hopelessness among young Iranians about education and employment prospects. Wealth is becoming increasingly concentrated in the hands of those with the financial and political resources to benefit from currency arbitrage, speculation in scarce goods, and corruption—all of which have flourished under the clerical regime. (C)

Iran's economy was dragged down by a variety of forces, some of which were beyond the control of the clerical regime and others the direct result of its policies. The fall in oil prices and the Iran-Iraq war, which cost Iran \$160 billion, consumed increasingly scarce resources. The clerics' nationalization of most economic institutions and a variety of subsequent policies, such as maintaining multiple, overvalued foreign exchange rates, undermined private investment. Government revenues plummeted, forcing drastic cuts in spending on public-sector enterprises and social welfare. (C)

The regime's radical political posture and its efforts to encourage Iranians to marry young and have large families resulted in additional drags on Iran's economy, including a severe brain drain and unprecedented population growth. Some 4 million Iranians, including many of Iran's professionals, have fled the country since the revolution, and few of the skilled have returned. Iran desperately needs this lost human capital to guide and manage an industrial recovery. Iran's population, which is likely to pass the

100 million mark by 2009 and is currently increasing by more than 1 million every seven months, has steadily raced ahead of the economy's ability to support its needs. (C-17)

President Rafsanjani's efforts to unify Iran's exchange rates and increase private participation in Iran's mostly state-run economy signal his concern that worsening economic conditions could undermine his power and Iran's regional ambitions. This concern almost certainly was heightened by a wave of economic protests and labor strikes in 1990. Rafsanjani is struggling not only to formulate appropriate reforms but also to implement them at the right pace. If he moves too quickly, the resulting pain could ignite popular and political sentiment against him. Proceeding too cautiously could allow the country to drift toward economic disaster and lead to the same political result. (C-17)

Rafsanjani has improved the clerical regime's economic and political relations with many West European states, a trend that is likely to continue and probably will include cautious attempts to improve relations with the United States. Although Western Europe and East Asia can provide all the resources Iran needs, Rafsanjani probably fears that, as long as US-Iranian relations are poor, Washington will use its influence with these states to impede Tehran's efforts to obtain economic resources. (C-17)

The USSR represents an alternative source of some goods, particularly military, but the economies of the two countries are uncomplementary. Both nations have energy resources to export, and they both need hard currency to finance purchases of industrial and consumer goods. (C-17)

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Iran's Economy: A Survey of Its Decline (U)

Materialist ideologues of the West advocate economic well-being, personal comfort, and self-indulgence . . . Islam teaches self-sacrifice.

Iranian middle school textbook (U)

Iranian President Rafsanjani is urgently trying to improve the economic well-being of Iranians through decentralization and Western participation in reconstruction. His efforts reflect concern that the impoverishment Iranians have suffered since the revolution will continue and could cost him his leadership. This concern almost certainly was heightened by a wave of Iranian protests and labor strikes in 1990 that were sparked by unrelenting economic pressures. Although Rafsanjani appears to be overcoming hardline opposition to his market-oriented economic agenda, most of Iran's economic problems are complex and deeply entrenched and will be practically impossible to overcome in the short-to-medium term. Even over the longer term, he probably will achieve only mixed results at best.

Forces Behind the Fall

Iran's economic troubles are the result of a variety of factors, some of which were beyond the control of the clerical regime. Two key developments were the softening of oil prices since the early 1980s and the Iran-Iraq war from 1980 to 1988. Although Iran's economy almost certainly would have faced difficulties as a result of these factors alone, a variety of policies implemented by the clerics following the revolution—particularly those that expanded state control over the economy—have seriously worsened its troubles.

Oil Revenues Plummet

Oil exports are vital to the Iranian economy, and declining oil earnings since the early 1980s delivered a sharp financial blow to the clerical regime. In addition to falling prices, declining reservoir pressure and deteriorating surface facilities throughout Iran's oil

system cut production capacity by 50 percent

Faced with declining hard currency earnings, Iran's financial options were limited. Besides slashing imports as oil exports fell, it could draw down its foreign assets or seek foreign loans. Tehran had already drawn down its foreign assets from \$19 billion to about \$6 billion—about five months' worth of imports—by 1984. Rather than borrow abroad, which most regime leaders viewed as antithetical to the revolution's commitment to financial independence, Tehran pared imports further.

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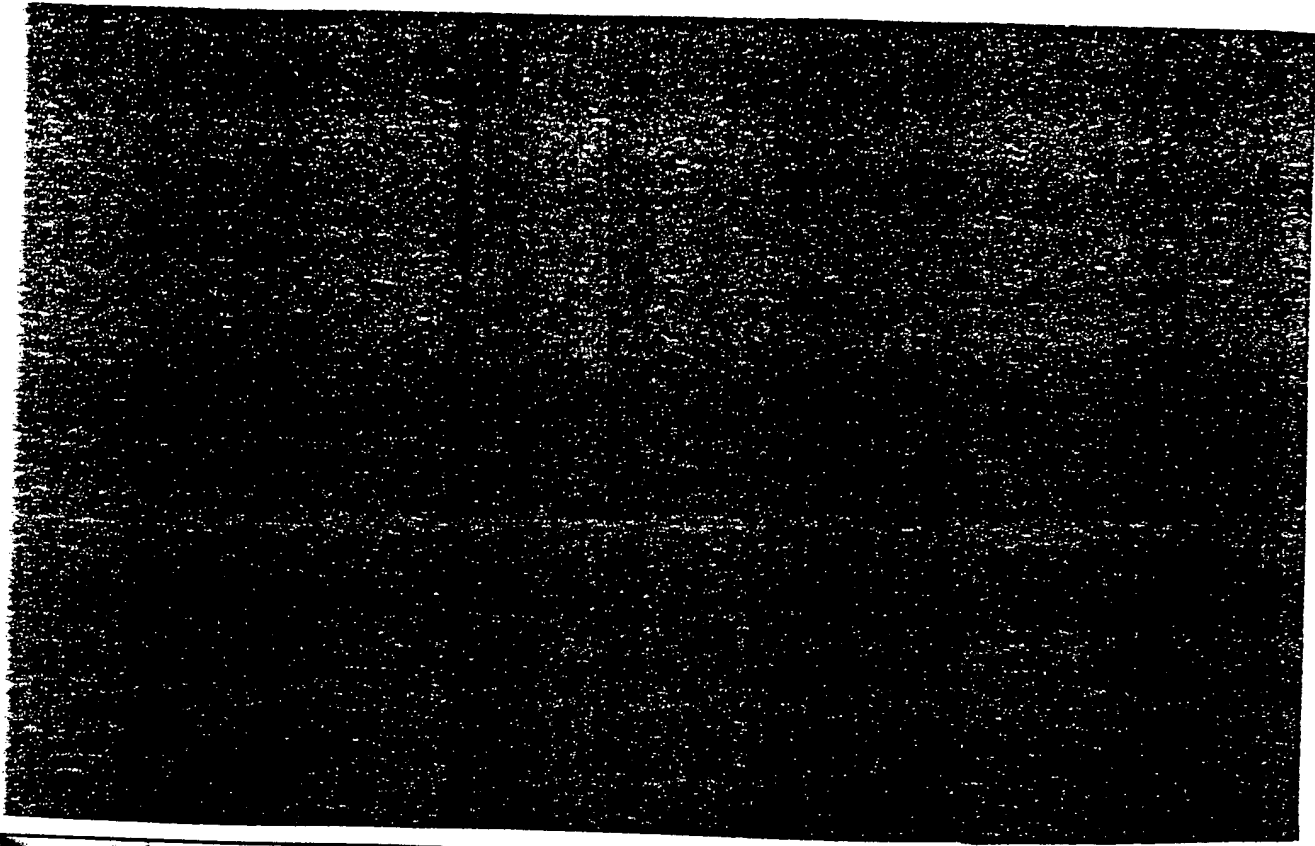
The Iran-Iraq War Adds to Burdens

The Iran-Iraq war dealt Tehran a heavy economic blow in part by forcing Iran to spend scarce hard currency on military imports. We estimate Iran's foreign military purchases during the war years averaged about \$2 billion annually.

