

BTI 2010 | Iran Country Report

Status Index	1-10	3.65	# 111 of 128	
Democracy	1-10	3.45	# 112 of 128	➔
Market Economy	1-10	3.86	# 109 of 128	➔
Management Index	1-10	2.33	# 118 of 128	

scale: 1 (lowest) to 10 (highest) score rank trend

This report is part of the Transformation Index (BTI) 2010. The BTI is a global ranking of transition processes in which the state of democracy and market economic systems as well as the quality of political management in 128 transformation and developing countries are evaluated.

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Key Indicators

Population	mn.	71.0	HDI	0.78	GDP p.c.	\$	10955
Pop. growth	% p.a.	1.3	HDI rank of 182	88	Gini Index		38.3
Life expectancy	years	71	UN Education Index	0.79	Poverty ²	%	8.0
Urban population	%	67.9	Gender equality ¹	0.35	Aid per capita	\$	1.4

Sources: UNDP, Human Development Report 2009 | The World Bank, World Development Indicators 2009.

Footnotes: (1) Gender Empowerment Measure (GEM). (2) Percentage of population living on less than \$2 a day.

Executive Summary

The period from 2005 to 2007 constitutes the core period of President Mahmoud Ahmadinejad's administration. Indeed, consistent elements have emerged in domestic as well as foreign affairs during this period that might be called "Ahmadinejad specific."

Domestically and economically, Ahmadinejad turned to new monetary and financial policies aimed at revising the previous failure of his administration to satisfy the material needs of the poorer segments of the population. Ahmadinejad came to office in 2005 with promises to redistribute oil wealth to the poor by means of social programs and subsidies. His predecessor Mohammad Khatami had focused too much on political and democratic improvements. However, Ahmadinejad's administration adopted economically destructive measures throughout the two years of the review period. In particular, increased withdrawals from the Oil Stabilization Fund (OSF), which serves as a repository for oil export revenues, were used for the import of consumption goods and the financial support of Iran's rising money supply. These measures resulted in enormous harm for the Iranian economy. An historic chance for economic growth, resulting from the unparalleled rise in the price of petroleum to \$140 per barrel in June 2008, was regrettably missed. Consequently, Iran's economic situation worsened, as can be seen in a variety of indicators.

Sociopolitically, the administration tried to push the legal and tolerated opposition, as well as civil society groups critical of the regime (women's rights and student organizations), as far to the fringe as possible. It was supported in this action by a conservative-dominated Majlis (parliament). The climax of this clash with the reform-oriented pragmatic faction was marked by the imprisonment of Seyed Hussein Mussavian in early May 2007. This high-ranking diplomat and nuclear negotiator of the Khatami administration was imprisoned due to suspected espionage.

Meanwhile, Ahmadinejad sought to uphold the absolute conservative majority in the Majlis with the help of his secretary of the interior as organizer, as well as the conservative Council of Guardians of the Constitution, the supervisor of the eighth post-revolution parliamentary election on 14 March 2008.

To this end, the president achieved considerable success, which was based on the exclusion of reform-minded candidates by the Council of Guardians. At the end of the seventh legislative period, a split within the conservative faction occurred, which was visible in parliament and also affected the composition of the eighth Majlis. The internal dispute climaxed in the dismissal of Ali Larijani as chief negotiator for nuclear affairs and as secretary-general for the National Security Council. However, conservative parliamentarians critical of these acts elected Larijani as president of the new parliament. The years 2007 and 2008 brought new crisis to Ahmadinejad's administration. During this time, 10 of his secretaries were dismissed either by the president himself or – as in the case of Secretary of the Interior Avaz-Ali Kordan – by means of a constructive vote of no confidence by the Majlis. At the close of the review period, Ahmadinejad was taking diligent steps to ensure his reelection in the tenth presidential elections of 12 June 2009, a campaign expected to be competitive.

With respect to foreign affairs, the conflict over Iran's nuclear program remained the prime focus of international debate in 2007 and 2008. Ahmadinejad's relentless support for the country's nuclear program resulted in two United Nations Security Council resolutions targeting the Islamic Republic in 2007 and 2008, attached to council resolutions U.N.-SR 1696 and 1737 of 23 December 2006. Despite the growing tension, the country avoided outright military conflict through the end of U.S. President George W. Bush's term in office. In general, Iran successfully pursued its nuclear politics without consideration of external threats or the threat of international isolation. Additional topics on the foreign affairs agenda during the last two years included harmonization with the Arab world, as well as seeking alliance with the U.N. Security Council's non-Western veto holders, Russia and China. The lack of improvement in relations with European Union states is remarkable. Unlike his predecessor Khatami, Ahmadinejad saw these relationships as holding no particular importance to.

History and Characteristics of Transformation

The Iranian regime is based on a constitution approved after the victory of the Iranian revolution over the monarchy in 1979, and later revised in 1989. Two contrary principles arise from the Iranian constitution, with the coexistence of republican-democratic elements with the Islamic legal system. The core change was the introduction of the principle of Supreme Jurisprudence (Velayat-e Faqih). Under this concept, a supreme leader not directly elected by the population leads and governs the state, thus overshadowing the republican-democratic principles of the constitution. These principles include the existence of three governmental forces, the direct election of governmental bodies and authorities like the parliament and the president, and local

elections. This duality of theocratic and republican-democratic law renders Iran's constitution one of the world's most complex. Although the supreme leader (rahbar) is elected by the Assembly of Experts, he acts as the representative of the 12th Shi'ite Imam Mahdi, who according to Shi'a doctrine has lived in a state of "Great Absence" since the 10th century. The Assembly of Experts, whose members are directly elected by the people, is in charge of electing or dismissing the supreme leader. However, candidates must be approved by the Council of Guardians. The current Supreme Leader Ayatollah Ali Khamenei's direct and indirect powers, as anchored in the constitution in Article 110, give him a superiority which de facto puts him atop the governing structure. He appoints the heads of many powerful institutions, including the commanders of the armed forces, the commander-in-chief of the army and chief of the joint staff, the commander-in-chief of the Revolutionary Guard Corps (IRGC), and the director of the national radio and television network. With the help of the chief judge, the twelve jurists of the Council of Guardians are also appointed; this powerful body decides both what bills may become law and who may run for president or parliament. The supreme leader must approve of any revision to the constitution. A constitutional legal transformation of the Islamic Republic is thus not possible without the consent of the highest religious leader.

Establishing the Islamic Republic was intended not only to reconfigure the concept of political sovereignty so as to privilege divine authority, but also to refashion the economic structure of government along ideological lines with the primary motive of protecting the poor. A plan for centralizing economic management was formulated, which involved not only the nationalization of the industrial and banking sectors, but also the establishment of charitable foundations to handle all the investment and distribution needs of civil society. Over time, this design has proven awkward to manage and highly susceptible to corruption, as it relies heavily on subsidies and lacks transparency. Yet, despite the long-term U.S. sanctions against Iran, which started at the time of the American hostage crisis and the eight-year Iran-Iraq war, the Iranian economy has grown at a consistent rate since 1991. This is in large part due to the country's significant income from both oil and gas exports (Iran is thought to have 11% of the world's total oil reserves; after Russia, it has the world's second-largest store of natural gas reserves). Though balancing the budget has remained an elusive goal, a growing awareness of the need to liberalize the economy and encourage private investment took hold during the presidency of Akbar Hashemi Rafsanjani (1989 – 1997), and has continued since. However, the looming specter of an economic squeeze as a result of the nuclear standoff is causing concern at all levels of government, a fact reflected in the budget for 2007 – 2008 and 2008 – 2009, which attempts to reduce important subsidies on oil and kerosene. Additionally, being largely dependent on oil revenues, Iran has traditionally been subject to the "oil curse." That is, the vagaries of the international spot market directly affect its operating budget, which, in good years, provides it with excess revenues for its Surplus Oil Fund (SOF), but which in bad years causes financial distress. Oil revenues account for 60% of the entire Iranian budget and for 85% of the overall Iranian export revenue.

Iran's population, numbering 72 million people in January 2009, exploded in the aftermath of the revolution, doubling within the span of 15 years. This new generation now dominates (70%

of Iranians are under 30), and the need to provide employment is both an economic and political imperative. Whoever is elected as new president in June 2009 will face great political and economic challenges.

Transformation Status

I. Democracy

Although democratic principles are laid down in the Iranian constitution, in the form of direct election of the president and the representatives in the Majlis, this does not mean that the imperative principle of sovereignty of the people is a foundation of the state. According to the constitution, sovereignty lies with God and it is executed by the supreme leader, or rahbar. Ayatollah Ruhollah Khomeini condemned democracy as a “Western construct.” Nowadays leading conservative clerics make no secret of the fact that they attach little or no value to the vote of the people. These clerics, led by ultra-conservative Ayatollah Mesbah Yazdi, the ideological mentor of President Ahmadinejad, are referred to by reformers and pragmatists as enemies of the republican principle of the constitution.

