Iranian Economy and the Contradictions of the Islamic Republic in Historical Perspective

By

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1. Introduction

Since the formation of the Islamic Republic in Iran there has been a tendency to reinterpret the history of contemporary Iran in the light of the developments since the 1979 revolution. The 'Islamic' reinterpretation of the modern history of Iran is of course dominant in the official historiography of the Islamic Republic and forms an important part in the ideology and the world view of the state. But such tendencies are not uncommon in the writings of more independent researchers as well, where hitherto neglected 'Islamic' drivers of the past history are being rediscovered in order to reconstruct the past to fit the present.

At the other extreme are those who, focusing on particular aspects of the Islamic Republic, analyse its development and change as a continuum of some elemental dynamics which have been at work throughout the contemporary history of the country. For example Gheissari and Nasr (2006) view democratic struggles under the Islamic regime as a continuation of the quest for democracy which started with the Constitutional Revolution of the early 20th century. More specifically on the economic front, Axworthy (2007) resembles the economic system under the Islamic Republic to a replica of the Pahlavi project of industrialization – with common elements such as state control of industry, economic autarchy, urbanization, neglect of agriculture, subsidies etc. Abrahamian (2008) highlights the unifying elements in the form of the tendency towards centralization and bureaucratization of power starting from the first Pahlavi regime in the 1920s and continuing even more vigorously under the Islamic regime.

Iran being an oil economy has also played its role in shaping this continuity framework within the economics literature. For example Mohaddess and Pesaran (2013) show that apart from oil being the main driver of the Iranian economy during the pre and post-revolution periods, the relationship between oil and non-oil economic growth has remained statistically stable from a long term perspective.

In this paper we build on the insights provided in the existing literature, but argue that in order to understand the medium-term economic dynamics under the Islamic Republic one needs to consider both the specificities of the Islamic Republic and its historical continuities. By historical continuities we mean those elements inherited as initial conditions from the recent history of the country as well as developments in the international political economy during the lifetime of the Islamic Republic which constitute another set of given conditions. By specificities of the Islamic Republic we mean those institutional innovations introduced at the inception of the Islamic Republic which were neither rooted in recent history of the country nor in current international political economy. By contradictions of the Islamic Republic in a historical perspective we mean the lack of congruence between the specificities of the Islamic Republic and the historical exigencies which give rise to institutional development and socio-political change. In this paper we are mainly concerned with those institutional changes which have had important implications for economic development under the Islamic Republic and can define likely future course of developments.

In Section 1 we start with an overview of the political economy of Iran prior to the formation of the Islamic Republic. This highlights the main developments during the 20th Century which defined the modern political economy of the country and its achievements and tendencies. Section 2 discusses the main features of the political economy of the Islamic Republic as they evolved on the basis of the interaction between the vision of the founders of the Islamic Republic and the prevailing historical realities. In Section 3 we discuss the implications for the economy, and particularly the management of the oil sector and its revenues and the implementation of various economic reform project by the government. Section 4 covers the outcomes in terms of social welfare and poverty and the paper ends in section 5 with concluding remarks.

2. Creation of modern state institutions and economic change before the Islamic Republic

The modern economic history of Iran begins with the growing integration of the Iranian economy in World trade and increasing contact with more advanced capitalist countries in the 19th century. Up to the early 20th century this process mainly led to the gradual dismantling of the established economic and social relations and in time led to the dissolution of the centuries old socio-political order, culminating in the Constitutional revolution in the first decade of the 20th Century. It was not however until the 1920s that the modernization of state institutions got under way in earnest, when a confluence of favourable internal and external conditions allowed the creation of a centralized state authority under Reza Shah[1].

Oil revenues which started to trickle in during the second decade of the new century played their role in financing the newly constructed state institutions, particularly the military, considered crucial for the unification of the country and ending the autonomy of regional governors and tribal chiefs and stopping widespread brigandage. Measures were taken by the state to rationalize and expand central administration to help consolidate the military-bureaucratic state. The new state institutions helped to undermine the political power of conservative coalition of landlords and traditional aristocracy, supported by the conservative clergy, opposed to the modernization project.

Effective measures were taken to regulate the civil service by establishing educational standards, introducing life tenure, and providing regular scale of meritocratic promotion and salaries. The same bureaucratic criteria were applied to the judicial and education systems. A comprehensive civil code as well as penal and commercial codes were devised which gradually transformed judicial practices from the prerogatives of the clergy or traditional Kadies, conducted according to their personal interpretation of *Sharia* and *custom*. Bureaucratization of administration of law was completed by introducing special examinations and university degrees for presiding over judicial courts.

The formation of this centralized and unified bureaucratic machinery, considerably aided by the availability of oil revenues in a predominantly pre capitalist economy and amidst a diversity of socio political structures, also enhanced the ability of the state to intervene in the economy. The finances of the state were rationalized and the

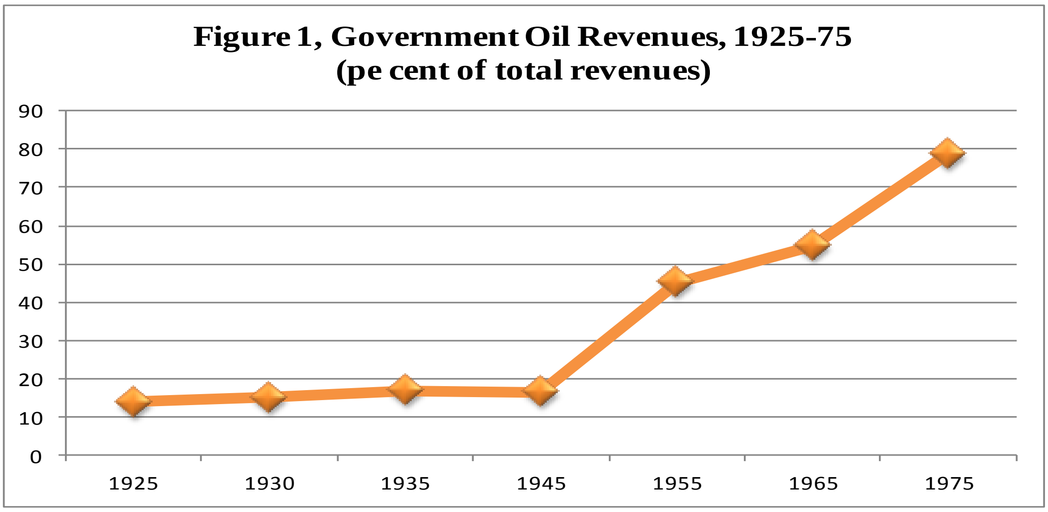
[1] For the economic and political history in this period see, Abrahamian, 1982, and Karshenas 1990, and the sources quoted there. The discussion of the Pahlavi Era in this paper is based on Karshenas 1990.

old practice of tax farming which had crippled the economy during the Qajar times was replace by a new and more efficient taxation system. The civil code and the land registration laws of the late 1920s which provided a firm legal foundation for private land ownership changed the status of landlords from tribal chiefs, princes, and conditional assignees of the state to private citizens with unconditional private proprietorship.

The rationalization of the state administration was accompanied by the creation of specialized ministerial branches and agencies which could play a more active role in the economy. The national bank (Bank Melli) was established in 1928 which took over the monopoly right of the banknote issue from the British Imperial Bank. In the interwar period the economy as a whole was not directly impacted by oil revenues and oil did not substantially contribute to domestic capital formation. Government investment in infrastructure and industry in this period was financed by taxes on trade and other forms of direct and indirect taxes. Major infrastructural investments were financed in this way, and this also provided the finance in the 1930s for a proliferation of state investments in modern factories in light import substitution industries. (see, Karshenas 1990, Ch.3).

The creation of modern bureaucratic state institutions during the interwar period dramatically expanded the realm of rule based government as well as purposive public oriented policy interventions, in contrast to patrimonial and personalized relationships which were the modus operandi of the old political order. There were of course serious limitations to the reach of the new state institutions, as the majority of the population still living in rural areas were under the tutelage of absentee landlords. Under the prevailing socio-economic conditions and the absence of a social class that could champion the modernization drive, state interventions inevitably took autocratic forms. The content of economic interventions however was mainly dictated by circumstances and the emulation of industrialization strategies of other developing countries in the interwar period (see, Karshenas 1990, ch.3).