Although Iran spent much less on military imports than did Iraq, we estimate Iran's total bill for the war—including lost oil revenues and economic output—was about \$160 billion.

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Iran has not enjoyed a significant peace dividend since the end of the Iran-Iraq war. Iran's military hardware and supplies were heavily damaged by the conflict, and Tehran wants to rebuild them to reestablish Iran as the preeminent regional power. The Gulf crisis fueled this interest because it provided a rare opportunity for Iran to regain lost ground toward military parity with Iraq. Tehran has announced plans to spend \$10 billion during the next five years on military imports, but we believe Iran's hard currency resources will restrict spending to about \$1.5 billion annually.

first shocks to Iran's postrevolutionary economy was the clerical regime's nationalization of all primary economic institutions, including banks, insurance and service companies, and all major industrial units. Private ownership was honored in the new, revolutionary constitution, but legal protection against additional public expropriation was vague at best.

As a result, private interest in fixed investments such as factories has remained generally low since the revolution.

Nationalizations Scare Investors

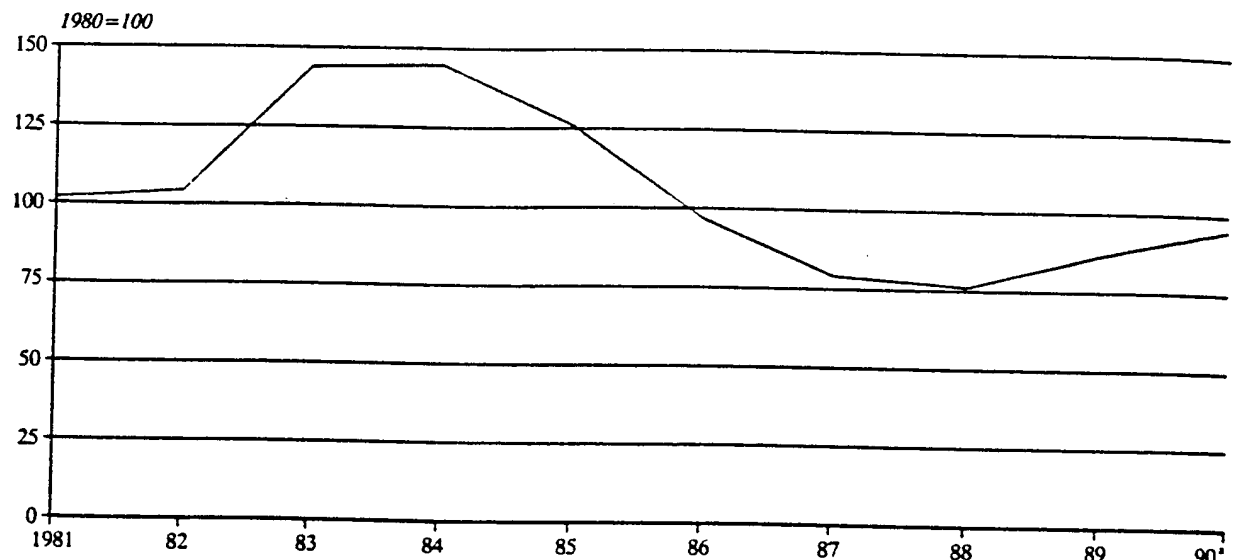
The clerical regime implemented a wide range of policies that have turned potential investors away from sectors that are critical to employment and economic growth such as manufacturing. One of the

OC: [redacted] (U)

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Figure 2
Iran: Index of Investment in Fixed Capital, 1981-90



* Preliminary estimate.

Note: Private investment typically composes about 50 percent of total investment.

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1.6(d)(1)(6)

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fixed capital investment was 11 percent lower during the 1985-89 period than it was during 1980-84. A former Iranian industrialist during a press interview in late 1990 said he had no interest in fixed investments in Iran because "the government is forever coming up with new rules and regulations, and I would always be worried about expropriation." Middle-class businessmen and merchants have little faith in Iran's economic future and do not invest in Iranian industry, according to [redacted] Western press reporting. (S [redacted] OC)

The decline in private investment was rendered more serious than it might otherwise have been by the government's falling revenues and thus its decreased ability to serve as an engine of economic growth.

[redacted] government spending on fixed investments at the end of the 1980s was 29 percent lower in real terms than it was at the beginning. (S [redacted])

The Overvalued Exchange Rate

The clerical regime has regulated Iran's imports through a system of multiple, extremely overvalued exchange rates. The Central Bank's official exchange rate for the Iranian rial has been maintained at about 70 rials per dollar since the revolution, but it has been trading for as little as 1,400 rials to the dollar in recent years on private currency markets. Iran has also maintained several additional discounted rates that are higher than the official rate but far below

market rates. Rafsanjani has been stepping cautiously toward unifying rates and devaluing Iran's currency.

[REDACTED] but Tehran continues to maintain at least two discounted rates. (S, NF)

Iran's foreign exchange system not only inhibits Iranian industrial activity but also encourages investors to divert scarce resources to speculation:

- Iran's Minister of Heavy Industries in December 1990 complained publicly about an Iranian car producer's ability to import rearview mirrors, which cost \$10 each in hard currency, for only 700 rials each. Iran's Central Bank sold the necessary hard currency to the auto company at the low official rate of 70 rials per dollar because autos are scarce in Iran and rearview mirrors are a legal requirement. Iranian manufacturers could produce rearview mirrors, but not for less than 3,000 rials each. Unable to compete with the import cost, local producers have no incentive to produce the mirrors.
- Iran's United Bus Cooperative was granted access to hard currency at the official exchange rate in late 1989 to import buses, according to Iranian press reporting. After the buses were delivered, the cooperative removed and sold the air-conditioners on Iran's open market for enough rials to cover the initial, subsidized cost of the entire buses. (S, NF)

Despite the negative effects of Iran's exchange rate system, Tehran has maintained it in part, we believe, because of the profits government officials earn from their access to foreign currency at preferential rates. Corruption was common throughout the Shah's government, but a large body of press [REDACTED] reporting indicates it has grown rapidly since the revolution. A widely respected Iranian economic journal in early 1990 summarized the situation in blunt terms: "The use of political power or position for material gain has reached epidemic proportions. More than half the political establishment is on the take." (S, NF)

Another key political obstacle to unifying the exchange rate is the fear that such a move would result in the elimination of major subsidies, causing popular

unrest. If access to cheap hard currency were cut off, the local prices of many essential goods would jump sharply. In addition to angering the general public, such a price rise almost certainly would encourage Rafsanjani's political rivals. A proposal by Rafsanjani to remove a gasoline price subsidy in early 1991 prompted radicals in Iran's legislature to virulently attack the plan, according to Iranian press reporting, apparently forcing Rafsanjani to compromise. (S, NF)

Massive Brain Drain

The revolution and the Iran-Iraq war prompted many of Iran's best-trained professionals to leave the country.