The Iranian calendar year 1386 (from 21 March 2007 to 19 March 2008) was declared by the establishment to be the “Year of National Unity and Islamic Harmony.” In reality developments took a different route. Throughout 2008, the conservative faction was deeply split. Even dubbing the succeeding year 1387 (20 March 2008 to 20 March 2009) as “Year of Innovation and Flourishing” cannot cover up this bitter reality.

Two major elections took place in the period under review. These were the election for the Assembly of Experts in September 2007 and for the Majlis in March 2008. Neither substantially affected the substance of Ahmadinejad’s course in domestic or foreign affairs. To ensure this, the president placed his own followers, many with a military or secret service background (for example, from the Revolutionary Guard Corps (IRGC) or the Basij militia, which has been subordinated to IRGC since 2007), in important key positions. Civil society in particular has suffered through harsh reprisals during the last two years. In this respect the last two years can be described as the climax of democratic retrogression in response to the opening of the Islamic Republic, which had begun with the presidency of Rafsanjani (who currently is president of the two important organs, the Assembly of Experts and the “Expediency Discernment Council of the System”) after the death of Ayatollah Ruhollah Khomeini in 1989.

1 | Stateness

Iranian military and police forces control almost all areas of the country, with the important exception of some border areas (the government's forces do not have full control over the eastern border areas to Afghanistan and Pakistan). Hundreds of Iranian soldiers die every year in combat against armed drug runners and separatist terror groups, which operate in the Iranian border areas based in Afghanistan and Pakistan. The Sunni terror group Army of God (Jondullah) terrorizes the provinces of Sistan and Baluchestan along this border region. By contrast, the longstanding conflict between the central government and the Kurds in the northeast seems to be less worrying. The oil-rich Khuzistan province along the southwest border is home to a Sunni Arab minority, along with related separatist groups with whom the state had violent disputes in the years following the revolution.

Monopoly on the use of force

Since the first Pahlavi shah in 1925, if not before, Iran has been a highly centralized state. The country has always been able to preserve its territorial integrity despite its character as a multiethnic state. Iran is linguistically and ethnically fragmented. Only about half the population speaks Persian as a mother tongue. Yet there is a strong connection between Persian ethnicity and the Shi'i confession as a specific of Iran. Approximately 98% of all Iranians are Muslims and 90% of the Iranian population is Shi'ite. For centuries, since the time of the 16th century Safavid dynasty, a strong Shi'i national identity has developed, in which has in many ways isolated the nation from the Sunni Islamic world. However, most Sunni Arabs in Iran remain loyal to the state. Their critical geographic location near the southern oil fields of Khuzestan makes their loyalty to the state more important to Tehran than that of perhaps any other minority. Nevertheless the ethnic religious minorities in the border areas remain the Islamic Republic's weak spot, due to substantial, persistent external attacks. Their home provinces have been poverty stricken and have faced considerable discrimination for decades. These factors have nourished the political turbulence.

State identity

Shi'a Islam is omnipresent in the Islamic Republic. According to the constitution all laws and codes in the areas of civil and criminal law, finances, economics, culture, military, politics and others must comply with Islamic standards. Over the last three decades the leadership has developed a strong military, national security and police machinery which guarantees ubiquitous Shi'i presence in all domains of state and society.

No interference of religious dogmas

The government retains both a standing army – the Artesh – of 450,000 men, as well as the more ideologically driven Revolutionary Guard of 150,000 men. The supreme leader controls both bodies. Iran also maintains a paramilitary force, the Basij, which is under the command of Major General Ali Jafari, commander of the IRGC. According to official indications, this force now totals 13.6 million volunteer

members, including both men and women. If need arose, Iran could mobilize at least one million active soldiers, which would be among the largest troop mobilizations in the world. Iran's Basij force is the regime's mainstay of domestic security. Although this body, with more than one million men, is concentrated on the capital Tehran, historically the center of riots against the regime, it is a large and omnipresent paramilitary organization with multifaceted roles. The militia acts as the eyes and ears of the Islamic regime. It is present in schools, universities, other state and private institutions, factories, and even among tribes. Basij members act as a "morality police" in towns and cities by enforcing the wearing of the hijab; arresting women for violating the dress code; prohibiting male-female fraternization; monitoring citizens' activities; confiscating satellite dishes and "obscene" material; intelligence gathering; and even harassing government critics and intellectuals.

Overall, the constitution's structures of power and codes enable religious dogma to define the fundamental rules of state, society and economy. Furthermore, insistence on ideological conformity has led to the rise of a clerical elite that exercises power at all levels of society, often with impunity and frequently through the abuse of human rights.

Apart from a few exceptions, the state's administration is present throughout the country. However, this presence seems to be more security-militaristic than service-oriented. It is clear from leaders' statements that they are always afraid of threats to the stability and existence of the regime. Enemies domestic and abroad, conspiracies and plans for overthrow of the regime are frequently topics of discussion. Critics are quickly accused of maintaining conspiratorial connections abroad. During the last two years, the regime undertook a number of striking measures. At the core of these measures was the reorganization of the Revolutionary Guard Corps. The appointment of Major General Ali Jafari as new IRGC commander-in-chief, the incorporation of the Basij militia, and the biggest training operations since the founding of the Islamic Republic (this took place in Tehran in November 2008, involving 30,000 Basij members) all evince a highly uneasy and insecure leadership. In addition, the state suffers from widespread corruption, particularly among the political and clerical elite. Due to religious dogmas, massive corruption and discrimination against citizens including Shi'ite dissidents, the state is not capable of guaranteeing even existing constitutional regulations.

Basic
administration

2 | Political Participation

In the history of the Islamic Republic, with the exception of the first free presidential election in January 1980, only the presidential election in 1997 was a relatively free election. In that vote, moderate Mohammad Khatami, who was not

Free and fair
elections

the hard-line clerics' choice, surprisingly won the election. The conservatives have since learned from their failures. Elections are held, but have limited influence on who in fact rules the state. Ayatollah Khamenei and the conservative constitutional organs such as the Council of Guardians, which are not appointed by elections, are superior and omnipresent. There are no free and fair elections in Iran.

According to the constitution it is the task of the supreme leader to set the Islamic Republic's general political objectives, concerning all domestic and foreign affairs. Authorities and organs elected directly by the people, such as the president and parliament, have only very limited scope. During the Khatami era (1997 – 2005), when the Majlis was dominated by reformers, both the president and the legislature encountered vehement protest from Khamenei and the Council of Guardians. The latter blocked and annulled proposals made by the reformist government and parliament. During the period of review, the hard-liner Ahmadinejad administration has enjoyed the total support of the supreme leader, who indirectly indicated several times that he favored a second term in office for Ahmadinejad.

Effective power to govern

Political parties have weak standing in Iran, as a firm culture of parties has not to date emerged. Without a ruling party through which to distribute power, the Islamic Republic itself serves as a party, and its theocratic leadership regards the voters as the party's members. Thus, only the conservative parties have broad official panels, organs and bulletins, which can almost act independently. Disagreement among the conservatives usually does not lead to a fundamental threat to the administration's course. Within the last two years, civil society groups were subject to harsh repression. Their stakeholders, workers unions, student and women's organizations and other such bodies have virtually no influence on politics. Even the elected parliament is powerless with respect to crucial governmental decisions. One member of parliament stated in late 2007 that the Majlis was unable to defend the right of the people.

Association / assembly rights

The regime is afraid of organized critical voices and protests. Therefore organized meetings and events are met with staunch pressure. The office for the Center for the Defense of Human Rights, headed by Shirin Ebadi, was shut down at the end of 2008 by security and police officers prior to holding a meeting to commemorate International Human Rights Day. Yet critical public events do take place. Daftare Tahkim Vahdat, the largest students' organization in the country, organizes massive protest meetings under difficult circumstances. As a result, Ahmadinejad and Khamenei rarely appear at universities in Tehran or Sharif. The public sphere is enormously vulnerable to distortion and manipulation through massive intervention on the part of the regime.

The country is dominated by a regulated media. Radio and television are largely state-controlled, and independent (in terms of political standing) newspapers find it almost impossible to function, even when they manage to secure a license to

Freedom of expression

publish. In 2007 and 2008, less reformist-oriented papers and magazines were prohibited, including the high-circulation *Sharq*, its successor *Ham Mihan*, and another subsequent replacement, *Shahrvand-e Emruz*. At the end of 2008, during the heat of the war in Gaza, the pragmatic paper *Karghozaran* was banned as well for publishing a text critical of Hamas. Because *Karghozaran* was a paper closely tied to Rafsanjani, the action was widely publicized. The government monopoly means that the population receives much one-sided information through the media.