While the first era of Pahlavi rule during the interwar period was mainly concerned with state building activities, the second phase from the mid-1950s under Mohammad Reza Shah had much more transformative effects on the economy and society. An important enabling factor in this process was the considerable increase in oil revenues from the mid-1950s following the 50-50 profit sharing agreement with the international oil consortium and the rapid growth of oil exports in the subsequent years (Figure 1). The share of oil revenues in total government revenues increase from its average of about 12 per cent in the interwar period to over 45 per cent in the mid-1950s. The share of the oil sector in GDP also increased dramatically, with the implication that government would be necessity have much more important direct impact on the economy. The most important interventions by the government in the new era was however more qualitative and indirect.



The first area in which the state played an important role was the attempt to create a new capitalist class by bolstering financial institutions and providing ample credit through both public and private financial institutions as well as the creation of plan organization which played an important complementary role in this process. This led to a remarkable growth of the corporate private sector and spread of managerial capitalism during 1955-75. A number of large diversified corporate conglomerates akin to the South Korean Chaebol were created in this period which formed the backbone of private corporate sector and played a dynamic role in introducing new technologies and modern management techniques. The significance of the entrepreneurial class in transforming the Iranian economy and society in this period has not been given due recognition in the literature. Some of these family conglomerates were created by old bazari families with astute business acumen which outperformed their South Korean counterparts in many respects.[2] The growth of modern manufacturing and service industries in Iran in this period was one of the highest in the World, easily outperforming South Korea (Karshenas 1990, Chs. 4-5).

The Second important area of state intervention in this period was land reform and the eradication of absentee landlordism in the 1960s. Apart from undermining the power of absentee landlords, which since the 1920s had been the main pillars of support for the autocratic regime of the two Pahlavi Shahs, this also opened the agricultural sector to commercial farming and increased labour mobility (see, e.g., Hakimian 1990). The land reform, combined with other initiatives known as the White Revolution, extended the reach of the state into the countryside, which by then still contained over 70 per cent of the population. The White revolution went beyond the issues of agricultural land ownership to encompass other social reforms including universal literacy programs, new rural health initiatives, the extension of voting right to women, reform of the family law, etc. These reforms set in motion irreversible social changes which were prerequisite for the creation of a modern dynamic economy and society, and were increasingly at odds with the autocratic form of the government.

The extent to which the autocratic form of government influenced the nature and pace of economic transformation varied across the different periods and was to some extent a function of the relative size of the oil revenues. In periods when significant

[2] See e.g., the history of Lajevardi family conglomerate in Saidi and Shirinkaam, 2005.

institutional transformations were needed as in the interwar period and during the 1950s and the 1960s, the autocratic state, relying on its independent source of oil revenues, was a boon for the effective implementation of economic reform. The autocratic state, however, had its many negative sides too, which became increasingly evident and damaging as the economy and society progressed.

A prominent episode was the oil price boom of the early 1970s when overriding the advice of the government technocrats, the Shah ordered a quadrupling of the size of the fifth five year plan leading to an overheated economy with enormous economic and social dislocations and inefficiencies. A more important aspect of the question of autocratic rule and economic development, however, related to the long term sustainability of the development process. This issue had to be confronted in the latter half of the 1970s decade when in the aftermath of the oil boom economic reforms were clearly necessary to sustain economic growth. Whether the Shah and the autocratic political order he had developed over time could have accommodated the economic realities and initiated the required reforms remains unknown. In similar situations, such as Turkey in the 1980s or in an earlier decade in South Korea, the state leadership allowed greater technocratic intervention and greater role and independence of the new industrial elites. Whether the Shah could do the same by opening up to these forces and, if so, how the economic system would cope in this period of lowered financial resources never got to be tested.[3]

3. The Islamic Republic and the invention of the clerical State

The 1979 revolution catapulted into power Ayatollah Khomeini an aging Grand Ayatollah from the seminaries in Qom and Najaf where he had developed his novel notion of Velayat-e-Faghih (Guardianship of the Jurist) as the principle pillar of an Islamic State. The idea was novel in the sense that it was never practiced in Iran's history – neither recent nor distant.[4] The first decade of the post revolutionary period witnessed the construction of the constitution of the Islamic Republic and evolution of new state institutions based on Khomeini's vision of Velayat-e-faghih.[5]

As the charismatic leader of the revolution Khomeini was in a unique position to see to fruition his vision of Islamic state before his death. The evolution of state institutions in that period was also conditioned by circumstances such as the war, the democratic demands of the revolution, and various other exigencies of the time as well as the pre-existing institutions. The outcome has been a juxtaposition of different organizational forms with various contradictory principles and practices which has prevented the system from settling down to some kind of equilibrium

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[3] The evidence suggests that it is unlikely that the Shah would have been capable of agreeing to the power sharing necessary for the required reforms (see, e.g., Saeidi and ShirinKaam 2005, ch.8). In the late 1970s the Shah is reported as saying that 'if the industrialists think that thanks to the wealth they have managed to amass they can participate in politics they will be mistaken' (Ettela'at newspaper, quoted in Saeidi and Shirinkaam, 2005, page.252).

[4] According to Abrahamian 2008, this was based on expanding 'the traditional Shi'i concept of Velayat-e-faghih 'from jurisdiction over orphans, widows, and the mentally feeble to clerical supervision over all citizens'.

[5] On the development of the constitution of the Islamic Republic and the construction of the new state institutions see, Schirazi 1997, Abrahamian 2008, and Amir Arjomand 2009.

decades after the formation of the new state. The development of the Iranian economy under the Islamic Republic has been critically influenced by such dynamics.

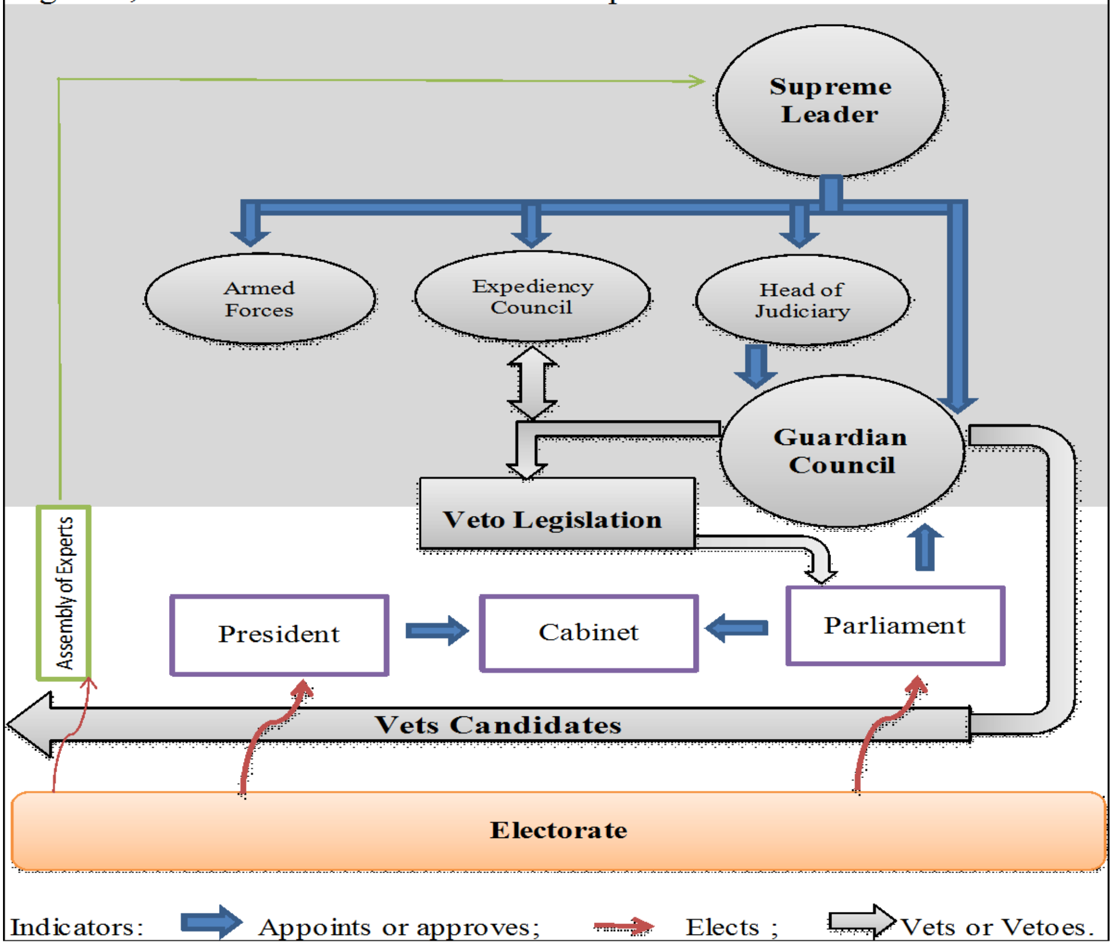
New State structures and state power in the Islamic Republic

An essential duality exists in the nature of state power in the Islamic Republic which finds its physical counterpart in the structure and form of state institutions and its apparatuses. Such duality is also manifest in the constitution of the Islamic Republic. One source of power emanates from the revolutionary pedigree of the republic and incorporates the democratic demands of the revolution. Another source is rooted in the notion of Velayat-e-faghih and its embodiment in ideological, regulatory, and coercive institutions established under the auspices of Ayatollah Khomeini and his followers. With the passage of time and growing remoteness of the revolution the latter has become stronger at the expense of the former.