[REDACTED] 4 million people left the country between 1977 and 1987. Emigration surged in the years of unrest leading to the revolution, then slowed markedly in 1980 and 1981. In 1983 emigration jumped sharply again and surpassed 650,000 annually by 1985, indicating growing numbers of Iranians had lost faith in the regime and had become exhausted by the Iran-Iraq war. Although some emigres have returned, [REDACTED] many who stayed away were scientists, engineers, and financial experts, whose skills were readily marketable abroad. (S, NF)

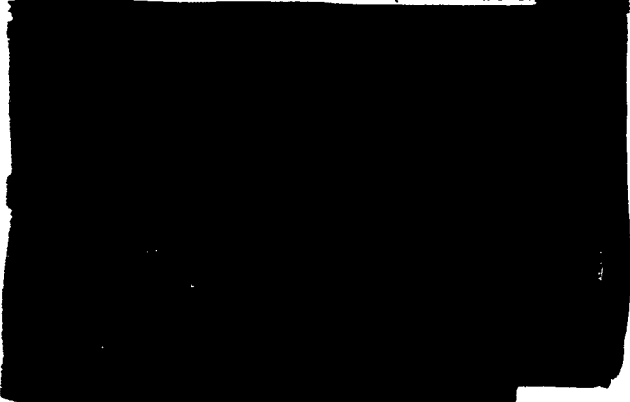
The clerical regime intensified the negative impact of this emigration by placing supporters in professional positions for which they were not qualified. For example, a serious lack of technical expertise and a great deal of mismanagement exists throughout Iran's Ministry of Industries. Many of the Ministry's officials were appointed because of their religious and political connections. (S, NF)

Tehran has repeatedly tried to lure emigres back to Iran, but few have been convinced by the clerical regime's promises. [REDACTED]

[REDACTED] (S, NF)

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The skills of some senior Rafsanjani appointees who are represented in Western media as technocrats with solid economic backgrounds are questionable.

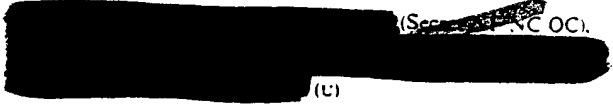


(S) (C) (OC)

Population Growth Races Ahead of Economy

Iran has experienced unprecedented population growth during the clerical regime's rule, further reducing the economy's ability to meet demands for goods and services. Iran's indigenous population grew by almost 40 percent from 1976 to 1986, according to Iran's 1986 census. The addition during that period of about 2.5 million refugees, most of whom are Afghans, pushed total growth to almost 50 percent. At its current 3.2-percent annual growth rate, Iran's population of 57 million will add another 1 million within seven months and will pass 100 million by 2009. The influx of Kurdish refugees following the Gulf war has worsened the situation and angered many Iranians, already frustrated by the increased competition for employment and particularly housing and public services caused by Afghan refugees. (U)

Although Rafsanjani has publicly acknowledged the seriousness of Iran's population problem and has quietly implemented efforts to slow growth, similar attempts have met with little success in the past. Amid harsh criticism from some Iranian clerics and radical members of Iran's legislature, Rafsanjani



(S) (C) (OC)

(U)

reversed the clerical regime's stance against family planning in 1989 and began encouraging birth control with efforts that include dispensing free condoms. The Shah also attempted to slow Iran's population growth with a relatively rigorous birth control program—which Ayatollah Khomeini angrily abolished after seizing power—but the slightly reduced growth rate he achieved still portended a doubling time of only 22 years. (C) (S)

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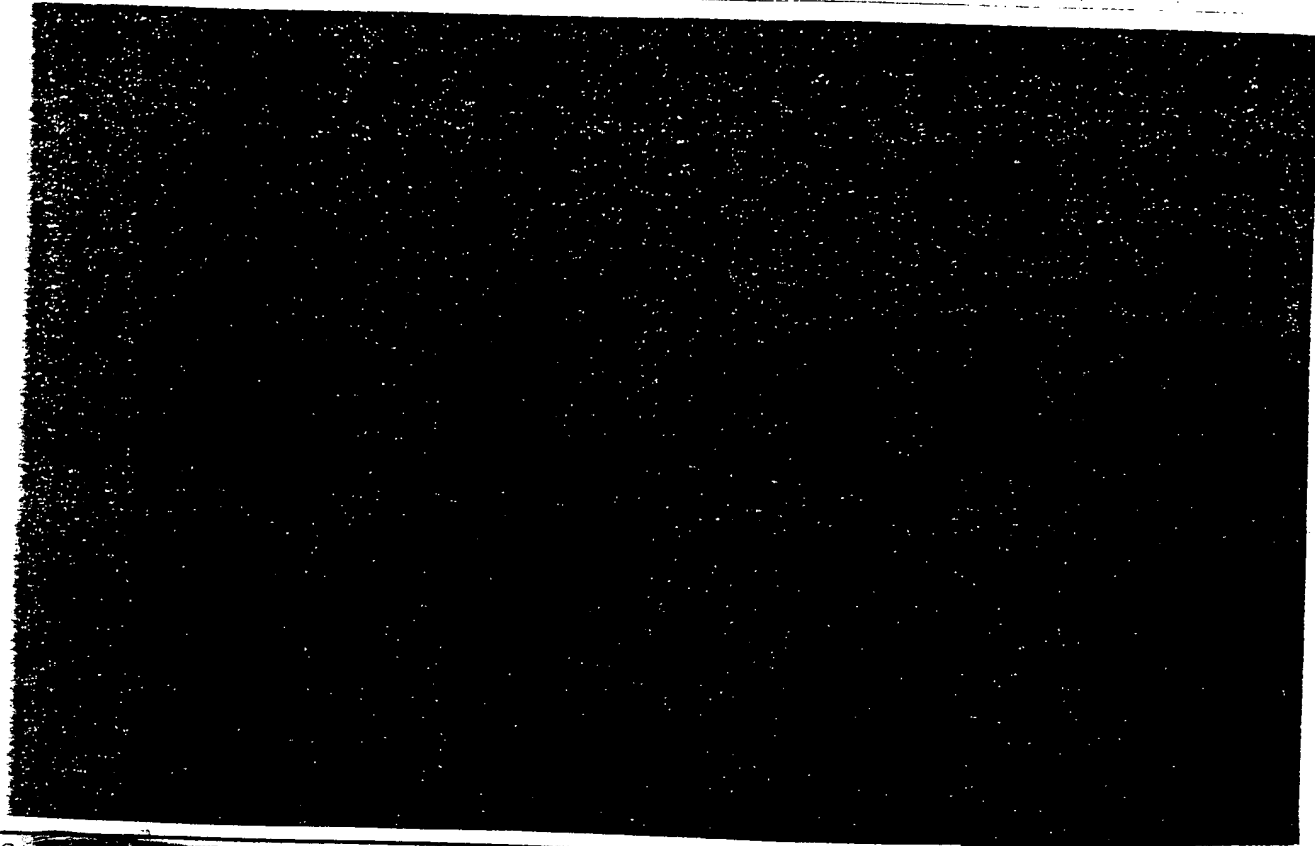
The Toll on GNP