3 | Rule of Law

Checks and balances are largely nonexistent, due to the role of the supreme leader in the Islamic Republic. The Majlis does hold debates on governmental plans and resolutions, has the power to dismiss ministers by means of a constructive vote of no confidence, and rejects some cabinet decisions and legislative proposals. However, the parliament cannot create real difficulties for the administration. Secretary of the Interior Awaz-Ali Kordan, who was dismissed by a vote of no confidence at the end of 2008, was replaced by Ahmadinejad's election campaign organizer for the 2005 presidential elections, a former IRGC commander. Sadeq Mahsuli, the new minister, is in charge of organizing the June 2009 presidential elections. The three powers (legislative, executive and judicial) often try to check each other, resulting in strong disputes. However, these apparent checks and balances disappear as soon as the supreme leader appeals for deliberateness and unity. Iran's parliament, the Majlis, passed a bill on 16 December 2008 that deprives the legislature of the right to oversee three major regulatory bodies, a move likely to further consolidate Supreme Leader Ayatollah Ali Khamenei's power. These major regulatory bodies include the Council of Guardians, the Expediency Council and the Assembly of Experts. In addition, all institutions and facilities directly subordinated to the supreme leader, of which there are many, can be the subject of parliamentary investigation only with approval of the supreme leader.

Separation of powers

The immutability of the two pillars of Iranian theocracy, Islamism and republicanism, often leads to conflicts in practice, and is the basis of intense debate concerning the maximalist view of Islamic legal rules (based on believers fulfilling their duties) versus the maximalist view of the state (based on granting citizens their rights). There are tensions between the judiciary and the legislative and executive alike. The judiciary does not serve as an effective check on corruption because corruption extends throughout the entire state apparatus, and the judiciary lacks functional efficacy as well as the necessary territorial penetration. In June 2008, Abbas Palizdar, a member of the Majlis' Investigative Committee, revealed the staggering level of corruption among some of Iran's highest ranking ayatollahs and military figures. A film detailing Palizdar's charges as made available on the Internet. Most of the ayatollahs Palizdar named as corrupt "profiteers" are among

Independent judiciary

the most senior cleric rulers of the Iranian regime. Palizdar's accusations were partially true, but instead of the accused persons, Palizdar was arrested. In addition, the judiciary plays a key role in banning newspapers. Saeed Mortazavi, current prosecutor general of Tehran and a hard-line conservative, has been responsible for banning several Iranian reformist newspapers.

Tehran's Prosecutor General Saeed Mortazavi has also drawn international scrutiny for his alleged role in the case of Iranian-Canadian photographer Zahra Kazemi, who died in Iranian custody in 2003. Although Mortazavi's involvement with the case is widely considered to be a fact, according to various international media reports, nobody dared to prosecute him. Prosecutions of abuse of office typically take place only after conflicts between antagonistic elements within the regime take on a substantial character. Only in such a climate will whistle-blowers emerge. Justices only rarely succeed in punishing office abuse. A notable exception was the case of Tehran's chief of police, General Reza Zarei, who was arrested after being found nude in a local brothel with six naked prostitutes. The moderate Ayatollah Hashemi Shahroudi, supreme chief of the judiciary, had personally ordered the arrest without the cooperation of Mortazavi, who was a friend of Zarei and therefore could have forewarned him.

Prosecution of
office abuse

Religious prestige and power guarantees protection. The hegemony of the mullahs over the political process is in effect paramount, with the result that access to clerical support is far more important than an independent rule of law. Discrimination against women and religious minorities, despite an ostensibly guaranteed freedom of religion, is founded in a legal basis. Members of other religions do not enjoy the same constitutional rights as Shi'ite Muslims. Members of "religions of the Book" – Christians, Jews and Zoroastrians – enjoy greater rights than others, including the right to have a member of parliament for their communities and to maintain religious schools. Christian congregations of varying confessions number approximately 300,000 members, including believers who converted from Islam to the Christian faith. While approximately 100,000 Jews lived in Iran in the late 1970s, largely in peace, this community has shrunk to about 25,000 today.

Civil rights

Of all religious minorities, the Bahai faith suffers from the most repression. This community, which is not acknowledged as an official religious minority, has experienced the deaths of more than 200 members, including many leaders, during the last 30 years. At the end of 2007, houses for Sufi prayers were destroyed by the Basij militia, and many members of these institutions were hurt and arrested.

By the close of the period of review, a new Draft Islamic Penal Law and Draft Law for Protection of the Family had already come to the Majlis for debate. The new Islamic Penal Law will abridge the rights of citizens, especially the rights of individuals to personal security and physical integrity, in an alarming way. In the

case of certain repeated offenses (such as robbery without homicide or drunkenness) the state will be able to execute citizens if the law is passed.

The draft law also includes a section on apostasy, which could obviously be used against religious minorities in Iran, especially Bahais and Zoroastrians and against anyone who is a convert from Islam. However, shortly after new pressure was exerted on the Bahai followers, Ayatollah Hussein-Ali Montazeri, who is considered to be Iran's highest-ranking religious authority critical of the regime, issued a fatwa (a religious opinion concerning Islamic law, typically issued by a leading scholar) in support of Bahai rights. This was the first time in Shi'a history an ayatollah had argued that Bahai believers should be given full citizens' rights, since they too were citizens of Iran. Ayatollah Montazeri had been designated as successor of Ayatollah Khomeini, but lost this position in 1989 after his sharp criticism of Khomeini's policy.

4 | Stability of Democratic Institutions

During the twentieth century, Iran experienced three revolutions or major political movements. All were focused on governance, the law and democratic institutions, and took place from 1906 to 1911, in 1953 and in 1979. Although in 1906, Iran became the first Middle Eastern state to have a constitution, achieving this even before Egypt and Turkey, subsequent phases of democracy have been quite rare. Since 1979, the institutions of the Islamic Republic have operated according to the specific logic of Supreme Jurisprudence (Velayat-e Faqih). Iran's constitution emphasizes the sovereignty of man as the vicegerent of God on earth. According to Article 56: "No one can deprive man of this divine right, nor subordinate it to the vested interests of a particular individual or group. The people are to exercise this divine right in the manner specified in the following articles..." But in reality Article 57 is applied: "The powers of government in the Islamic Republic are vested in the legislature, the judiciary, and the executive powers, functioning under the supervision of the absolute religious leader." Therefore, a reformist president and a reformist parliament might be able to carve out room for more activities in civil society, but cannot accomplish any fundamental changes. Any such attempts would be annulled by the Council of Guardians or the supreme leader, just as happened during the era of reformist president Khatami and the sixth parliament. Iran's constitution thus provides for a "semi-democracy," but not more than that.

The Majlis has a strong relationship with the regions its members represent. The views of local populations on the conduct of the Majlis and the executive frequently find voice in provincial media, which act as forums for comment and criticism on government actions. Iranian civil society as a whole, with the exception of the conservative Islamist bodies, does not see Islamic Republican institutions as legitimate. Relatively speaking this was the case with the sixth reformist parliament

Performance of
democratic
institutions

Commitment to
democratic
institutions

and Khatami as president. Only political power groups such as the bazaar merchants, the clergy, military powers (such as the Basij) and the IRGC protect and have influence with the government and decision-makers. In October 2008, after a week-long strike against a new value-added tax, Ahmadinejad canceled its introduction. The bazaar merchants played an important role in the revolution three decades ago and are strategic allies of the clergy. Civil society elements critical of the regime, such as women's rights groups, students' organizations and journalists have no opportunity to influence Ahmadinejad's government.

5 | Political and Social Integration

Iran's party system is fragile and lacks a long tradition. The (print) media has historically played a greater role than have the parties, which have largely been produced by the government. This was especially true in the era of the Shah. The Islamic Republic has developed a broad spectrum of parties, but they nevertheless play only a narrow role in the political process. Iranian parties are not particularly productive, and are not deeply rooted society. Today there are two relatively large conservative factions, one minority faction and also an independent group, which is also conservative. There is quantitatively moderate fragmentation in parliament, in which the minority reform fraction can not realistically influence decisions. The most important parties in the parliamentary elections of 14 March, 2008 were (among the reform parties) the Islamic Iranian Participation Front (Jibhe Mosharekat Iran-e Islami) and the Organization of the Mujahedeen of the Islamic Revolution (Sazemane Mojahedine Enghelabe Eslami). In addition, the Executives of Construction Party (Hezb-e Kaargozaaraan-e Saazandegi) operates under the unofficial protectorate of former President Rafsanjani. The National Confidence Party (Hezb-e Etemad-e Melli) of former parliamentary President Mehdi Karubi, along with two other parties, also exists. The illegal but tolerated Iran Freedom Movement (Nahzat-e Azadi-e Iran) can also be counted among the opposition's ranks. The conservatives are represented by the Unified Principalists Front and the Broad Principalists Coalition, with the latter being made up of conservatives critical of the regime. The entire conservative block won the March 2008 election with a two-thirds parliamentary majority. The conservatives who control the executive and the legislature use the means at their disposal to prohibit any election victories on the part of reformists.

Party system

Despite dissension within the conservative ranks, the Majlis articulates the interests of the system of Velayat-e Faqih. A widening gap between the people and the system has resulted result. For example, there are no strong parliamentary groups which protect the rights of women, workers or students. Many prominent members of these populations, including the vice president of the Syndicate of Workers of Tehran and Suburbs Bus Company, Ebrahim Madadi, have been arrested in the past

Interest groups

two years. Interest groups also have difficulty developing to the point where they can articulate their interests at the broader societal level. Only the groups that are represented in official circles, and which conform to the prevailing political norms, are allowed opportunity to influence policy. This situation has become increasingly stark since the beginning of Ahmadinejad's presidency.