This duality of state power is also reflected in a duality in state structures and their operational forms. On the one hand the official state structures, namely the elected parliament and state executive under the elected president, function in a relatively transparent, accountable, and meritocratic milieu. They exist, on the other hand, side by side a network of apparatuses controlled by the clergy and headed by the supreme leader, which constitute the clerical or what we refer to as the 'core' state. The core state controls important state apparatuses such as the judiciary and the security forces and through its institutions such as the Guardian Council it screens candidates for parliamentary and presidential elections and has veto power over the legislation passed by the parliament. It can also exert considerable influence over day to day affairs of the official government through informal networks and the representatives of the supreme leader in various ministries.

A sketch of the dual state structures of the Islamic Republic is shown in Figure 1. The core state and its various supervisory, consultative and executive arms are depicted by shaded area, and the elected official state institutions are shown as un-shaded rectangles. The difference between the core clerical state and the official state however is not solely arising from the fact that one is elected and the other unelected. They have entirely different modus operandi too. The official state, or the legal-rational arm of the Islamic state, is more attuned to bureaucratic modes of operation. The ministerial branches and their offices operate on similar well demarcated and codified principles and impersonal regulations which they inherited from the pre revolutionary state bureaucracy. This mode of operation requires transparency and enforces accountability by the operatives. Competences rather than personal connections matter more in recruitment in such organizational arrangements. The core clerical state on the other hand operates more on the basis of personal networks and patrimonial relations. Personal trust rather than impersonal qualities and criteria rule in that sphere. Transparency is minimal and accountability is equally lacking. The application of laws and regulations depends on the exigencies of the time and the persons involved. This applies to the dealings of the core state with third party persons or organizations as well. The Guradian council for example disqualifies parliamentary or presidential candidates on grounds of being un-Islamic without bothering to give reasons for its decisions in each individual case. The judiciary aat times orders closing down newspapers on the basis of charges which do not seem to matter at other times, etc.

Figure 2, State Structures of the Islamic Republic of Iran



The operational distinctions between the two arms of the dual state should not be over-exaggerated. Large organizations such as the judiciary and the revolutionary guards which fall within the core state by necessity require internal codified rules and regulations and recruitment based on competences. Penal and civil laws need to be codified and applied by judges with specialized competences. Under the 'guardianship of the jurist' system, however, the ultimate authority lies with the supreme leader and his selected clerical councils, and this is perhaps the main distinction with the 'legal rational' systems where legitimacy derives from the rationality and hence impersonality of the regulations and relations.

Similarly, the official elected arm of the Islamic state, being dominated by the core clerical state by no means fulfils the ideal type legal rational criteria. Preferential treatment in awarding government contracts is given to individuals or organizations close to the core state, who also receive preferential treatment in receiving privatized government assets. Even in personnel recruitment there have been instances of cronyism on a massive scale, when for example during Ahmadi Nejad's second term an attempt was made to replace a large part of the government middle management officers with 'trusted' elements (khodi) without due consideration of their competences.

The growing encroachment of the core clerical state in the functioning of the elected official state should not induce the impression that the dual state model and the distinction between the core state and the official government are superfluous. On the contrary, this distinction can highlight some of the important aspects of both economic and political dynamics under the Islamic Republic. On the political front, at times of crisis the core state often attempts to deflect the responsibility from itself by giving more leeway to the elected component of the dual state. At such times of crisis, particularly of the type that cannot be dealt with by the coercive state apparatuses, the issues of the rule of law and technocratic competences are pushed to the fore by popularly elected governments. On the economic front, the significance of the dual state is even more important for understanding the dynamics of economic change under the Islamic Republic. The luck of success of various economic reform attempts by the elected official government, as we argue below, is connected to this phenomenon. More significantly much of the dynamics of capital accumulation since the 1979 revolution has been shaped by the changing relationship within the dual state, and such economic change has in turn influenced this relationship. In the next section we discuss the capital accumulation dynamics by focussing on agents of accumulation within the core state, the elected official state, and the private sector.

4. New agents of accumulation and the blurring of private public distinctions

The core clerical state gradually built its power around the charisma of Khomeini as the leader of the revolution, by championing the ideology of social justice and equity, and by constructing its coercive apparatuses during the war with Iraq. It nevertheless lacked a material base independent of the official state. The first step in bolstering its material base was to declare the Pahlavi Foundation and other assets of the family of the deposed Shah, and the assets of many of the big industrialists who left the country at the time of the revolution, as 'war booty' belonging to the Muslim 'umma' to be administered by the clergy on behalf of the downtrodden 'mostaz'afan', distinct from the public sector assets controlled by the official government (Maloney, 2000, Saeidi, 2004, Amir Arjomand, 2009). Bonyad Mustaz'afan (the Foundation for the Oppressed) was set up to control such assets and in time other charity foundations controlled the core state were set up with considerable economic power and command over a large section of the modern corporate sector of the economy.

Many of the foundations, particularly during the first two decades of the revolution, have had a shadowy existence with their operations and accounts not open to public scrutiny. As a consequence researchers have speculated about the nature of their activities and their size – e.g., estimates of the size of the bonyads ranging from negligible to controlling over half of the GDP are reported by different authors. Since 2005 the Mustaz'afan Foundation, the biggest and most powerful of the *bonyads*, has been publishing their accounts with lists of their activities and holdings, which can help shed light on the nature of these entities as well as their command over economic and financial resources.

A comparison between the first charter of bonyad Mustaz'afan composed in 1979 and its last update of 2000 reflects the changes in political power within the dual state structures of the Islamic Republic. The bonyad was formed in March 1979 as a non profit organization to manage the assets of the Pahlavi Foundation and other confiscated assets. According to the 1979 articles of association of the bonyad, the board of trustees appoint the supervisory board and the president of the company. The board of trustees was itself to be appointed by the Revolutionary Council. The bonyad's accounts were to be audited by independent auditors, and independent legal and operational inspectorates were set up to report to the board of trustees. The board of trustees could liquidate the company with surplus assets to be transferred to the government. According to the 2000 articles of association all of the powers ranging from the appointment of the board of trustees, the manager, and the various inspectorates are transferred to the supreme leader. Company accounts are audited by auditors of the office of the supreme leader. Liquidation of the company and divesting of its remaining assets are also at the pleasure of the supreme leader. In short, the company has turned into the personal fiefdom of the supreme leader.

The original mission statement of the Mustaz'afan foundation emphasized the management of the confiscated assets in the wake of the revolution for the benefit of the deprived. In later statements however the emphasis is on profit-making and expansion, which sits awkwardly next to the legal status of the institution as a non profit organization. Over time the bonyad has developed into a sophisticated conglomerate with numerous holdings in services, banking, mining and manufacturing, energy, construction, transport and trade, etc.[6] The most valuable assets of the bonyad are in fact in new companies in banking, communications, and energy sectors which have been developed since the revolution.

The assets of the bonyad have been growing rapidly with lucrative investments in banking, energy and telecommunications. Provision of social assistance and particularly housing for the deprived, which was the original purpose of the bonyad now forms a very small part of its activities. The charitable activities are now consolidated in the Alavi Foundation which is one of the very small holdings of bonyad Mostaz'afan. For example, in 2010 the charitable grants disbursed by the Alavi foundation in Iran were only a quarter of total grants disbursed by the Mostaz'afan foundation, with seventy per cent of the grants transferred to the supreme learder's office[7]. The grants transferred to the Alavi foundation for charitable purposes were no more than 1.5 per cent of the gross profits of the Mostaz'afan foundation. In other word, the Mostaz'afan foundation is a powerful commercial conglomerate, with full tax exemption and the legal status as a charity, which along with numerous other foundations established by the core clerical state form part of the material base of the core state and its patronage network.