Iran's GNP in 1980—the first full year of Ayatollah Khomeini's rule—dropped about 20 percent in real terms [redacted] reflecting in part the government's self-imposed cutback in oil exports. Tehran's decision to resume oil exports helped Iran slowly recover from this initial shock until 1986, when low oil prices contributed to an 8-percent fall in GNP. In 1988 another gradual recovery began, and we estimate Iran's 1990 GNP of about \$80 billion was 44 percent above the low levels to which it fell in 1980. Nevertheless, we estimate Iran's 1990 GNP was about 7 percent below prerevolutionary levels. (C) (S)

Industrial Sector Stumbles

Iran's nonoil industries performed particularly poorly. The fall in Iran's hard currency earnings sharply reduced Iran's ability to purchase foreign raw materials and machinery needed for domestic production. [redacted] Tehran allocated \$7.3 billion in hard currency to industry in 1983, a year when Iran's nominal oil export earnings peaked at \$19.3 billion. By 1988 hard currency allocations had fallen to only \$700 million, reflecting the decline in oil export revenues to \$8.5 billion. (S) (S)





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Tehran's local spending to fund and operate state-owned enterprises also declined, paralleling falling domestic revenues. Government subsidies to operate Iran's large factories—all of which were nationalized following the revolution—not only failed to offset declining factory revenues but also slipped themselves, further undermining production. In constant terms, Tehran's budget allocations for state-owned enterprises were 20 percent lower in 1990 than they were in 1985.

was during 1980-84. The per capita fall in output was a sharp 21 percent.



Agricultural Sector Runs in Place

Iran's agricultural sector performed better than other areas of the economy during the 1980s. Iran's inability to feed itself had been one of Khomeini's major

The lowered hard and local currency spending caused industrial output and capacity utilization to fall. Iran's industrial production in the period 1985-89 was 7 percent lower than it

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[REDACTED]

[REDACTED]

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Commerce Buys Services Sector

The output of Iran's services sector appears to have remained roughly constant since the revolution, although the commerce component of services has almost certainly expanded.

[REDACTED]

Nonetheless, we estimate that the regulations and distortions that have become commonplace since the revolution have led to a wide variety of shortages that have made commerce in scarce goods an extremely lucrative growth industry.

most other areas of Iran's services sector, including health care, have shrunk since the revolution.

1572(d)
1582(d)

Per Capita GNP Plummet

Iran's per capita GNP performance since the revolution presents a much more negative view than does overall GNP. Although Iran's economic output in 1990 was only slightly below its 1977 level, Iran's population jumped 61 percent during this period, causing the goods and services produced to be spread much more thinly to meet the demands of the much larger population. Iran's 1990 per capita GNP of \$1,384 was at least 42 percent lower in real terms than it was in 1977 and 16 percent below 1985 levels.

Some overall GNP gains are losses when viewed in per capita terms. Iran's real GNP grew a respectable 2.2 percent in 1988, but per capita growth that year was negative 1 percent. Iran has fallen from being numbered among the world's top one-third in terms of per capita GNP, to near the middle.

Living Conditions Deteriorate

Although GNP by itself provides few specific insights into living conditions, it often serves as a leading indicator of trends in quality of life. In Iran's case the

[REDACTED]

criticisms against the Shah. We estimate that the average of Iran's grain output in 1988 and 1989 was 33 percent higher than it was in 1980 and 1981. The improvement reflects in part Tehran's continued commitment to development spending in this sector. This achievement is muted, however, when population growth is factored in. Per capita grain output increased by only 3 percent during the period.

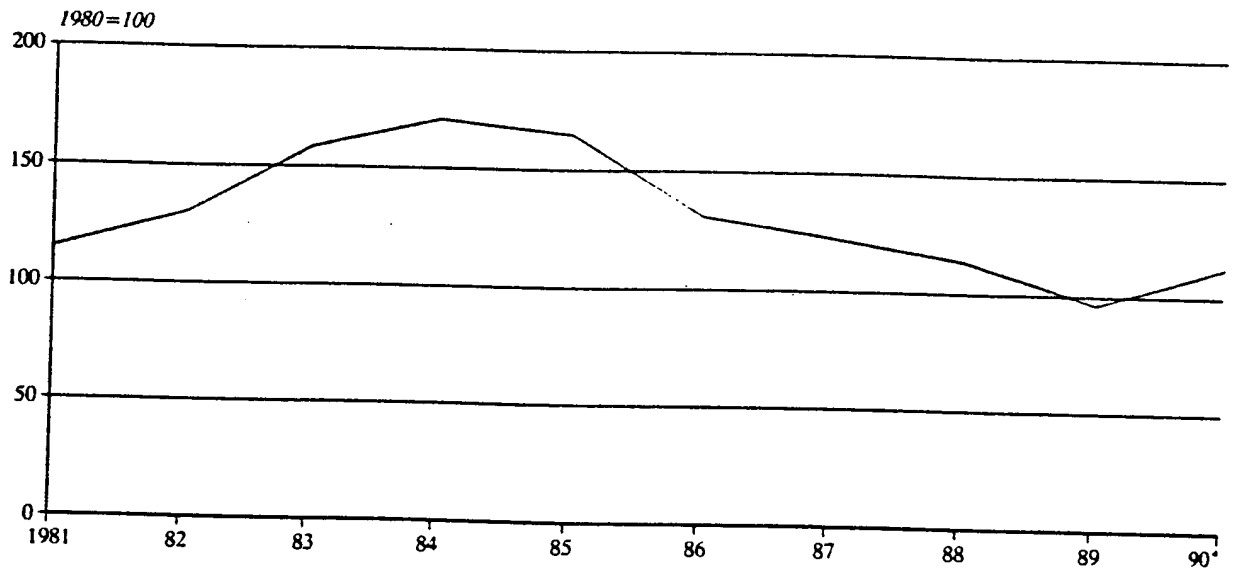
Despite the agricultural gains, Iran's foreign food bill now consumes a larger portion of its export earnings than it did a decade ago because of the steady growth in population and lower export earnings. We estimate Iranian imports of foreign food and agricultural supplies absorbed 15 percent of foreign exchange earnings in 1979 and 1980, as compared with 20 percent in 1989 and 1990, according to OECD trade data.

[REDACTED]

[REDACTED]

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Figure 5
Iran: Index of Large Manufacturers' Volume of Output, 1981-90



* Preliminary estimate.