There are no reliable data concerning public consent to democratic norms, which is not surprising given the repressive political climate in Iran. The Ministry of Intelligence and Security (MOIS) acts as the regime's iron fist, although it was reasonably restrained under Khatami. The MOIS, as well as other security forces controlled by the supreme leader, de facto stand above the law and thus can use any techniques they wish to achieve their objectives, including torture, sexual abuse and extrajudicial execution. MOIS also operates the Herasat, a system designed to monitor and control public morality and political orthodoxy in public and educational institutions. Under the guise of religious Shari'ah order and the protection and maintenance of the regime, any crime is allowed. For the majority of people, there is no consent to the regime. However, the Islamic Republic is not a pure theocracy, but rather an authoritarian system in which the clergy plays the key role. Unlike most Islamic countries, in which the president is appointed for life, presidents serve regular terms. Ahmadinejad is the sixth president of Iran since 1980.

Consent to
democratic norms

Due to rising economic misery, many urban dwellers in the big cities are focused on their own specific needs. Even among family members and relatives, unethical and solidarity-undermining behavior is now widespread. Significant levels of trust between individual citizens and as manifested in self-organized civic groups exists in only rudimentary form. However, in small towns and villages, family bonds are still strong. Villages often raise funds for the needy, such as older or divorced women.

Associational
activities

II. Market Economy

6 | Level of Socioeconomic Development

Iran is a state-dominated economy with the vast majority (80%) of industry, banking, transportation, communication and energy functioning as nationalized entities. Nothing about this has changed within the last two years. Reformers' attempt to turn Iran's economy into an market-oriented, private sector-led economy has been disordered because of the stop-and-start nature of reforms, and because of

Socioeconomic
barriers

resistance from various elements of Iran's political establishment. Significant such attempts took place during the Khatami era, under the third five-year plan (2000 – 2004). Iran is currently in its fourth five-year plan (2005 – 2009), which has taken a largely populist approach. President Ahmadinejad came to office in 2005 with promises to redistribute oil wealth to poorer segments of the population by means of social programs and subsidies. The Iranian central bank estimated GDP growth for calendar year 1386 (21 March 2007 to 19 March 2008) to be 6.9%, which is an improvement of just 0.7% compared to the previous year. For 2009, the World Bank Group predicts a decrease in GDP growth to 5.7%, and a further fall to 4.5% in 2010. If this proves to be true, Ahmadinejad's administration will have missed the declared goal of the fourth five-year plan to increase national growth to at least 8%. Even the relatively small increase during the calendar 1386 can be attributed to the astronomical gain in oil prices, for which the Iranian central bank calculated an average of \$78 per barrel for the calendar year 1386. In 1387 (20 March 2008 to 20 March 2009), Ahmadinejad again benefited substantially from the unexpected rise in oil prices. The price was well above \$100 per barrel from January to November 2008, reaching a record high in June at \$147. Nevertheless, the economic reality matched neither Ahmadinejad's elections promises nor the potential offered by this energy-price windfall. In 2007 – 2008, inflation was 21%, rising from only 13.2% at from the end of President Khatami's term. In November 2008, inflation reached 25%, and continued to trend upward. This means that inflation doubled during Ahmadinejad's term. The unemployment rate, which is distorted by the Iranian Center for Statistics, is estimated to be 15% – a population that includes many well-educated Iranians – according to Iranian economics experts who wrote a critical open letter to Ahmadinejad in November 2008. In the World Bank's Doing Business Report 2008, Iran is ranked 135th out of 178 countries. Ahmadinejad's expansionary budgetary policy, the increase in the amount of currency in circulation, the substantial increase in imports that has harmed domestic production and the striking incompetence of his ideological Islamic government are the main reasons for the deficits of the last two years. International sanctions furthermore led to a rise of import prices, which has amplified import-induced inflation. According to a member of the government, 15 million people live below the poverty line. That is about 20% of the entire population, and even those depressing statistics may still be far from reality. Wealth and capital are very unevenly distributed; the UNDP's 2008 Human Development Index (HDI) value for Iran was 0.777, earning the nation a rank of 84 out of 179 countries. As Iran's economy is largely dependent on oil and is therefore highly susceptible to oil price shocks, the rapid drop in oil prices will bring Iranians more challenging years ahead.

Economic indicators		2004	2005	2006	2007
GDP	\$ mn.	163226.6	192014.9	222880.5	286057.9
Growth of GDP	%	5.1	4.6	5.9	7.8
Inflation (CPI)	%	14.8	13.4	11.9	17.2
Unemployment	%	10.3	11.5	11.3	10.5
Foreign direct investment	% of GDP	0.2	0.5	0.1	0.3
Export growth	%	-0.8	6.8	5.1	2.8
Import growth	%	13.9	2.1	7.1	4.9
Current account balance	\$ mn.	-	-	-	-
Public debt	\$ mn.	9984.9	10492.5	11095.9	11145.9
External debt	\$ mn.	20356.1	21259.5	20119.0	20577.2
Total debt service	% of GNI	1.3	1.3	1.2	1.2
Cash surplus or deficit	% of GDP	4.1	6.0	3.2	10.6
Tax Revenue	% of GDP	6.0	7.9	7.4	7.3
Government consumption	% of GDP	11.4	13.0	14.2	11.2
Public expnd. on edu.	% of GDP	4.9	4.7	5.1	5.5
Public expnd. on health	% of GDP	2.7	3.2	3.4	-
R&D expenditure	% of GDP	0.6	0.7	0.7	-
Military expenditure	% of GDP	3.3	3.8	3.8	2.9

Sources: The World Bank, World Development Indicators 2009 | UNESCO Institute for Statistics | International Labour Organization, Key Indicators of the Labour Market Database | Stockholm International Peace Research Institute (SIPRI), Yearbook: Armaments, Disarmament and International Security.

7 | Organization of the Market and Competition

Iran's economy is still dominated by the state (which is the recipient of revenues from crude oil exports) and quasi-state actors such as the Bonyads (foundations which were established after the revolution) and the commercial entities of the IRGC. Private sector activity is limited. The Bonyads are not state bodies, but operate under the control of the supreme leader. They are economically powerful, with a workforce (the so-called Oppressed and War Veterans (Bonyad-e Mostazafan va Janbazan, MJF)) that exceeds 200,000 employees. Controlling more

Market-based
competition

than 400 companies and factories, these groups have an annual budget amounting to more than 10% of Iran's total government spending. The commercial entities of the IRGC have taken on gigantic state projects, often receiving preferential treatment. On 25 June 2006, the National Oil Company of Iran gave Ghorb (one of the largest and strongest contractors in Iran, whose council of directors is chaired by the IRGC commander-in-chief) a no-bid contract to develop the fifteenth and sixteenth phases of South Pars gas field, one of Iran's most valuable gas development projects. The IRGC is also heavily involved in the oil, gas and telecommunications sectors, among others. As Ahmadinejad has inserted former IRGC commanders into most centers of power, and as the IRGC develops itself further into a business conglomerate independent of state regulation, the Islamic Republic is becoming a military-industrial complex hiding behind a civilian façade. There are also many companies which are guided by persons loyal to the regime or by former officials, which also enjoy certain privileges. In the Islamic Republic connections and corruption dominate the economy. In this context there is no market-based competition in terms of free competition. Consequently, the Heritage Foundation's Index of Economic Freedom ranked Iran 168th out of 179 countries in its 2009 edition.

Privatization and liberalization of trade in the Islamic Republic began in the era of Rafsanjani (1989) and was continued under Khatami. Both aimed to implement the demands of Article 44 of the Iranian Constitution. According to this article the Iranian economy is comprised of a mix of state, private and cooperative elements. During the Ahmadinejad era, especially within the last two years, the goal of limiting the state's monopolies came to a halt. Iran lacks a stock exchange culture, as well as incentives for private investors and investment banking. However, in July 2006, the government announced a major privatization program under which large, strategic industries mandated to be state-owned by Article 44 of the constitution could be privatized. The implementation of the program failed due to low demand for large and expensive public-sector assets in the private sector. Indeed, the private sector is too weak to finance the acquisition of shares in state-owned companies without the state aid. Iranians prefer to invest their assets in more secure regions, such as the United Arab Emirates (Dubai) and Turkey. Dubai is referred to as a commerce outpost for the Iranian market.