The foundations are not the only powerful economic institutions within the core state. Since the early 1990s, the Islamic Revolutionary Guards Corps (IRGC) have also been engaged in business activities and have since established their own powerful economic conglomerate under Gharargah Khatamul Anbia, acronyms Ghorb or Khatam, which has amassed considerable financial capital and engineering expertise. Ghorb's commercial activities could be more clearly characterized as belonging to the government sector, as compared to the Bonyad Mustaz'afan. But its activities, though physically visible throughout the country, are less transparent commercially. It differs from state owned enterprises in the official elected arm of the government in that its

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[6] In 2012 42 per of the company assets were in the energy sector, 32 per cent in services including banking, 18 per cent in industry and mining, 5 per cent in construction and 3 per cent in agriculture.
[7] Bonyd Mostaz'afan Auditors Report (2010).

accounts are not part of the government budget and open to scrutiny by the parliament. Unlike the Mostaz'afan bonyad, its accounts are not openly available either.

There are other independent sources of wealth within the clerical establishment such as religious Vaqf properties and regular religious donations to various Mujtaheds. According to Abrahamian (2008) for example, the combined real estate assets of shrines of Imam Reza in Mashed, Fatemeh in Qom and Abdul Azim in Rey are as much as $8 bn. He refers to them as 'states within the state – or clerical fiefdoms accountable only to the Supreme Leader' (ibid, page 178).

The different sources of independent economic power of the core state, the Bonyads, the Ghorb of IRGC, and the religious Auqaf, seem to coexist without serious tensions under the umbrella of the Supreme Leader's office. The multiplicity of sources of economic patronage can in turn be a source of strength of the core state, as long as the office of the Supreme Leader can remain an authoritative co-ordinating centre for them. Such arrangements however to a large extent depend on the relative size of the economic assets of the core state. In the existing literature there seems to be some exaggeration as to the size of the core state's economic operations. Lack of transparency has led to some wild speculations as to the dominance of the bonyads in the national economy. It has been suggested for example that the bonyads in themselves control over 40 per cent of the economy (Amir Arjomand 2009, p.121). This is a highly exaggerated figure by any measure.

One way of looking at this is to consider the relative size of employment in the bonyads. According to Abrahamian, quoting Amuzegar (1993), in the early 1990s the bonyad's employed over 400,000 people (Abrahamian, 2008, p.178). This figure itself looks like an over-exaggeration, but even if we take it at face value, it does not seem plausible that in a country of over 70 million population 400,000 people account for over 40 per cent of the economy. This becomes even more implausible when one considers that some of the bonyads are largely engaged in non-commercial charitable activities with government budget as their main source of income. A more accurate picture may be drawn by considering employment in bonyad Mostaz'afan, the largest and most productive of the bonyads. The estimates are again wide ranging from 200,000 top estimate, to 650000 reported in Amuzegar (1993), and just below 35000 reported in 2005 by the bonyad itself. Nevertheless, even the 200000 figure constitutes only 1 per cent of the 20 million nation-wide employed labour force.

More direct definition of what is meant by economic control and measurement based on the accounts of the Mostaz'afan foundation also hint to a different picture than is conveyed in the literature. According to the consolidated accounts of the bonyad, in 2005 the total gross sales of the bonayd and its affiliated companies was about 12000 billion Rials, which does not constitute more than 0.28 per cent of non-oil GDP and 0.20 per cent of the GDP including the oil sector – figures which are more in line with the employment figures discussed above. Considering that all the other company metrics such as net income, wages and salaries paid etc., are subsets of the gross sales, clearly any quantitative flow measure of economic dominance would not improve on the 0.2 to 0.3 per cent of GDP. Looking at the stock of assets of boyad Mostaz'afan, according to the auditors' report at the end of 2005 the consolidated stock of the company and all its affiliates added up to about 1 per cent of the GDP in that year.

However, as the measurement of assets is based on historic cost, and considering the high rates of inflation in Iran, this can be a gross undervaluation.

To sum up, the economic strength of the core state institutions when measured by their size relative to the rest of the economy is not as significant as portrayed in the current literature. Set against the 6.5 million working in private services, over 3.5 million working in manufacturing, even the exagerated 400,000 active in the Bonyads pale to insignificance. Public employees of over 3.5 million working within the institutions of the elected official state, and the accrual of oil revenues to the official state which in terms of gross sales are 160 times higher than the Mustaz'afin foundation, clearly indicate that despite the appearances the official state is still the dominant force in the economy.

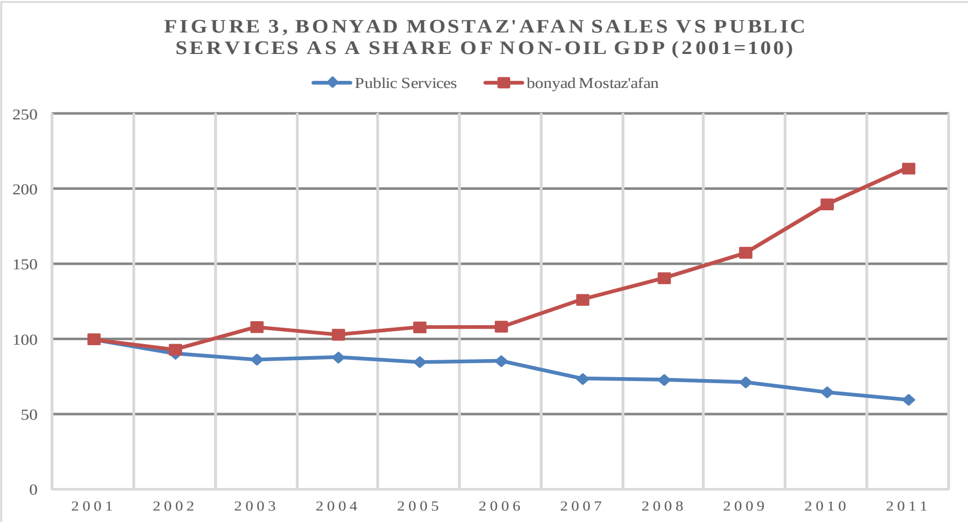
This nevertheless does not imply that the economic institutions of the core state do not play a significant role in the political economy of the Islamic Republic. Their role is much more significant than their quantitative size may indicate. Firstly, as highly profitable economic entities the bonyads supply considerable funds utilized in building up and maintaining important ideological apparatuses of the core state in the form of mass media, educational institutions, publishing houses, religious charities etc. (See, Saeidi 2004). Similarly, the commercial activities of the IRGC are significant in furnishing the core state with independent sources of funding for the coercive apparatuses under its control, immune from the official scrutiny which regular budgetary spending on military and law enforcement are subjected to. The fact that such funding remains partial and limited may not be a bad thing as far as the clerical state is concerned, as too independent a military force can be a double edged sword.

On the economic front, the commercial institutions of the core state have an even more significant impact well beyond what their relative size may indicate, due to their close association with political power. This, on the one hand, gives them access to subsidized credit, lucrative government contracts, and at times other subsidized rationed resources such as foreign exchange. As such, they form the nodal points of a vast clientelistic network through which access to business activities is opened to private sector as subcontractors, or start-up businesses barred to those outside the network. The least criterion is to be an obedient subject of the state, and for more lucrative gains, to be a part of the trusted network of the core state.

Another implication of this fusion of economics and political power within the core state has been that the state itself has become the arena of factional infighting between many of the particular interests that in democratic societies normally fight their battles openly through civil society activism. Such factional infighting, increasingly taking place through the obscure personal networks of the core state, has had important implications for economic policy making under the Islamic Republic.

An important area of contestation has been the distribution of economic assets and revenues between the core and the elected state institutions. Since the establishment of the Islamic Republic one can witness a gradual strengthening of the economic base of the core state relative to the modern state institutions as well as the rest of the economy. Figure 3 highlights this phenomenon in clear relief for the 2001-2010 period for which we have the data. The figure shows the trends in gross sales of Mostaz'afin foundation against the value added in public services, both as a share of non-oil GDP, with 2001 as the base year.[8] During the first half of the decade the bonyad's size seems to be keeping up with the non-oil GDP by moderately outpacing the value added in public services. From 2005 onwards, however, the boyad shows a relatively explosive growth relative to the non-oil GDP while at the same time the relative size of public services takes a dive. Considering that the period covered in Figure 3 was one of particularly rapid growth in non-oil GDP makes, the growth of the boyad's size especially between 2005 and 2010 appears quite impressive.