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GNP picture, particularly when viewed in per capita terms, strongly suggests that living conditions have eroded significantly for most in Iran since the clerical regime came to power. We believe [REDACTED]

[REDACTED] that life in Iran has become more difficult since the revolution. (S/F)

Budget Reduction Hits

Government spending in Iran since the revolution has dropped dramatically, reflecting falling revenues from oil exports, state-owned enterprises, and taxes. Budget expenditures in 1990 were 58 percent below 1980 levels in constant terms and 71 percent lower in constant per capita terms, [REDACTED]

[REDACTED] Despite Tehran's claims of spending increases since the Iran-Iraq war, per capita spending in 1990—two full years into Iran's postwar reconstruction effort—was 19 percent lower than 1988 levels in constant terms. (S/F)

Although it had promised to help poorer Iranians, the clerical regime's spending trends on social services entered a near free-fall following the Shah's ouster. Total spending in constant, per capita terms was 64 percent lower in 1990 than it was in 1980 and hit the education, health care, and housing sectors especially hard. (S/F)

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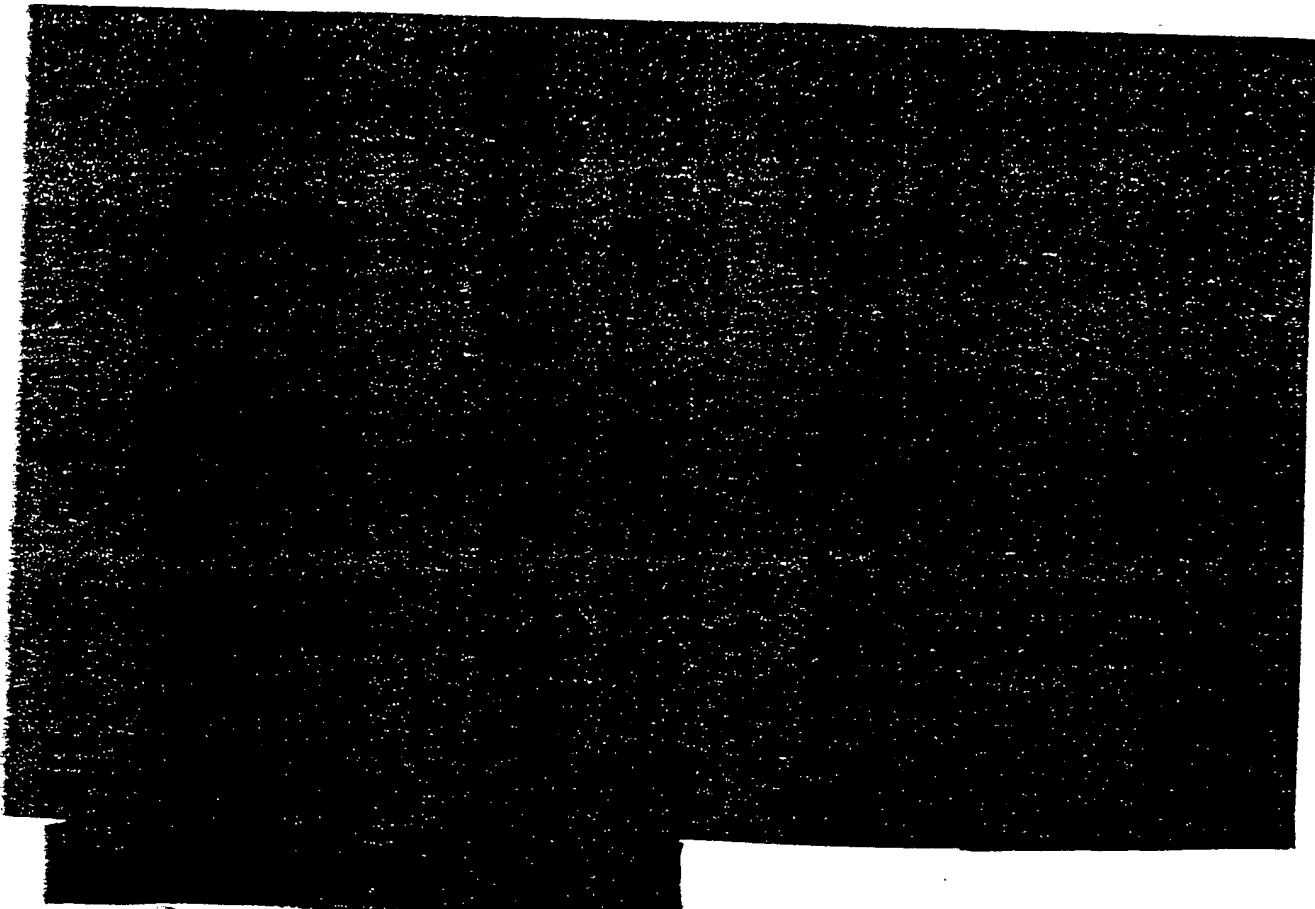
Education. Tehran reduced spending on education drastically, which almost certainly will hurt Iran's labor competitiveness over the long term. Tehran's per capita spending on education in 1990 was 71 percent lower in constant terms than it was in 1980.

University admittances in 1989/90 were restricted to about 9 percent of applicants largely as a result of shortages of teachers and dormitories. In 1976, Tehran University had 13,000 students and a 2,000-member teaching staff. By 1990 student enrollment had increased 50 percent, but declining real salaries caused the number of professors to drop 43 percent. Iran's Deputy Minister of Culture and Higher Education announced publicly in

early 1990 that Iranian professors had not received a salary increase in 11 years despite high annual inflation.

Elementary and secondary school services have also seriously deteriorated. Students in some rural areas of Iran go to school in five different shifts because of insufficient facilities and instructors, according to Iranian press reporting. Iranian media reported Rafsanjani expressed surprise during a tour in 1990 of several Iranian provinces on learning that girls did not attend school at all. Shortages of almost all teaching materials are common.

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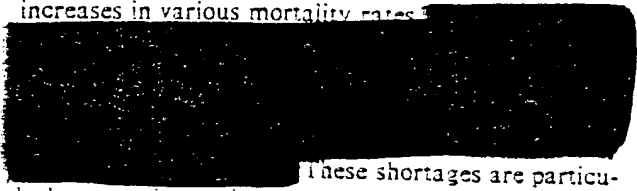
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1.3 (2) (1) (13)

In a reversal of the clerical regime's free education policy, Iranian parents are being asked to support public schools directly with tuition payments. In October 1990, Iran's Minister of Education and Training announced that the government had prepared legislation that would require parents, beginning in 1991, to pay tuition for their schoolchildren.

[redacted] tuition collection had become so common even before the announcement that Iranian officials received frequent complaints from parents angered by the practice. (U)

Health Care. Iran's per capita spending on health care has dropped 65 percent since 1980, leading to a steady decline in the availability of these services and increases in various mortality rates.