Anti-monopoly
policy

The Iranian market, and particularly in the oil and gas sector, is potentially very lucrative for foreign investors. However, in the calendar year 1386 (21 March 2007 to 19 March 2008), Iran attracted only \$700 million in foreign direct investment. Commerce with the big EU countries, except for Italy, decreased dramatically in 2007. In that year, only 46 big companies were active in Iran, with a total of only 57 subsidiaries or other sub-units. This decline was reversed in 2008, however. Within the first nine months of the calendar year 1387 (March to December 2008) Iran imported goods and services worth \$10,672 billion from the United Arab Emirates

Liberalization of
foreign trade

(41% more than in the first nine months of the previous year), \$4,147 billion from Germany (an increase of approximately 6%) and \$3,800 billion from China. Overall Iran achieved a record import high in the last two years despite sanctions, a situation only possible due to the high oil price. Mass imports, mainly of consumer goods, extensive withdrawals from the Oil Stabilization Fund, and the injection of large amounts of money into circulation resulted in damage to domestic production and a high rate of inflation of 25%, with prices continuing to trend upward.

In general, Iran should be attractive to foreign investors. Among the reasons for the relatively low level of investment, diminishing even further over the past two years, are the U.N. sanctions and the pressure that the United States government has put on corporations to avoid doing business with Iran. Additionally, cultural and social reasons, as well as concerns over legal stability, also make the country less attractive to foreign investors. In 2008, the biggest foreign investors in Iran were Russian state gas company Gazprom, which established a joint venture company to develop the offshore Iranian South Pars gas field, and China National Offshore Oil Corporation (CNOOC), which struck an investment deal with Iran to develop Iran's North Pars gas field, and to build a liquid natural gas installation (LNG).

Liberalization of the Iranian banking system is progressing very slowly. Until 2004 – 2005, only four private banks existed in the country. Another two were established in 2005. Thanks to their efficiency they now hold approximately 23% of all assets. This fact gives hope to experts, since the gap between asset returns and interest on loans has narrowed considerably. Interest on savings has risen substantially, which has attracted more investors. However, Iran's private banks are not genuinely private, because they are committed to the administration in their decisions. They cannot operate apart from the laws which regulate state banks. Under President Ahmadinejad private banking has fallen out of favor.

Banking system

Monetary and financial policies are under full control of the administration. Two central bank directors have been dismissed in the course of three years. In July 2007, Ahmadinejad shocked experts by annulling the Management and Planning Organization of Iran, which had been responsible for preparing the country's budget since 1948. This experienced, sixty-year-old organization monitored foreign currency reserve funds related to the oil business and prevented the government from arbitrarily withdrawing sums for present-day expenditure. Investor trust in Iran's banks has dropped dramatically. The growth rate in investments shows clearly negative values. In any case, Iran's citizens do not have a cultural affinity for investing money in banks. Iranian women often invest in goods deemed likely to hold value, such as gold or jewelry, rather than save their money in a bank. Iran's banks often invest funds in speculative, non-productive businesses, and grant loans through intermediaries to non-productive sectors. Substantial loans are granted based on connections to high-ranking figures with a political or clerical background or their families. The loans regularly go unrepaid. Non-performing loans has

weakened the banking system by 31 trillion toman (\$31 billion; the toman is a widely used super-unit, equivalent to 10 Iranian rial), according to Mahmud Bahmani, governor of the Central Bank of the Islamic Republic of Iran. Banking personnel is extremely poorly trained and educated. In 2008, Internet banking accounted for barely 1% of transaction volume. At the time of this writing, experts were concerned that the global financial crisis would hit Iran's banking system hard in 2009.

8 | Currency and Price Stability

According to the central bank, Iran's growth rate has been below the average value seen for Central Asian and oil-producing states in recent years. In addition, Iran had the highest rate of inflation among these countries. High levels of inflation have been associated with growth in Iran's money supply.

Anti-inflation /
forex policy

The central bank figures suggest that in 2007, money supply growth was about 40%. The government provides extensive public subsidies (\$100 billion) primarily for gasoline, food and housing. Energy subsidies alone represent about 12% of Iran's GDP. Some observers estimate that total subsidies reach more than 25% of GDP. When including implicit subsidies, the government's spending on subsidies may be even higher. In view of the high inflation rates, Ahmadinejad introduced a bill for economic reform in the parliament in late December 2007. The bill of course also had a political background, with the reform of subsidy policy serving as its cornerstone. In fact, President Ahmadinejad intends to annul the subsidies and instead hand out cash to the needy, who make up as much as 70% of Iranian population. However, experts say that eliminating the subsidies on essential goods could lead to a strong increase in prices for consumer goods, possibly elevating inflation to as high as 50%. In 2007, a well-known conservative criticized Ahmadinejad's economic policies as a "ship without a compass." However, at the time of writing, it appeared that the handouts of cash subsidies to the public, while granting the poor a higher share of these benefits, would have an effect in the June 2009 elections.

According to the president of Iran's central bank, Ahmadinejad took over the administration in 2005 with a total of \$24 billion in foreign debts. At the end of calendar year 1386 (March 2008) the central bank estimated this figure to be \$28.6 trillion. Ahmadinejad's negative economic balance sheet, the country's negative growth rates and the region's highest (after Iraq) rate of inflation become evident if one looks at the following central bank statistics: overall revenue from oil exports were \$124 billion during the eight years of the Rafsanjani era, and \$193 billion during the eight-year Khatami presidency. Ahmadinejad's administration made \$255 billion in oil export revenue between August 2005 and the end of 2008 alone. Yet according to central bank statistics, he spent virtually all of this revenue. This is

Macrostability

completely contrary to the content of the fourth five-year plan (2005 – 2009), which demanded an annual 10% decrease in dependence on oil revenues. As a result of falling oil prices, Iran's growth rate is expected to drop from 5.8% in 2008 to 3.5% in 2009.

9 | Private Property

Private property is legally protected in Iran. Although many small, family-run businesses and mid-sized industrial parks have been founded, the processes of licensing and closing businesses are regulated heavily by an intrusive and highly inefficient bureaucracy. Corruption is rampant, and the fair adjudication of property rights in a court of law cannot be guaranteed. The foundation of private business (mid-sized industrial parks) has to be carried out with government support which is not easy to obtain – connections and corruption (provisions, i.e., bribes) are the most important criteria. Resorting to the courts is often counterproductive, and finding an influential local business partner with substantial political influence is a more effective way to gain and protect contracts. Few laws protect intellectual property, computer software piracy is extensive, and infringement of industrial designs, trademarks and copyrights is widespread. The Heritage Foundation's Index of Economic Freedom, which reviews property rights, ranks Iran at second-to-last place, just above Libya, in the Middle East (Sudan and Iraq were not included in this evaluation).

Property rights

Iran's private sector has grown in the last years. Many private enterprises have been founded; 90% of the real estate and building sector, 98% of the agricultural sector and more than 10% of steel production are controlled by the private sector. But these enterprises rarely work effectively and productively. Iran's private sector has a small share in key industries or the new class of companies owned and operated by the Revolutionary Guards. Under Ahmadinejad, hundreds of small and large private companies have been created by former members of the Revolutionary Guards or by the corps itself in a number of areas, including construction, energy, food processing and textiles. This offers inducement to pro-revolutionary forces, and has created a new class of sympathetic entrepreneurs capable of running the economy.

Private enterprise

In this respect, administration statistics regarding the transfer of publically owned companies to the private sector show only half of the picture. Unrestricted government of the economy through regulation, interest rates, wages and the exchange rate are factors which need to be taken into account.

10 | Welfare Regime

According to the government 15 million people – about 20% of the population – live in poverty. Ahmadinejad came to power in 2005 in partly with the slogan of sharing Iran's oil wealth more fairly with the poor. He has injected significant amounts of cash into local infrastructure projects, pushing liquidity growth substantially. To meet the demands of the population, and to keep consumer prices at a low level, Ahmadinejad flooded the Iranian market with consumer goods. The value of the country's imports was expected to reach \$60 billion in the fiscal year March 2007 to March 2008. The government has completely controlled the prices of some basic goods, such as gas, water, bread and electricity. The president did set up some programs to help the poor, including a fund to help young people meet the expenses of marrying and setting up households, a populist pledge that helped the former Tehran mayor win the presidency in 2005. By the end of January 2009, six months before the end of his presidency, his social and economic policy had nevertheless proved to be disastrous. The wealth gap has widened due to profligate spending that has spurred inflation, mostly harming the poor, and as a result of subsidies that often mainly benefit the rich. Seventy percent of subsidy spending has ended up in the hands of the country's richest 30%. Promoting cash injections and increasing import volumes boosted inflation, which in conjunction with the effects of the foreign sanctions is driving many industries into ruin. Unemployment has also been on the rise. High unemployment and the government's interference in all aspects of individuals' private life have encouraged more and more young university graduates to leave the country. Iran has experienced one of the most damaging periods of brain drain in the world.