Given the rapid growth of the real sales of bonyad Mustaz'afin one may raise the question of the reason for its size relative to both the private sector and the official government operations still being so small. One explanation of course is that the bonyads started from a relatively small base. More important explanations however have to do with the nature of growth of these institutions which makes their growth unsustainable and subject to periodic collapses. As we argue in the next section, by influencing economic policy and competing away resources from more transparent and competitive economic units, the periods of rapid growth of bonyads are followed by episodes of growth collapse in the economy as a whole.



Notes: All variables are measured in real terms. For 2001-5 period Bonyad sales price inflation is estimated.
Source: Bonyad Mostaz'afan (2014) and Bank Markazi Iran databank 2014.

5. Islamic Republicanism and the Economy

The dual nature of state power and the growing encroachment by the theocratic core state over the political and economic powers of the elected state institutions has had important implications for the nature of economic policy making and economic development in the Islamic Republic. What has been critical in this relationship is the fact that Iran is an oil state and the management of oil revenues cannot be divested from the budget of the elected official state. The encroachment over government policy making and particularly the management of oil revenues has therefore had to be done by stealth, often manifesting itself at the implementation stage, and causing policies and institutions designed to address particular problems often producing the opposite outcomes. In this section we discuss two broad aspects economic policy

[8] The only variable available for a long enough period of time with respect to the bonyad is gross sales rather than value added.

and their implications for the economy at large. The first is the management of oil resources and its macroeconomic effects in terms of economic stability and growth. The second aspect relates to economic isolationism – its political economy logic and its implications for economic efficiency.

Diagnostics of the oil malaise and the management of oil resources

The Iranian economy has been highly dependent on its oil export revenues since the mid-1950s. Despite incessant rhetoric about reducing economic dependence on oil by successive governments, the degree of oil dependence as measured by the share of exports and particularly government revenue is currently even higher than the 1960s (see, e.g. Karshenas and Malik 2012, Mohaddes and Pesaran 2014). Some have attributed this inability to diversify away from oil to the abundance of the natural resource itself. For example according to the 'Dutch Disease' theory, foreign exchange revenues from the oil sector can lead to the overvaluation of the exchange rate and hence the inability to diversify into sectors such as industry and agriculture. On the other hand it can be argued that the availability of oil revenues in a developing country such as Iran provides both the finance and the foreign exchange necessary to import more advanced technologies and industrial inputs necessary for improved productivity and enhanced competitiveness. The empirical evidence seems to supports the latter view. In the first half of the 20th century the United States, at the time the major oil producer and exporter in the world, built an important part of its engineering industry and developed important aspects of its technological supremacy around its oil industry. In the case of Iran and other current day oil exporting countries also we observe strong industrial growth during the oil booms and frequent growth collapses during the downturns in the oil industry.

The problems of oil economies are more associated with economic policies and politics than the oil revenues per se. This is particularly true in the case of Iran and other oil exporting countries in the Middle East where oil revenues directly accrue to the state. As the intermediary between the oil market and the economy in Iran, the government plays an important part in this process. Institutions such as the five year development plans and oil stabilization funds are put in place in many oil producing countries including Iran to maintain macroeconomic stability in the face of a volatile oil market in the short run and optimal resource use in the long run. The evidence, however, shows that despite the existence of these institutions, the volatility of government expenditure in Iran more than mimics the volatility of oil prices – the government behaviour under the Islamic Republic appears to even exacerbate the macroeconomic impact of oil price volatility. The economic volatility and inflation resulting from unbridled fiscal and monetary policies by the government have had significant negative effects on economic growth (see, Mohaddess and Pesaran 2014).

It may not be too difficult to see how despite the existence of medium term planning autocratic governments may be enticed into expanding their annual budgets and even medium term expenditure plans during oil price rises, overruling their own medium term plans. A notable example of course is the 1970s oil boom and Shah's intervention to overrule the technocrats in the central bank and plan organization to increase government expenditures by many times. Apart from the 1970s episode, there was a general tendency towards short-termism in responding to oil revenue fluctuations during the Pahlavi era – partly due to the influence of the court and partly resulting from the dynamics within the government bureaucracy itself (see, Karshenas 1990). Such tendencies continued under the Islamic Republic during the 1990s which was the first decade of 'normalcy' in the post Iran-Iraq war era. In 2000 an oil stabilization fund (OSF) was created precisely to deal with this problem under president Khatami and the reformist dominated parliament. Under the peculiar political configuration of the Islamic Republic, however, the creation of the oil stabilization fund appears to have led to opposite outcomes from what it was expected to do.

The creation of the oil stabilization fund coincided with a period of rapid increase in oil prices which initially led to large accumulation of funds in the OSF. By 2005 the assets of the fund had reached $15 bn, with $10 bn deposits in the central bank. At this juncture what may have appeared at the time to be the final onslaught of the core state took place in the parliamentary elections of 2004, when the reformist candidates were barred from participation en mass by the Guardian Council, and the subsequent appointment of a president with deep roots in the ideology and networks of the core state, and particularly its IRCG wing, in 2005. Ahmadinejad was fast in spending the accumulated funds in the OSF on his populist projects, mostly taking the form of construction projects contracted out to Ghorb, the IRCG's business arm, bonyad Mostaz'afan's construction companies and others close to the core state. The deputy director of Ghorb in an interview with a national newspaper in August 2006 confirmed that most of the projects of Ghorb are funded by the OSF reserves.[9] Rather than acting as a stabilizing institution, under the political configuration of the Islamic Republic the OSF became a destabilizing institution.

The onslaught continued with the dismantling of the plan organization in 2007.[10] The Plan Organization which was created as a semi independent entity in the 1950s and spearheaded the modernization project of the old regime was reduced to a bureau under in the presidential office. The regional branches of the organization which over the years had played an important part in introducing a measure of bottom up planning as well as important regional development functions were to be abolished. The final and dramatic onslaught however was yet to come, in the form of the creation of the National Development Fund of Iran (NDFI) in 2011. The National Development fund which was to receive 20 per cent of oil revenues, gradually to be increased to 32 per cent by annual increments of 3 percentage points, was set up as an 'independent' fund to finance private sector projects on demand and on purely commercial bases. With the creation of NDFI the issue of economic stabilization went out of the window and the Oil Stabilization Funds became de facto defunct.

Some have resembled the Islamic Republic's idea of NDFI to the existing Sovereign Wealth Funds in other oil economies in the region or the Norwegian pension fund. The fund has been also compared to other short term stabilization funds such as the natural resource stabilization fund of Chile. The Iranian NDFI however is far from any of the mentioned institutions. Sovereign Wealth Funds in the small oil surplus economies in the Persian Gulf are in charge of investing their huge surplus oil

[9] Shargh newspaper, August 13, 2006, interview with Abdolreza Abedzadeh.
[10] The Plan organization was renamed Plan and Budget Organization in the 1970s, and later renamed to Management and Planning Organization under the Islamic Republic, but its independence and mode of functioning remained more or less intact throughout these name changes. In this paper we use the generic name Plan Organization to refer to this institution for all periods.

revenues in an optimal fashion and mainly in the form of overseas investments. Norway's Government Pension Fund Global operates within an advanced country setting with a well-developed fiscal system and is also engaged in maximizing the return to surplus oil funds, again mainly invested overseas. The operations of NDFI are very different. By extracting a fixed 20 to 32 per cent of the oil revenues the NDFI puts the finances of the official state into a straightjacket.[11] It totally annihilates the anti-cyclical functions of the OSI and undermines the flexibility of the fiscal policy of the government.[12] More importantly, the operations of the NDFI are such that it has itself turned into a major source of economic instability and waste.

According to its articles of association, NDFI is meant to invest its resources by granting loans to the private sector or non-government public institutions such as the bonyads through its agent banks. The agent banks are some fifteen private or government banks who process the loans and have oversight over the selection of the projects for NDFI approval and are responsible for repayment of loans with interest to NDFI. The Articles of Association of the fund specifies a 6 per cent rate of interest on its loans (called the general rate) with a 1 per cent discount for deprived regions. In a country with over 20 per cent rates of inflation clearly one would expect a rush to access such lucrative funding. Funds would clearly need to be rationed with access restricted to those with close connection to centres of power. Though the board of trustees of the NDFI is composed of the president and heads of various ministries, the parliament and other representatives from judiciary and chamber of commerce, the institution is effectively run by its own board of directors and managers and its activities are as opaque as the parastatal institutions within the core state. As of February 2013, the latest date for which information is provided by NDFI, the fund had a portfolio of $18.1 bn hard currency loans allocated to 9 agent banks for some 330 projects, with an average project loan size of about $54 mn. No information on actual projects or the recipients of the loans is publically available.