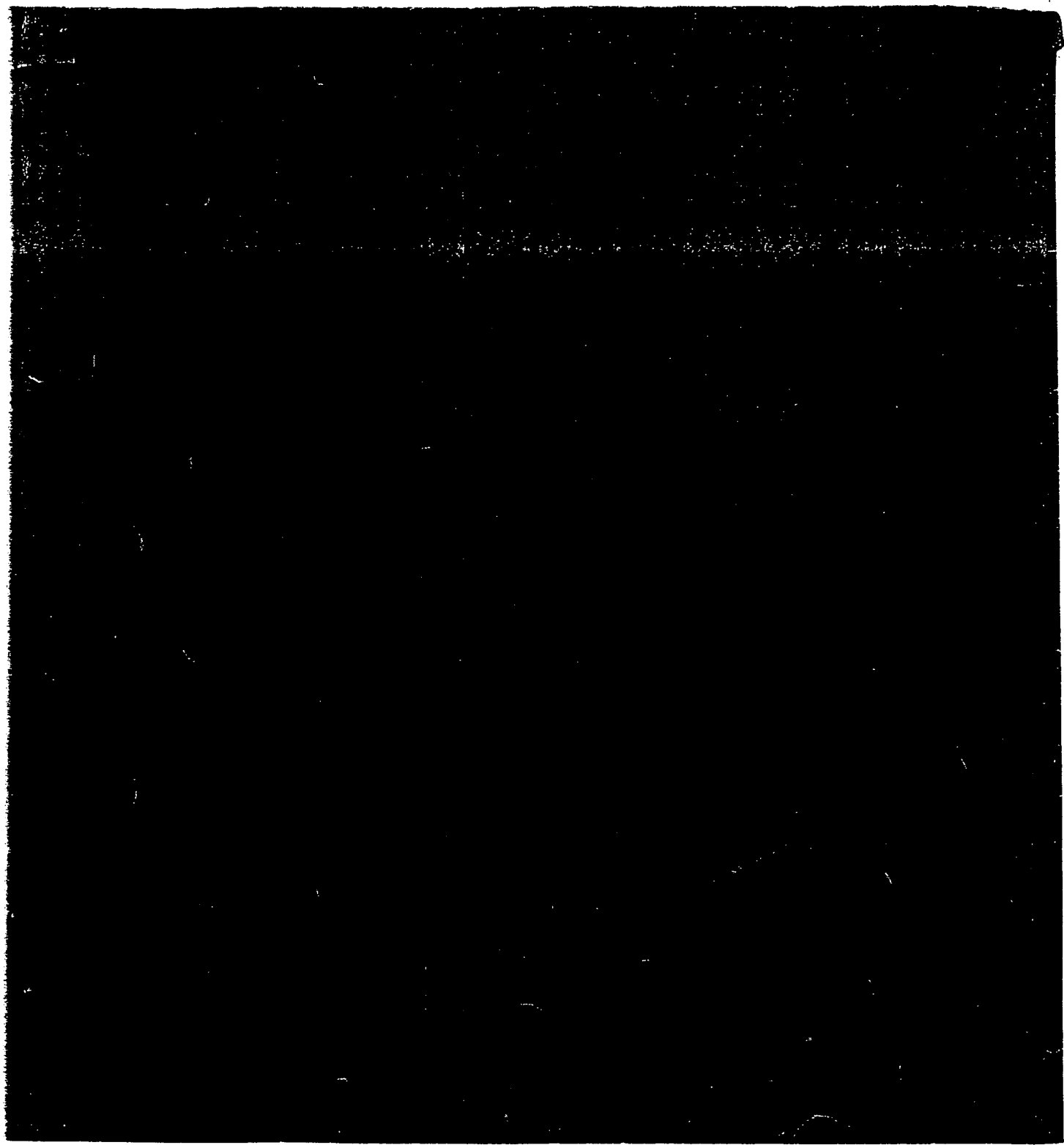
[redacted] These shortages are particularly severe in rural areas. Most hospitals in Iran's

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remote Sistan va Baluchestan Province, for example, are only partly operational or are closed because they lack surgeons and other skilled personnel, according to Iranian press reporting. Two recently completed 25-bed hospitals in Baluchestan have not opened because they lack a sufficient number of physicians to support the facilities. (S [REDACTED] OC)

Housing. Public spending on housing dropped 94 percent from 1980 to 1990, leading to serious housing shortages. Iran's Ministry of Housing and Urban Development released a study in late 1988 that indicated that rent for a two-bedroom apartment in Tehran's poorer section had increased 135 percent since 1984 and that rental security deposits demanded by Iranian landlords had jumped 900 percent. The same survey showed that Iranians were responding to the rising costs of housing primarily by making do with increasingly smaller accommodations. Almost half of Iranians who rent—homeowners are a minority—live in apartments that have two total rooms or less, and 11 percent of rented accommodations provide housing for three families. [REDACTED]

Rafsanjani was shocked to find Iranians living in straw huts during a tour of several provinces in 1990, according to Iranian press reporting. (S [REDACTED] OC)

Wealth Becoming More Concentrated

One of the proclaimed goals of the revolution was to redistribute wealth to poorer Iranians, but after initial progress the regime began losing ground. An indicator of wealth distribution is the Gini coefficient or index, a statistical measurement that reflects perfect equality with a 0.0 rating and perfect inequality with a 1.0.* If a nation's wealth is becoming controlled by increasingly fewer citizens, its Gini coefficient will move closer to 1.0. The clerical regime scored some early successes in improving Iran's Gini coefficient from 0.49 in 1977 to 0.40 in 1980, largely by expropriating land and other

* Tehran releases some data on income distribution, which provides the basis of Gini coefficient estimates on Iran. A Gini coefficient can be calculated as $G = 1 + 1/n - 2/n^2 \sum_{i=1}^n y_i$, where y_1, \dots, y_n represents individual income, z represents average income, and n represents the number of individuals being observed.

personal property from wealthy Iranians and distributing it to farmers and other poorer citizens. As the economy has become depressed and distorted—resulting in highly profitable opportunities for speculation for the relatively few Iranians with savings or surplus income—the earlier trend has been reversed. The World Bank in 1990 gave Iran a 0.46 Gini coefficient, which is almost as bad as the rating under the Shah and placed the Islamic republic among the world's bottom 10 percent. (U)

Civilian Imports, Purchasing Power Down

Iranians have experienced a sharp decline in nonmilitary imports since 1985. In constant 1990 terms, Iran's per capita civilian imports in the period 1986-90 were 52 percent lower than they were in 1980-85, when they averaged \$441 annually, according to [REDACTED] OECD trade reporting. Nonmilitary imports turned slightly upward following the Iran-Iraq cease-fire, but they were 50 percent lower in 1989-90 than they were in 1980-81. (S [REDACTED] OC)

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The fall in nonmilitary imports, ranging from consumer items to machinery for domestic production, fueled shortages and helped push prices steadily ahead of wages. [REDACTED] consumer prices rose by an annual average rate of 16.4 percent from 1982 to 1988. We believe Tehran underestimates inflation by weighting consumer purchases outside of government price controls too lightly, and Iranian press reporting [REDACTED] have consistently indicated Iran's inflation is higher than the government estimates. [REDACTED] private-sector urban wages from 1982 to 1988 rose by an annual average of only 10 percent, significantly below official inflation estimates. Government employees in urban areas saw their salaries fall even further behind prices, rising only 8 percent annually on average. (S [REDACTED] OC)