Social safety nets

The Iranian Social Security Organization (SSO) is one of the largest insurance organizations, with more than 27 million beneficiaries. Yet the country has a weak system for support and compensation in case of illness, retirement provision or unemployment. The Iranian insurance system is not well organized. Services provided by publicly owned hospitals and clinics are mostly ineffective and insufficient. Prices for medication are very high. According to Sadeq Rejai, former chairman of the board of Medical Services Insurance Organization, insured individuals must bear the costs for 60% to 70% of their own medical expenses. According to the fourth five-year plan they should only bear 25% to 30% of these costs. Retirees' income has grown substantially in the past, but high inflation rates have meant there has been little if any increase in purchasing power. In 2008, there were 5.2 million elderly people of age 65 years or older living in Iran. A quarter of this population lacks insurance. Elderly people are nursed at home by their families due to a lack of nursing homes and high costs connected with what such facilities do exist. The rural population and nomads, which together make up 36% of the country's total population, are still excluded from social insurance due to their

specific situations and characteristics. In 2005 a rural insurance fund was founded. But because of barriers, only 6% of rural dwellers and nomads were covered by this fund before 2007. People living in villages cannot afford the per capita contributions, and thus cannot participate in the fund. Poor people are supported by the village community if possible. Community bonds in villages are still stronger than those in the cities. The state-financed, ideologically oriented Bonyads (foundations) also cover many people, but these have their own clientèle. They cannot be seen as strong informal social safety nets.

Under the Velayat-e Faqih system, anyone who does not fully comply with the prevailing political ideology faces discrimination. Even Shi'ite Muslims who are ideologically opposed to the regime face disadvantages, not to mention religious minorities, secularists and atheists. Within the religious minorities, the Bahais de facto have no right to enroll in universities. They are extremely disadvantaged with respect to social, economic and educational rights. They are not allowed to practice any religious activity. Liberal, secular and dissident students and college lecturers have been dismissed or have retired since Ahmadinejad began tightening the politics of Islamization. Members of the Sentinels of the Revolution or the Basij enjoy preferential admittance rights. In 2007, 200,000 Basij members were enrolled in independent universities. Currently, women outnumber men at university level. To reduce this surplus of female students enrolling, certain fields of study were limited for women. This took place in 26 fields in 2007 and in 32 in 2008. Discrimination against women is codified in the new Islamic Penal Code and the Family Protection Draft Bill.

Equal opportunity

11 | Economic Performance

The Iranian central bank estimated real GDP growth for the calendar year 1386 (21 March 2007 to 19 March 2008) to be 6.9%. This was an increase of 0.7% compared to the previous year. For calendar year 1387, (20 March 2008 to 20 March 2009) the World Bank predicted a slight decrease, to 5.7%. Therefore, the growth in per capita GDP has not been in accordance with the current five-year plan (2005 – 2009), which aimed at yearly GDP growth of 8%, annual investment growth of 11%, an average inflation rate of 8.5% and an unemployment rate of 9.6%. Iran's Strategic 20-Year Vision Document, development of which began in 1999 and which was assessed in 2002 by the Expediency Council, was approved and submitted to the three branches of the government in 2003. At this time, oil prices were estimated at \$25 per barrel for the purposes of planning. The first year for implementing the general policies of the 20-Year Vision was 2005.

Output strength

In 1386 (21 March 2007 to 19 March 2008), the inflation rate rose to 17.8%, and then reached 25% in the year 1387 (20 March 2008 to 20 March 2009), with a further rise likely. The official unemployment rate was between 10% and 12.5% in

these two years. In 1386 Iran exported a total of \$97 billion in goods and services, with oil exports accounting for \$81 billion of this. Income from non-oil products has doubled compared to the year 1382 (21 March 2003 to 19 March 2004). Yet oil based exports have clearly more than doubled (from \$36 billion to \$81 billion over the same period). According to the central bank, the government under Ahmadinejad made \$237 billion (\$197 billion of this from oil and gas income) between March 2005 and March 2008. Over the same period, GDP growth showed an increase from 4.8% (in 2003 – 2004) to 6.9% (in 2007 – 2008).

12 | Sustainability

According to the World Economic Forum (WEF), Iran was ranked at 67 out of 149 states in the Environmental Performance Index (EPI). This means Iran dropped back 14 places since 2006, when it was ranked at 53rd place. Iran is fighting against chronic environmental problems, but to date the country's administration has shown little competence in terms of management or improvement of the environment. The most urgent challenges are the rapid expansion of population and, related to this, the advancing urbanization which has left cities with increasingly inadequate infrastructure. The major cities are overpopulated. Tehran as the capital city has more than 12 million inhabitants. Millions of old cars running on leaded petrol still pollute the air. Thousands of companies and refineries producing in the city or the surroundings fail to meet modern environmental standards. In January 2009, according to Mohammad Hadi Haidarzadeh, adviser to the mayor of Tehran, 4,000 citizens of Tehran died as a result of complications related to the extremely polluted air. Currently, Iran holds 14.2 million forested hectares. A few years ago this figure was 18 million hectare. Many species are in danger of extinction. Independent Iranian conservationists have criticized the government's State Environment Organization, directed by Fatemeh Vaez-Javadi. A number of professional executives have been replaced by unqualified regime loyalists. Critics charge that Vaez-Javadi always approves the regime's projects, no matter how polluting. Vaez-Javadi has approved regime plans for road construction which include large scale destruction of wooded areas. Kavir National Park in north-central Iran, home to several rare native and endangered species, is highly endangered. Two Iranian oil ministry projects, which began in summer of 2007, could affect the entire area of the park. The ministry will be digging for oil and storing gas under the reserve in two projects that will require the construction of pipelines and salt-water canals throughout the park. The injection of 4 billion cubic meters of gas under the national park will likely force large amounts of salt water to the surface. This would destroy the park's soil and, presumably, its vegetation.

The causes for the Iranian environmental problems are evident. The environment has never been of great importance for Iran's administrations. The Iranian public

Environmental
policy

does not have substantial awareness of the need for environmental protection. The state does not undertake such actions, even though protection of the environment is grounded in Article 50 of the constitution.

There are well-educated, skilled workers in Iran. Investment in the education sector expanded after the revolution. In 1978 there were 175,675 enrolled students, out of a total population of 35 million people. Today there are 3.3 million enrolled students according to Iran's Minister of Science and Technology, Mohammad Zahedi. The country is home to 1.4 million university graduates and 14.5 million pupils. Every year, 400,000 graduates leave universities and other higher centers of learning, many of whom subsequently fail to find a job in the labor market. The number of universities has risen rapidly since 1979. The Islamic Azad (free) universities, which were founded in 1981, played an important role in the expansion of education. In 2006 – 2007, 45.6% of all students studied at Azad universities. But there is a difference in quality in favor of the state-run universities. The share of the budget devoted to education has fluctuated between 3% and 4% of GDP in recent years. In 2008 it accounted for 3.6% of GDP, and is therefore much lower than the international average of 5%. During the Khatami era, state-run universities had a certain amount of autonomy. Principals and faculty directors were elected by the Faculty Council. Intervention by the Ministry of Education was kept within limits. This was curtailed during the Ahmadinejad administration. Now pro-government principals are appointed by the ministry. For the first time in history, a clergyman became principal of the University of Tehran. Ahmadinejad's ideological Islam-oriented education policy is not focused on improving quality. Pillars of his education policy are rather the enforced separation of the sexes and limitation of the number of female students. Another objective is to enroll applicants in their hometown universities. This results in refusing city dwellers enrollment in top-level universities, which are predominantly based in Tehran. Since January 2009, the administration has been determined to enforce the clause reserving 40% of enrollment slots for active Basij members, without any entrance examination required.

Despite the qualitative constraints, Iran still has the highest literacy rate in the Middle East, reaching 85% in 2008. Among those between 6 and 29 years of age, it even reaches 95.5%. In 1979, at the beginning of the Islamic Republic, the literacy rate was only 52%.

Education policy /
R&D

Transformation Management

I. Level of Difficulty

Iran's structural handicaps preventing good and competent management performance are manifold. The biggest constraint remains the practical superiority of the state over the economy, resulting in interference by the state. Since economic units cannot emerge based on innovative skills, due to lack of competition, they try to win the favor of those in charge by using unfair means and bribes. Relatives, friends and acquaintances of members of the administration and the regime receive concessions for importing and exporting profitable goods. Ahmadinejad in particular has introduced many persons close to him into the political corridors of power. Therefore, pro-government individuals now have easier access to economic resources and profitable orders. In some industries Iran's own production has almost been destroyed because of import intervention. For example, Iran has long exported finished textiles to other countries, mainly to Europe. However, importers with close contacts to the corridors of political power have opened for the door to inferior but inexpensive Chinese products within the last two years. As a result, many weaving mills have or will have to close down, as they can not compete with Chinese, Indian or Turkish products.

Structural
constraints

This negative development in Iran's economy has been accelerated by a lack of juridical autonomy, which emboldens corrupt market participants, as there is little fear of prosecution. This is amplified by the lack of freedom of the press or media, which limits opportunities to control or discover corrupt practices. In addition, low state employee wages serve as further motivation for corruption. Last but not least, informational rent exists due to the monopoly and control of the administration over information, which also nourishes political and economic abuse.