The dismantling of the Plan Organization and the allocation of a large part of state revenues to NDFI to be distributed in an ad hoc and as yet undisclosed fashion is equivalent to the cannibalization of the government finances and personalization of public assets in an unprecedented scale. The rapid increase in the share of the Bonyads in the national economy and the declining share of public services shown in Figure 3 above, are some of the manifestations of this process. Some have tried to justify the formation of the NDFI on grounds that it helps bolster national savings and investment and hence enhance growth. This is again a fallacy just like stabilization and sovereign wealth type arguments discussed above. Since 2000 the Iranian economy has had some of the highest savings rates amongst nations, and in fact a considerable excess savings, due to a number of reasons discussed in the literature (see, e.g. Karshenas and Malik 2010, Karshenas and Moshaver 2012). The main constraint to sustained growth in this period has been low productivity of resource use, which the granting of loans at highly negative interest rates to monopoly interests who use their political connections to access the funds surely does not help alleviate. Under the highly inflationary environment of Iran, NDFI loans would have certainly contributed to the enrichment of the lucky 330 individuals or companies who had

[11] NDFI's share of oil export revenues was 20 per cent in 2011, rising to 23 per cent in 2012, 26 per cent in 2013, and is envisaged to increase by 3 per cent a year to reach maximum 32 per cent by 2016.
[12] In fact, as to be expected the assets of OSF which in 2007 stood at over $27 bn declined to almost zero by 2011.

managed to access the loans by February 2013, but surely it could not have improved economic efficiency and productivity of resource use. There are of course other inbuilt mechanisms within the Islamic Republic political system which inhibit productivity growth and lead to periodic growth collapses, to which we shall turn next.

Economic isolationism and lack of competitive environment.

From a long-term perspective, economic isolationism and the absence of a competitive economic environment have been perhaps the most costly aspect of economic policy in Iran with cumulative effects which cannot be easily undone for a long time to come. Economic isolationism, as manifested in the hostile environment for foreign direct investment and low degree of openness to world trade, especially with more technologically advanced economies, has hindered productivity growth and technological progress. Combined with lack of domestic competition arising from the industrial dominance of shadowy parastatal organizations and institutions at the heart of the state with strong political connections, this has had a dramatic effect on efficiency and competitiveness of the Iranian economy[13].

A comparison with the case of Turkey will bring home the stark realities of the cumulative productivity gap which has developed in the case of Iran. In terms of industrial development the two countries were not dissimilar during the 1970s. If anything, given the relative abundance of capital in Iran, the Iranian industries where more capital intensive than Turkey and hence labour productivity in Iran was somewhat higher than Turkey. By the early 1970s, manufacturing exports from Iran were higher than Turkish manufacturing exports, both in absolute terms and as a share of merchandise exports. In 1979 Turkey embarked upon a long and arduous economic reform program with the aim of greater integration in world trade and economic openness. Table 1 below brings into sharp relief the changes that have taken place in the two countries since. Labour force engaged in the manufacturing sector in the two countries is similar both in absolute terms and as a per cent of total employment. However, Turkish manufacturing workers are now four times more productive than their Iranian counterparts. The same number of workers in Turkey now produces 80 per cent of exports of that country's exports which is higher than the entire Iranian oil exports. In the case of Iran of course one should not expect the same manufacturing export performance as in Turkey, as Iran is an oil-producing and exporting country. But successful diversification and the remedy to periodic growth collapses in the case of Iran require similar if not higher labour productivity levels as Turkey.

[13] Surely there has been considerable trade liberalization in the form of tariff reductions and removal of quantitative restrictions under the Islamic Republic. However, monopoly practices of traders with strong political ties has meant that price and quality of merchandize imports are set to benefit the trading merchants more than domestic producers and consumers.

Labour Productivity in Iranian and Turkish Manufacturing Compared, (Average 2005-2007)

	Manufacturing Employment ('000)	(% employment)	Value added per person employed (US $)
Iran	3844	18.4	6433
Turkey	4120	19.0	22951

Source: Calculated from ILO labour statistics and World Bank WDI.

The availability of oil revenues has allowed the continuation of these processes for a far longer period than can be tolerated in non-oil economies by hiding the immediate implications for the standards of living of the population. The longer-term implications however can be dire. The past two decades have presented a unique window of opportunity where due to favourable demographic trends Iran should have been able to build up the necessary industrial knowledge base and skills for a diversified economy capable of sustainable growth. Even if this loss can be reversible, it will burden the future generations with considerable costs and unnecessary hardship.

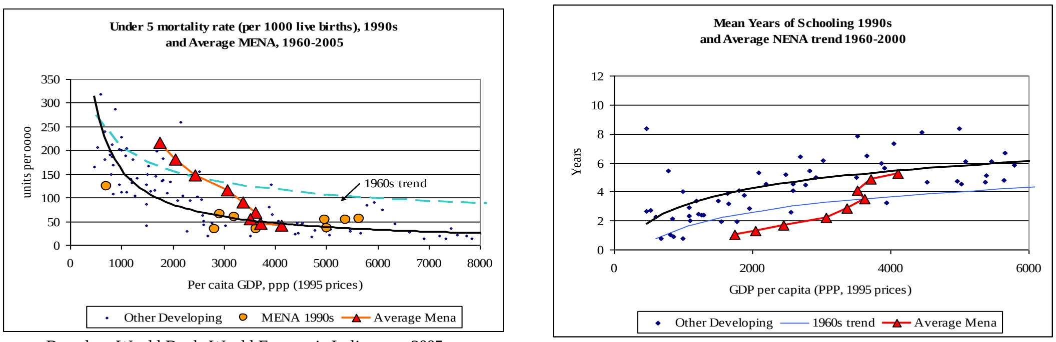
6. Social Development and Social Welfare Outcomes

A central tenet of the ideology of the Islamic Republic has been social justice. Social justice is engrained in the constitution of the Islamic Republic and the defence of the Mostaz'afan's livelihood seems to be given pride of place amongst all other considerations in justifying any major decisions or actions by the Islamic regime. And this has not been a merely empty ideological stance; enormous sums have been allocated to parastatal organizations to support the poor and underprivileged, energetic youth have been mobilized to take the fruits of civilization to the deprived rural areas, large budgets have been allocated to government ministries in charge of social security and education, state assets have been distributed in the form of justice shares, etc. In view of these efforts, and observing relatively good progress in terms of health and educational indicators, the record of the Islamic Republic in this relation has often been referred to in favourable terms by various commentators.

There are however often wide discrepancies between intensions and outcomes when it come to social issues. Furthermore, to judge the success of the Islamic Republic in the social welfare and social development fields one also needs to taken into account the costs associated with the progress achieved. One way of doing this is to compare the performance of the Islamic Republic with other countries in the region with poorer resources and with a less single minded devotion to Mustaz'afan. This is what we shall attempt in the rest of this section starting with comparison of Iran with the rest the countries in the Middle East and North Africa (MENA) in relation to a number of social indicators and their evolution over the past few decades.

Iran along with other countries in the MENA region suffered from extremely low levels of social development well into the latter half of the twentieth century. The earliest available data on social development indicators such as educational and health attainments indicate that as late as the 1960s and the 1970s Iran and other MENA countries stood well behind other developing countries relative to their levels of per capita income and also in absolute terms (see Karshenas and Moghadam 2006). It is also well established that during the subsequent four decades the MENA countries had attained impressive achievements in social development which set them at par or even above their peers (see, Karshenas, Moghadam and Alami 2014). Figure 4 below summarizes these achievements with regards to infant mortality and mean years of schooling. As shown, on average MENA region had sub-par indicators in the 1960s, but by the start of the new millennium it had achieved social development levels commensurate to its per capita income levels. This was common to all the countries in the region including Iran.