The drop in buying power has led an increasing number of lower- and middle-class Iranians to seek additional sources of income, including crime. According to an Iranian press article in October 1990, prices have become a "nightmare" for most Iranians, causing those with one job to seek a second and those

with two jobs to seek a third. [redacted] many middle-level government employees have resorted to driving their personal vehicles as taxis at night to supplement their incomes. [redacted] many young Iranian males participate in the black market, spending their time on street corners selling anything for which they can find buyers. A large body of press reporting [redacted] indicate a steadily growing percentage of young Iranians are turning to drug trafficking—at least 3 percent of Iran's population is addicted to opium—for income despite the high risk of execution if caught. (S, NF, NC)

Unemployment Up

Unemployment has risen steadily in Iran through the 1980s and represents one of the regime's most daunting challenges. Government data have consistently shown Iran's unemployment at about 15 percent, but an Iranian official in 1986 admitted publicly that the number is probably closer to 30 percent. During a demographics and development seminar organized by the Iranian Government in September 1988, attending experts estimated that Iran's unemployment was at least 30 percent. (U)

Tehran's ability to meet the demand for jobs appears to be slipping steadily behind Iran's rapidly growing labor force. Rafsanjani's current five-year development plan calls for the creation of 398,000 new jobs annually, but Iran's 1986 census indicates about 600,000 young Iranians are currently entering the work force annually. An additional 3 million or more working-age Iranians are unemployed or underemployed. [redacted]

Iran's more educated citizens are not immune from the nation's worsening unemployment. [redacted] college graduates in Iran are finding it increasingly difficult to find jobs, a trend that is contributing to drug use and suicide. Only 17 percent of the 23,000 Iranians who graduated from college in 1990 will readily find employment, according to Western press reporting. (S, NF, NC)

Iranians Tolerant

We believe Iranians have been relatively tolerant of the economic decline for a wide variety of reasons. Ayatollah Khomeini's teachings emphasized that sacrifice was necessary to remain independent and truly Islamic, a precept that many throughout Iran's mostly Shia population embraced, at least initially. In addition, the clerical regime won the loyalty of many poorer Iranians by giving them wealth expropriated from richer citizens and positions of responsibility unavailable to them under the Shah. [redacted] 1.5(d)(d) 1.6(d)(d)(c)

During the Iran-Iraq war, Tehran employed additional means of maintaining support. It successfully appealed to Iranian nationalism and patriotism and used religious symbolism to rally support. The regime portrayed itself as providing for the masses through a program of rationing essentials at subsidized prices and successfully shifted responsibility for the nation's declining economic conditions to Baghdad and its supporters. (C, NF)

The clerics benefited from the political exhaustion of Iranians. [redacted] many Iranians became increasingly apathetic politically in the 1980s. The revolution, hostage crisis, and war with Iraq wore Iranians down, and many turned away from political activity. (C, NF)

The regime's harsh oppression of dissent throughout the decade also helped keep its power intact. Political enemies were repressed brutally at home and, if they went into exile, pursued by assassination squads. For example, in 1989 prominent Kurdish critic Abd al-Rahman Qasemlu was assassinated in Europe. (C, NF)

The absence of an effective leadership alternative worked against widespread dissent. Many Western-oriented Iranians who prefer a secular government in Tehran probably viewed the revolution as a disaster. We judge that few want to try again, and most hope that Rafsanjani's pragmatism will result in improved living conditions. He boosted their morale by pushing

his ambitious development program through Iran's legislature and continues to buoy their hopes by seeking Western participation in Iran's reconstruction. (C-18)

But Trouble Looms

Despite the relative tolerance and popular good will, Rafsanjani has not escaped the public's discontent over economic pressures. In 1990 at least 15 large strikes, demonstrations, or brawls erupted throughout the country:

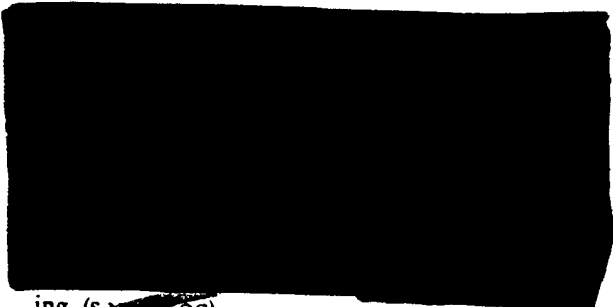
- For nine days in January virtually all 7,500 employees of the Iranian National Shoe Factory—one of Iran's largest plants—struck to protest a revised pay schedule of the Ministry of Labor that reduced average take-home pay [REDACTED]. The government threatened the strikers with dismissal and arrested 15 individuals suspected of helping to organize the strike, which subsequently collapsed.
- According to [REDACTED] Western press reporting, cancellation of a soccer match in Tehran in February prompted 15,000 people assembled in front of the stadium to set fire to three buses, overturn several Revolutionary Guard jeeps, and destroy pictures of Ayatollah Khomeini and current Supreme Leader Khamenei.
- An Arab newspaper reported in March that anti-regime demonstrations occurred in four Iranian provinces. Protesters in Esfahan burned pictures of Khomeini, Khamenei, and Rafsanjani.
- An increase in bread prices in August sparked numerous brawls in Tehran, according to Iranian press reporting. Rises in food and housing prices that same month caused three demonstrations in Esfahan [REDACTED].
- In mid-November virtually all primary and secondary school teachers and a small number of other government employees in the Iranian cities of Yazd and Shiraz staged strikes to protest low wages [REDACTED].



Iranian press comment on popular frustration with economic conditions (U)

[REDACTED] The strikes spread to Esfahan and prompted authorities to arrest all organizers.

1.5(c)(d)
1.6(d)(1)(6)



ing. (S) (C) (OC)

The brief oil price boost in 1991 following Iraq's invasion of Kuwait allowed Rafsanjani to provide limited relief, but signs of economic stress remain. In March the Speaker of Iran's legislature, the Minister of Energy, and several officials of Iran's Martyrs' Foundation visited a southern Iranian city to "investigate the problems of families of war dead and other deprived people in the region," according to Iranian press reporting. In the past, senior Iranian officials have rarely made personal visits unless public unrest threatened. (C) (NF)

Treacherous Road Ahead

Although we believe Rafsanjani is trying to improve Iran's economic conditions, the country's ills are complex and entrenched and cannot be cured quickly or painlessly. Higher oil prices would allow Iran to increase imports, ease inflation, and push forward on some reconstruction projects. They would do little to address the economy's underlying structural problems. (C) (NF)

Rafsanjani has begun to implement a variety of economic reforms that he probably hopes will jumpstart the economy, but the results of his efforts have been limited:

- He ordered his Minister of Economic Affairs and Finance in 1990 to unify Iran's exchange rates. Three rates now exist instead of the former six, but two of the three rates remain overvalued.
- Rafsanjani has tried to sell state-owned enterprises, but few of these mostly outdated, inefficient, and money-losing operations have attracted buyers.