The position of civil society has improved considerably since the founding of the Islamic Republic, as compared with the era of Mohammad Reza Shah. More parties and media outlets exist today than was the case 30 years ago. Khatami's reformist government injected some life into civil society. President Ahmadinejad appointed many former IRGC commanders and heads of intelligence services as ministers, vice ministers, governors and directors of key institutions. They are known to be enemies to independent parties and civil society at large. The regime believes independent parties and the civil society to be a threat to security. The regime cannot tolerate a basis for power outside the system. According to the Statistical

Civil society
traditions

Center of Iran there are 6,914 NGOs in the country. Most are active in the financial sector, for example in the awarding of interest-free long-term credits and loans. Then there are human and social trust NGOs. Of these, 1,337 receive state funds. Most of the 6,914 NGOs are nonpolitical organizations. A number of human rights and women's rights organizations also exist, although for the most part these do not hold an official license to operate.

Iran is a truly multiethnic country with a number of recognized religious minorities (Christians, Jews, Sunni Muslims and Zoroastrians) and other ethnic groups. Typically, its ethnic minorities inhabit Iran's borderlands, thus giving their presence a strategic dimension. The tensions between the state and its ethnic-religious minorities have currently taken on a new peak, especially in Khuzestan in the south, home to an Arabic Sunni minority, in the northwest inhabited by Kurds, and in the southeast region where the Balutchs live. Khuzestan Arabs account for 5% of the total population. Violent hostilities occurred in 2005 and 2006, when the Arabs in Khuzestan were encouraged by the Sunni Iraqis fight for their rights against the Shi'ite-dominated Baghdad. Iran accused the British secret service of being behind the hostilities. Turkish Azeris and Kurds in the northwest presented relatively minor problems to the regime, due to the strong military presence in these regions. The southeastern province of Sistan-Baluchestan, which borders Afghanistan and Pakistan, has been the scene of recurrent battles between Iranian forces, drug and arms smugglers, and terrorists. The effect of drugs on the Iranian population is intense. The UNODC (United Nations Office on Drugs and Crime) estimates that 60% of Afghanistan's opium is trafficked across Iran's border (much of it on its way to Europe). Iran has an estimated 3 million drug users, and by many accounts the world's worst heroin problem.

Conflict intensity

Currently a big challenge for the regime is the fight against a terrorist group called Army of God (Jondolla), which is based in the southeast. This group has kidnapped and killed a number of Iranian soldiers and civilians. Iran borders Iraq, Afghanistan and Pakistan, all states deeply in crisis at present. Nevertheless, the regime fears internal threats the most. These threats are posed by civil society and the legally tolerated opposition. The establishment accuses them of planning a "color revolution" modeled after the pattern of the Ukraine, Georgia or Kyrgyzstan.

II. Management Performance

14 | Steering Capability

No single government since 1989 has been able to pursue its objectives effectively. By extension, no government has been able to achieve the goals it has set itself at the time of taking office. Rafsanjani's administration set the reconstruction of the country after the devastating Iran-Iraq war as its main goal. It failed because of Iran's international isolation, massive corruption and last but not least its own faults. From 1997 to 2005, Khatami's governmental priorities included the development of democracy, civil society and civil rights. His administration was committed both to democracy and to a market-based economy. Khatami failed due to massive resistance by the powerful conservative and Islamist establishment, especially by Khamenei and his allied IRGC and Basij militia. Ahmadinejad turned to populism during his election campaign, promising the people a fair distribution of the state's wealth. As a short-term priority, his government promised to funnel oil money to the citizenry. He also promised to take action against corruption as a long-term administration goal. These promises helped Ahmadinejad to win the presidential elections against Rafsanjani, who was publicly believed to be corrupt. Ahmadinejad's administration subsequently pushed the process of Islamization, Islamic purity and a return to revolutionary values. His role model is Islamist Mohammad Ali Rajai, the second prime minister of the Islamic Republic, who was killed in a bomb attack in 1981.

Prioritization

Thanks to high oil prices, Ahmadinejad's administration was presented with the most favorable conditions in the history of the republic under which to implement its short-term and long-term goals. Yet, as detailed above, the population's socioeconomic situation has worsened as compared to the situation under Khatami. Ahmadinejad has lost the fight against corruption simply because the problem is intrinsic to the system. Many high-ranking personalities of the system, including those close to the supreme leader, have been heavily involved in corruption. Overall, all these goals failed because of the incompetence of the cabinet and its ideological Islamic orientation, which is not geared toward the country's national interests but toward the unfair advantaging of a few conservatives at all levels of society.

Implementation

Ahmadinejad's administration and the supreme leader have shown little interest in or capability for learning. The president backed Secretary of the Interior Awas-Ali Koradan, who was proven to have committed fraud and to have acquired an illegal

Policy learning

doctor's degree. Finally the Majlis removed him from office by means of a resolution of no confidence. Ahmadinejad subsequently appointed his advisor Sadeq Mahsuli, a former IRGC commander, as new minister. Mahsuli is a billionaire who had been rejected by parliament as oil minister at Ahmadinejad's inauguration, as he had earned his billions in a suspiciously short period of time. The supreme leader seems to support a second term in office for Ahmadinejad. Yet the pragmatist-reformist groups seem to have learned from mistakes of the past. They always refer to national interests which must be given more prominence than differences between political groups. They are searching for a pragmatic means of problem solving, which is supposed to lead the country out of the crisis.

15 | Resource Efficiency

The government of Iran uses its assets with only rudimentary efficiency. Firstly, administrative staff is selected less according to education or qualifications than due to personal connections. This has led to a clear loss of competence in the state administration. Secondly, the political elite has proven unable to manage the revenues of Iran's vast natural resources responsibly, in a way that would bolster the country's economic development. Instead, the elite has turned the country into a rentier state based on oil revenue. The extra cash injected into the economy has encouraged speculative activities, diverting capital away from production to real estate speculation and the ballooning services industries. Apart from agriculture, which has been a priority sector for the government since the revolution, the natural resources of the country are not being efficiently exploited. The reason for this is first and foremost the ailing oil and gas industry; at the end of the fourth five-year plan (2005 –2009), covering most of Ahmadinejad's first term, the country should have invested \$121 billion in the oil and gas industry. Instead, investments under Ahmadinejad amounted to only \$13.5 billion between 2005 and the summer of 2008. Further investments will be difficult at present due to decreasing oil prices. Additionally, sanctions based on U.N. resolutions have caused massive loss of foreign investment, and have also led to the absence of foreign professionals in the economy.

Thirdly, the government receives only minimum amounts of taxes because the tax system is so inefficient. The huge shadow economy is neither correctly taxed nor sufficiently monitored by the government. In the 1990s, the black market accounted for some 25% of the Iranian economy. Today it makes up 50% of the total. The government's tax income amounts to just 7% of the GDP, as compared to a international average of 30%. Tax evasion accounts for a loss of 20% of taxes. However, the political elite evinces not the slightest interest in reforming the tax system. Therefore the state loses billions of dollars each year, which are badly needed if the country's dependence on oil revenues is to be decreased.

Efficient use of assets

Ahmadinejad's government has been unable to formulate and follow a clear set of policy objectives. The dismissal of 10 ministers and additional vice ministers within the last three and a half years shows the president's perplexity. The structure of government is absolutely hierarchic and totally tailor-cut for Ahmadinejad. Only the supreme leader has the power to stand in his way. Ministers often contradict each other and interfere with other departments. For example, Secretary of the Supreme National Security Council Saeed Jalili bears more responsibility for foreign affairs than does Secretary of State Manuchehr Mottaki. During the 2008 – 2009 Gaza war Jalili and Ahmadinejad's Vice President Mohammad Reza Rahimi were traveling in the Middle East, while Mottaki received visitors in Tehran from less important African states. In addition, coordination with the parliament does not take place effectively. The cabinet is largely inexperienced, and this is the first time that an incoming government has sidestepped all existing and experienced ministers in favor of new faces. This clean sweep came with a price: the inability to produce innovative policies and strategies.

Policy
coordination

No government in Iran can develop an integrity mechanism to control corruption if it does not work tightly together with the Majlis, the judiciary and its own administration. But this fight must be backed by the supreme leader as well. Under the current conditions, this hardly seems possible. Neither the institutions under the control of Ayatollah Khamenei nor the Council of Guardians, the Expediency Council or the Assembly of Experts can be made subject to any audit. Furthermore, the IRGC and its rich companies are given considerable freedom concerning income and expenditure. In the Khatami era, the parliament, then dominated by reformers, ordered an investigation and audit of radio and TV stations. Even though the parliamentarians pressed hard, the accounts of only five institutions could be checked. The fact-finding committee reported defalcation of 525.8 trillion toman to the parliament. The director of Iran's state-run radio and television network at that time (from 1994 to 2004) was the conservative Ali Larijani. Larijani is currently chairman of the Majlis. No manager of the state-run radio and television network was prosecuted as a result of the fact-finding committee's reports. Even parliamentarians do not know in detail what expenditures the administration has made from its budget. There are no audits of government expenditure.