Figure 4, Health and educational indicators in the 1990s, and average trends for MENA region since the 1960s

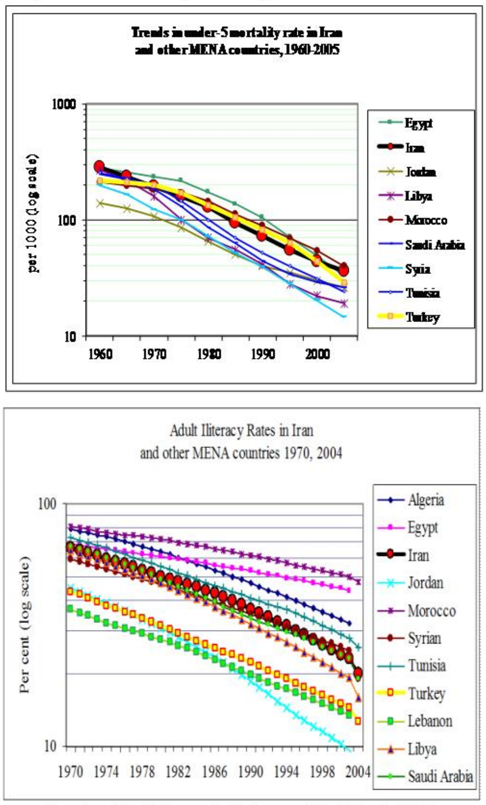


Source: Based on World Bank, World Economic Indicators, 2005.

This general regional picture provides an appropriate context in which the achievements of Iran can be judged both in a historical and a comparative perspective. It is estimated that average years of schooling for the population over the age of 15 in the 1960 in Iran was less than 1, with over 80 per cent of the population having received no schooling. As late as 1970, total illiteracy rate for adult population was 66 percent – 54 per cent for men and 77 per cent for women. This situation was common to all the MENA countries, but the cases of Iran and other oil exporting countries stand out as their educational attainments were well below the levels expected at their prevailing per capita incomes. A similar situation prevailed in relation to health indicators. Life expectancy was 48 years and under-5 mortality rate was 290 in a thousand in 1960 in Iran, and the majority of the population living in rural areas had little access to modern medical treatment. Similar to the educational attainments, child mortality rates in Iran, as in most MENA countries, were well above the levels expected at their prevailing per capita incomes.

The trends in under-5 mortality rates and adult illiteracy for Iran and other MENA countries are shown in Figure 5. As can be seen the trends in Iran during the Islamic Republic are a continuation of the trends prevailing in the pre-revolution period, and in particular the achievements are very close to the average norms in the MENA region. In comparison to some of

Figure 5, Trends in child mortality and iliteracy in Iran and other MENA countries



Source: Based on World Economic Indicators, World Bank, 2008.

the poorer countries in the MENA region, however, the performance of the Islamic Republic, particularly in relation to health indicators shows considerable deficiencies. For example, under 5 mortality rates in the Islamic Republic at the inception of the new regime in 1980 was below Turkey and well below Egypt. By 2010, a low income country such as Egypt seems to have outperformed the Islamic Republic in terms of under 5 mortality rates (See, Table 2).

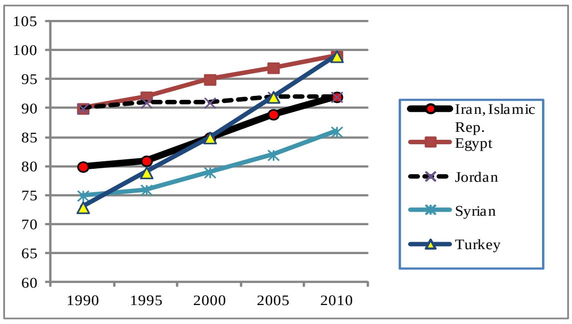
Table 2, Under 5 Mortality in MENA region, 1980-210.

	Mortality rate, under-5 (per 1,000 live births)			
	1980	1990	2000	2010
Algeria	121.7	67.6	48.9	36.0
Egypt	166.4	93.5	46.5	21.8
Iraq	69.0	46.1	42.8	38.6
Jordan	60.1	38.3	29.4	21.7
Lebanon	47.9	38.3	29.3	22.1
Libya	73.3	44.5	27.2	16.9
Morocco	134.9	85.9	55.3	35.5
Syrian Arab Republic	72.4	38.2	23.0	16.0
Tunisia	95.5	49.3	28.4	16.1
West Bank and Gaza	77.2	44.7	30.6	22.3
Yemen, Rep.	193.8	128.0	99.5	77.0
Iran, Islamic Rep.	**107.4**	**64.8**	**43.9**	**25.8**
Turkey	135.3	79.8	42.7	17.6
MENA Average	**91.84**	**54.64**	**36.14**	**24.7**

Source: World Development Indicators, World Bank, 2013.

Social development indicators however have many determinants, ranging from demographic trends to urbanization, resource constraints at the household and public sector levels, as well as social spending and its efficiency, the quality of the services provided etc. One would need to control for many such determinants before being able to judge the comparative efficacy of any one national policy. However, given the Islamic Republic's avowed intention to attend to the livelihood of low income groups and socially excluded Mostaz'afan, distributional aspects of social development can provide more ready indications of the relative success of the Islamic Republic in social welfare provision. For example Figure 6 below on improved access to safe water in rural areas shows that despite improvements since 1990, the Islamic Republic has substantially underperformed in comparison to Turkey and in 2010 still a lower proportion of its rural population have access to safe drinking water as compared to Egypt. In view of the great deal of manpower and other resources mobilized by the Islamic Republic in support of rural development, this may appear disappointing. A more detailed examination of the distribution of social welfare does not seem to produce a better picture (see, below).

Figure 6, Rural access to improved water sources (% population with access)



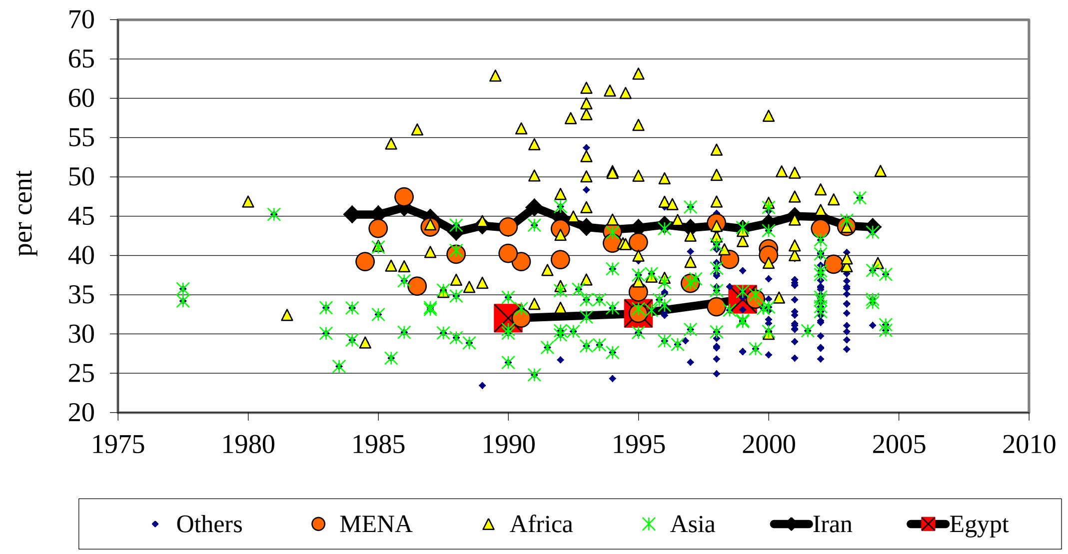
Source, Based on World Development Indicators, World Bank 2013.

Income Distribution and Poverty

Personal distribution of income has complex determinations. However, social development indicators discussed above, such as health and education, are also important determinants of personal income and hence can play an important part in income distribution. Given an initial distribution of assets and economic structures, social policy that provides a more level playing field in gaining access to health and education is likely to lead to a better distribution of income over time. Such policies can also have immediate beneficial effects with regard to income distribution through their tax / spending (subsidy) impact, but in oil economies such as Iran these fiscal effects are likely to be less significant. There are of course other important factors such as technological developments, globalization, etc. which affect the employment and distribution of returns across different assets and skills, further complicating the association between social development and income distribution. Looking at income distribution and poverty in the Islamic Republic in a global context can help reflect on some of these issues.

Figure 7 shows the gini coefficients of the distribution of individual consumption expenditure for Iran during 1984-2010 against countries in Asia, Sub-Saharan Africa and the MENA region. Despite their shortcomings the data on consumption expenditure are more accurately reported in household surveys than income data and may be better indicators of social welfare. Latin American countries are excluded from the graph as they mainly report income rather than consumption distribution. The term income distribution here is used interchangeably with consumption distribution and it refers to the distribution of consumption expenditure. As the Figure shows, there is a considerable overlap in the range of gini coefficients between the Asian and Sub-Saharan African countries, but the labour abundant countries in Asia on the whole have a better distribution of income than the African countries, which is not unexpected. The MENA region takes an intermediate position and the MENA countries fall in the range where Asia and Africa overlap.