- He has made some progress in increasing Iran's access to foreign financing, but the large multi-billion-dollar loans Iran desperately needs to rebuild its crumbling industrial base have not been forthcoming.
- He has offered tax breaks to Iranians for investment in industry, but speculation in scarce goods and real estate continues to be much more profitable and entails less risk of expropriation. (C) (NF)

Rafsanjani probably recognizes that a serious economic recovery will require sweeping reforms, but such changes—including reducing government control over foreign trade, dramatically increasing foreign participation in reconstruction, and attacking corruption—risk fueling popular unrest and political attacks against his leadership. Not only are the specific reforms he proposes important, but the pace at which he tries to implement them is critical. If he pushes reforms too quickly, he could ignite sentiment against him, but proceeding too cautiously could lead to the same result. Although Rafsanjani could suppress his opposition, we believe he wants to avoid violent confrontations for fear of damaging the legitimacy of his regime or providing a rallying cry for his opponents. (C) (NF)

Even if Rafsanjani successfully navigates the difficult policy waters ahead, implements economic reforms, and increases nonoil output, especially in the industrial sector, we believe Iran's population problems will continue to be a significant drag on the economy. Iran's overall GNP would have to achieve 5 percent real annual growth through the year 2000 for per capita GNP to return to the modest levels of the mid-1980s. With its population expanding by almost 40 percent every decade, a generally stagnant or even downward real per capita trend appears likely, although some years will show improvement. (C) (NF)

Tehran's influence and strength in the region and internationally will remain linked, at least indirectly, to its economic fortunes. Despite Iraq's recent defeat, Iran will find it difficult to become the dominant

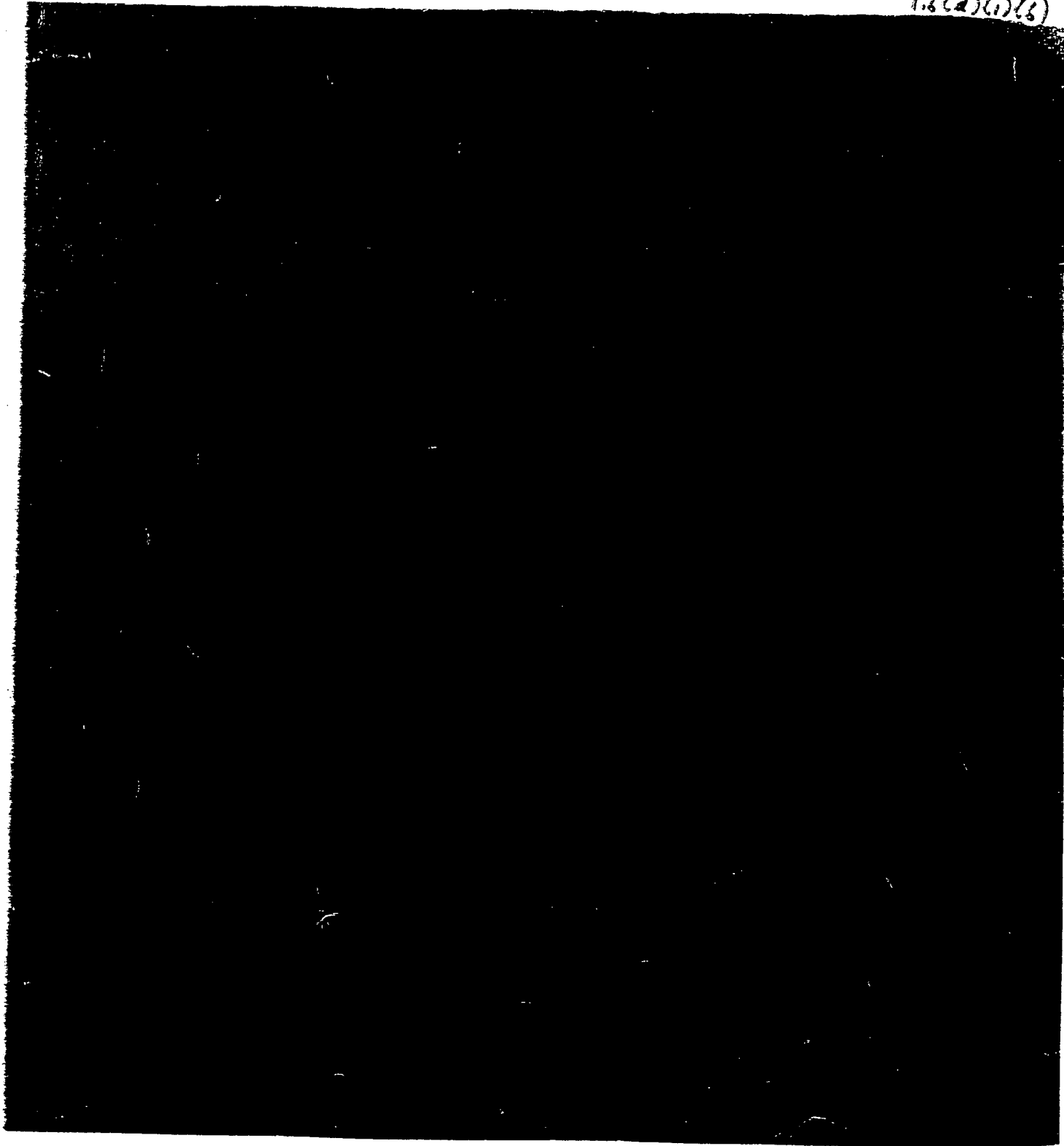
power in the Persian Gulf without the resources needed to rebuild its military, and worsening economic conditions probably will absorb much of the government's attention. Iran will retain significant influence over world oil markets, if only because of its location. Many states may continue to view Iran as a potentially lucrative market for trade—it is one of the largest markets in the Middle East. Its failure to sustain economic growth will diminish interest by foreign investors. Although firms may probe for profitable construction contracts, we anticipate that many will be discouraged by their inability to secure financing or majority equity stakes in Iranian projects. (CONF)

Iran's economic pressures have prompted Rafsanjani to turn increasingly to the West for help. His most recent efforts included holding an international oil conference in Iran in May 1991, during which he and several of his ministers told participants that Tehran seeks cooperation, not confrontation, and that "economic considerations overshadow political priorities." Although Western Europe and East Asia can provide all the resources Iran needs, we believe Rafsanjani fears that, as long as US-Iranian relations are poor, Washington will use its influence with these states to

impede Tehran's efforts to obtain economic resources. This perception will probably spur a cautious attempt by Rafsanjani to improve relations with the United States. (CONF)

The USSR presents Iran with an alternative source of some resources, particularly military goods, but it cannot replace the West as an oil export market or provide Tehran with the credit and industrial goods it wants. Soviet arms deliveries to Iran—including the MiG-29, a modern tactical fighter—increased significantly in 1990, and Tehran probably is paying for them in part with natural gas, which it resumed exporting to the Soviet Union in May 1990. Despite the recent trade improvements, the uncomplementary economies of the two nations sharply limit the potential for bilateral economic cooperation. Both countries sell energy resources and need hard currency to purchase industrial and consumer goods. (CONF)

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