Anti-corruption
policy

16 | Consensus-Building

Iranian politics are deeply divided and polarized at the highest level. The pragmatic reformist camp believes in the development of a market economy and democracy within Iran's Islamic context. This camp has shown a convincing willingness to implement these projects should it attain the power to do so. However, the powerful conservative camp itself shows deep internal splits. Numerous well-known persons of public interest disagree with Ahmadinejad's economic policies. The president's

Consensus on goals

economic policies clearly show that the administration is not familiar with basic market economy principles. On a political level, the entire conservative spectrum opposes democracy and human rights. This is why many violations of human rights have been committed under Ahmadinejad without noteworthy protest by conservatives. There is little agreement among the political elite and the two camps (conservative and reformist) over the desirability of a free market economy or democracy.

At present, there is little room for compromise between the competing pro-reform and anti-reform camps, particularly as the latter now dominates the executive and the legislative wings of government. Ayatollah Khamenei plays a key role because of his veto right on any matter. This right cannot be challenged due to its base in the constitution, detailing the absolute authority of the jurist (Velayat-e motlaqeh-e Faqih, a consequence of revision of the constitution in 1989). But not much is known about Khamenei's exact methods. He engages and encourages the ongoing political activity of reformist leader Khatami as much as that of economic pragmatist Rafsanjani. Still, Ahmadinejad's administration seems to be a government according to Islamic laws.

Anti-democratic
veto actors

In mid-December 2008, Khamenei called Ahmadinejad a young, dynamic and brave statesman, while indirectly labeling former President Khatami, a reformist, as weak and cowardly. So, as long as the general political system remains as it is, reform-minded politicians will always be confronted with powerful anti-democratic actors. Successful reform politics, limiting the power of anti-democratic actors and taking a course of market-based democracy, will only be possible if the constitution is revised. Otherwise every move will depend on the discretion of the supreme leader.

Ayatollah Khamenei tends to the conservative camp. Yet, like his predecessor Ayatollah Khomeini, he appears mainly focused on stopping serious conflicts before they grow to endanger the regime. Rarely do cleavages escalate into open conflict. However, under Ahmadinejad the regime has experienced the biggest tensions so far between the conservative and reformist camps, as well as the first visible split within the conservative camp. At an overall social level, the gap between the administration and its clients on the one side and the broader population living in miserable economic and political circumstances on the other has grown wider and wider. The government's ideologically oriented Islamic politics are incapable of neutralizing the tensions in the country. Therefore the administration often counts on the interventions of judiciary, security forces, the secret service, the IRGC and the Basij militia. Ahmadinejad has widened the gap between ethnic minorities and the state by using violent measures against them.

Cleavage /
conflict
management

The current political leadership is distinctly uninterested in civil society and its activities, and has made it harder for such organizations to establish themselves or

Civil society
participation

operate without fear of closure and arrest. Activities of the portions of civil society allied with the administration itself, such as the Basij students, the only ones tolerated. The same is true for media, unions, chamber associations and other groups. The Ahmadinejad administration has taken the toughest approach to civil society since the death of Ayatollah Khomeini in 1989.

During the thirty years of the Islamic Republic, many crimes and injustices initiated by the state have occurred. The peak of injustice was reached during the 1980s. In the summer of 1988, shortly after the end of the Iran-Iraq war, the regime ordered the execution of at least 3,000 convicted political prisoners. Since then, none of the persons in charge has been allowed to talk about these events officially. Instead, the Islamic Republic has made great efforts to cover up historical events and injustices. No system exists by which the government could address past injustices, or even recognize past abuses as such.

Reconciliation

17 | International Cooperation

Under the Khatami administration, there was brisk cooperation with European Union states, especially Germany, France and Great Britain, and a number of international organizations in both economic as well as political aspects. Dialogues about democracy and human rights took place on a regular basis in the capitals of the respective countries. This cooperation has been put on hold in almost every respect since the inauguration of Ahmadinejad, due to his aggressive and martial presentation techniques. Currently, international relations take place solely on an economic level. The major dispute with the U.N. Security Council and the International Atomic Energy Agency (IAEA) over Iran's nuclear program and uranium enrichment facilities, in combination with the strong pressure of the U.S. administration under Bush, has forced Iran to intensify cooperation with Russia and China. To date, Ahmadinejad's government has shown no viable long-term development strategy regarding a market-oriented economy. Democratic transformation of the society is not a goal. His administration has not had to depend on individual, bilateral or multilateral international investors or donors due to high oil prices.

Effective use of support

Under the Ahmadinejad administration, Iran gambled away the credibility and reliability regained during Khatami's term in office. Ahmadinejad's repeated denial of the Holocaust and anti-Israel statements have opened a wide gulf between Iran (and even non-state Iranian institutions) and the Western states. The government's lack of credibility and reliability has led several big European banks to pull out of business with Iran, and has prompted big European insurance companies to drastically reduce debt guarantees (for example, Germany's Hermes lowered debt guarantees for imports of German goods into Iran starting in 2007).

Credibility

Relations between Iran and its neighboring countries are difficult and complex. Generally, the heated tensions between Iran and the United States affect the whole region, and will do so even more if the likelihood of war rises further. In addition, the neighboring Sunni Arab countries fear for their stability because of their Shi'ite minorities, which make up 15% of the population in Saudi Arabia, and as much as 70% in Bahrain. The entire Middle East fears the "Shi'i crescent," even more so after Shi'ites gained power in Iraq. Iran's borders with Turkey, Pakistan and Afghanistan are stable, although that with the United Arab Emirates is controversial, due to three islands in the Persian Gulf. There has been no final settlement detailing the exact course of the border with Iraq in the Schatt el-Arab region. The Organization of the Islamic Conference (OIC) is the only regional panel in which Iran participates. But the OIC has only symbolic relevance. Bilateral economic relations exist with certain individual neighboring countries, especially the United Arab Emirates and Turkey, regardless of disputes over borders. Ahmadinejad has undertaken a remarkable diplomatic offensive to push for an improvement in relations with the Arab world. In December 2007, Ahmadinejad accepted an invitation to the summit of the Gulf Cooperation Council (GCC) in Doha (Qatar) for the first time. In March 2007 he was the first president of the Islamic Republic to visit Iraq. In May 2007 he advocated resuming relations with Egypt, which had been broken off by Iran in 1979 after Cairo's peace agreement with Israel.

Regional
cooperation

Strategic Outlook

Regarding its most important goal, the country's controversial nuclear program, Ahmadinejad's administration did not give in to external pressure. Contrary to all fears, this stance survived the end of George Bush's U.S. presidency without military escalation. Nevertheless the topic has resulted in four U.N. Security Council resolutions. Iran will be forced to revise its foreign policy under the impact of the financial crisis which has also arrived in Iran. Additional reasons include the current low oil price, in combination with the changeover of power in the White House, which will enable the United States to put more pressure on Iran in the future. If Barack Obama's avowed readiness to negotiate is put into practice, there will simply be no room for razzle-dazzle actions on the part of any Iranian government. Iran's relations with the European Union also need revision. To get the talks started, Iran's top nuclear negotiator, Saeed Jalili, mentioned export of Iranian gas to Europe as a first step in January 2009. Ahmadinejad's remarkable attempts to improve relations with the Arab world collapsed quickly after the release of an offending film production about former President of Egypt Anwar as-Sadat, and were also affected by Iran's position during the 2008/2009 Gaza war. In this way, ideological dogmas can often cripple Iran's strategic objectives. To improve its relations with the United States, Europe and the Arab countries, Iran urgently needs to build up international trust. This is also the basis for economic engagement of foreign investors in the country. Iran must open its market to greater international corporate investment. Its vast human resources would make it a highly attractive and profitable site for joint ventures and foreign business activities. Massive investment in its ailing gas and oil industries is of eminent importance for the future of Iran. If these needs are neglected Iran might become an oil importing country by the end of the next decade.

To achieve all this, the country must make two choices. Firstly, national interests must be awarded priority over ideological Islamic interests. The leaders in Tehran are too interested in keeping up the Islamic system (Nezam). The regime is always afraid of this being endangered. The omnipresent dogmatic ideological climate diminishes the country's attraction for foreign investors. Secondly, a consensus must be achieved regarding the domestic challenges. Ahmadinejad's administration has turned out to be bad for the legal and tolerated opposition, as well as for civil society. Thus, the presidential elections of 12 June 2009 are of great importance for the republic. Iran is currently in desperate need of a moderate reform-oriented president. Nevertheless chances are not necessarily great for such a president, even though Ahmadinejad's record is poor. Ahmadinejad is well prepared, and he can be sure of the support of crucial authorities such as the supreme leader, the Council of Guardians (which will supervise the elections), and the Ministry of the Interior (which will organize the elections). Furthermore, he can count on 12 million organized conservative voters. This number includes the persistently conservative voters, the Revolutionary Guards and members of the Basij militia, as well as the families and relatives of all mentioned above. If someone poor contacts him directly or via letter, Ahmadinejad has also typically found ways to grant money directly from the state's treasury. Change will thus be difficult in this election.