Figure 7: Gini Coefficient of per capita Expenditure
Afirca, Asia, MENA, Egypt and Iran



Amongst the MENA countries the Islamic Republic of Iran seems to have the worst income distribution, bordering on some of the most unequal countries in Sub-Saharan Africa. This applies to other indicators of inequality, such as the share of the bottom 10 per cent or bottom 40 per cent income groups, where Iran has consistently had the lowest shares in the MENA region[14]. Another notable feature of income inequality in Iran is that the gini coefficient has remained remarkably stable since the early years of the revolution despite the egalitarian rhetoric of Islamic Republic and substantial improvements in educational standards. In fact income distribution under the Islamic Republic does not seem to have significantly changed from those prevailing in early 1970s under the previous regime (see, e.g., comparable figures for urban areas in Pesaran 1976, and Salehi Esfahani 2007).

How the poor have fared under the Islamic Republic is perhaps a more important question give that the whole bonyad system within the core state has been justified in the name of the poor. Poverty has remained a controversial issue in Iran due to sensitivity of the measurements to the choice of poverty line and the relevant metric for poverty measurement. To avoid such controversies and also gain a comparative perspective on headcount poverty in the Islamic Republic we would discuss the poverty situation in Iran in a global context. This is done by the use of international poverty curve shown in Figure 8. The poverty curve is based on the relationship between headcount poverty and mean consumption expenditure normalized by poverty line (y/z, where y mean consumption and z is the poverty line). The analytics of the relationship are discussed in Karshenas and Pyatt (2012) where it is shown that this relationship remains invariant to the choice of the poverty line and the metric which is chosen to represent average well-being in different countries, as long as the same distribution scales are used. Similarly, the poverty curve in Figure 8 remains invariant to the choice of poverty line, be it the $1.0 or $2.0 dollar a day international poverty lines, or any national poverty line which may be deemed appropriate. Each observation in this diagram depicts headcount poverty in a particular country for a given poverty line.

Figure 8, International Poverty Curve

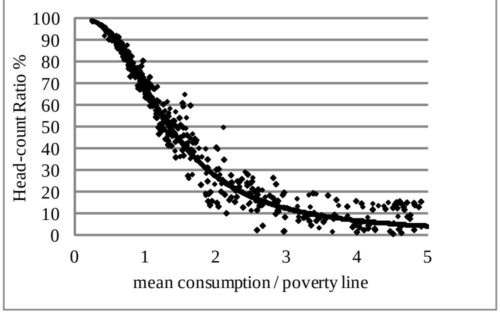
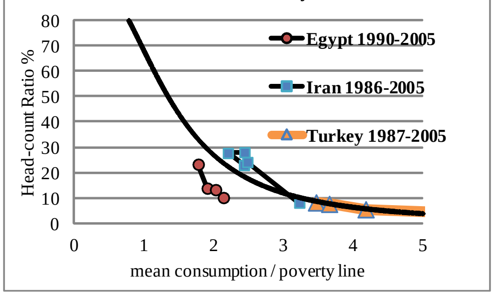


Figure 9, Iran Turkey & Egypt relative to International Poverty curve



Source: Based on Karshenas 2010.

Headcount poverty trends in Iran, Egypt and Turkey are shown relative to the international poverty curve in Figure 9. Headcount poverty in the three countries is measured on the basis of the $2 a day international poverty line, and survey means for all the three countries are calibrated to national account consistent average consumption levels (see, Karshenas 2010). The issue to focus on here is not the absolute levels of poverty across the three countries, because the $2 poverty line is probably too low for Iran and Turkey. But the position of each country relative to the international poverty line and their trends over time are worth commenting on. As expected Iran lies above the international poverty curve due to its high income inequality and Egypt has relatively low poverty by international norms and given its per capita income levels due to its much better income distribution than international

14 The share of bottom 40 per cent income group remained at or below 15 % and that of the bottom 10 per cent of the population fluctuated around 2 % in this period in Iran.

norms and a fortiori better than Iran. The individual country trends, relative to the international poverty curve, indicate that during 1998-2005 period growth has been pro-poor in Iran. Poverty has declined not only due to economic growth but there seems to have been also an improvement in income distribution in favour of the poor during president Khatami's government.

To sum up, social development and distribution of income in the Islamic Republic, when situated in an international context, doe not paint a rosy picture – at least not one that is generally expected given the rhetoric of the theocratic state and the enormous sums that has been diverted from productive economic activities in the name of the Mostaz'afan. This is not surprising, as monies that are allocated and distributed through charitable and personalized mechanisms normally follow a tortuous path and have a tendency to get absorbed in porous and complicated pipelines before they trickle through to the poor or the socially excluded groups. Statutory social policy measures based on citizen's rights and distributed through modern bureaucratic mechanisms, despite their own shortcomings have produced more robust results.

7. Concluding Remarks

Since the 1979 revolution the Iranian state has been the site of contestation between two sets of principles. One set has been centred around the legal-rational ideas and institutions of the modern era, embodying transparent, formally accountable, legally bound, impersonal and universal institutions – partly inherited from the country's own recent history and partly following what appears to be best practice international norm – combined with democratic ideals inherited from the revolution itself. These are at least in principle embodied within the elected executive and legislative branches.

The second set of principles, centred around the theocratic institution of velayat-e-faghih, by and large invented by the charismatic leader of the revolution Ayatollah Khomeini, are based on the rule of the jurist, faith, personal trust, non-transparent networks, akin to traditional aristocratic and patrimonial modes of government. These principles are institutionalized in a layered network at the centre of which is the office of the supreme leader, surrounded by its own kowtowing network of media, religious and ideological apparatuses, coercive forces, economic monopolies and a large group of wealthy parasitic elements feeding from this system. We referred to this setup as the core state.

In this paper we have argued that the political economy of the Islamic Republic since its inception has been dominated by strivings of the core state to establish its hegemony, and its gradual supremacy over the modern state institutions. Nevertheless, this process has turned out to be a highly contradictory one for a number of reasons. Firstly, the democratic elements built into the constitution of the Islamic Republic constantly raise their head from the depths and need to be dealt with. Ironically, by constant reference to the autocratic rule of the Shahs during the Pahlavi era the core state ideologues refresh and keep alive the democratic demands of the 1979 revolution in the collective memory of the nation. More importantly however, the process of the supremacy of the core state is contradictory in that due to the very nature of the modus operandi of its institutions it carries the seeds of its failure within itself. Each apparent victory leads to economic and social crises which grow in vehemence as the core state becomes more dominant.

The 2004-05 parliamentary and presidential elections appeared to herald the final victory of the core state, and what followed in the subsequent decade only confirmed this. The onslaught on the economic assets and finances of the government were quite unprecedented. Privatization of public assets, which required the reinterpretation of article 44 of the constitution, led to wholesale transfer of the ownership of public enterprises on a colossal scale to the shadowy institutions of the core state set up to manage the assets on behalf of the Mostaz'afan. The Plan organization was dismantled and the National Development Fund was set up by cannibalizing the finances of the official government and transferring a large part of the oil revenues under the control of non-transparent and unaccountable NDFI. With that, fiscal policy went out of the window and with subjugation of the Central Bank governing body to the presidential office the taps of credit were opened to the coteries of the core state. President Ahmadinejad's largesse in his provincial trips resembled more like a holy warrior distributing the assets of a conquered land amongst the faithful. The economic crisis which followed was inevitable. But this time, as the victory of the core state looked complete, the resulting crisis was also very deep rooted and not amenable to quick fixes through standard fiscal and monetary policies. Deep institutional changes are required to reverse some of the excesses of the past decade. This, however, is likely to face stiff resistance from the beneficiaries close to the core state and cannot be done without serious political commitment.

The record of the Islamic Republic in terms of economic development has been quite disappointing. However, even more disappointing has been its record of achieving its avowed goals of social justice, social development, and better distribution of income in favour of the Mostaz'afan. Effective improvement on the social side, apart from achieving better economic development, also needs effective, transparent and accountable institutions for service delivery, which are not strong points of the core state institutions. With the current economic crisis, and with at least two years of negative growth and high inflation, it is likely that the number of the poor has been in fact growing rapidly during the past two years. With the deepening economic crisis the Islamic Republic appears to have once more resorted to the technocratic and elected institutions of the government to find a way out of the crisis. This time, however, the problems are unlikely to be just a matter of technocratic fixes. This may be the time for the Islamic Republic to re-examine its governing institutions and show the necessary political commitment for institutional reform.

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