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The Economic Legacy of Mahmoud Ahmadinejad

Prof. Nader Habibi

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About the Author

Nader Habibi is the Henry J. Leir Professor of the Economics of the Middle East at the Crown Center, Brandeis University. Before joining the Crown Center in 2007, Habibi was Managing Director of the Middle East and North Africa Division at IHS-Global Insight. He is a regional economist with a concentration on the Middle East and North Africa. His recent research projects have focused on the economic policies of Islamists in Egypt and Tunisia, as well as the latest economic trends in the Islamic Republic of Iran. He holds a Ph.D. in economics and a Masters in systems engineering from Michigan State University. He has also worked as a research fellow at the Middle East Council at Yale University.

Crown Center for Middle East Studies
Brandeis University
MS 010
415 South Street
Waltham, MA 02454
Phone: 781-736-5320
Fax: 781-736-5324
www.brandeis.edu/crown
crowncenter@brandeis.edu

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Abstract

Mahmoud Ahmadinejad won the 2005 presidential election promising economic justice and fairness. Throughout his eight-year presidency, he paid more attention to economic fairness and redistribution of wealth than had previous presidents, and he adopted several populist financial and fiscal policies intended to fulfill his promise. These policies did reduce income inequality, but they also resulted in a loss of fiscal and monetary discipline. Yet, Ahmadinejad, a self-assured politician, often dismissed the warnings of both his critics and his supporters about the consequences of his economic policies.

Ahmadinejad brought many commanders of the Revolutionary Guards and Basij militia into his cabinet and facilitated the sale of a large number of privatized firms to these institutions and their economic units. As a result, the Revolutionary Guards are now actively involved in all types of economic and financial activities in Iran. Initially, Ahmadinejad was skeptical of the market-oriented economic reforms of previous presidents, but he gradually changed his mind and continued many of them. His most important achievement in this regard was the reform of energy and fuel subsidies. With the active support of the Supreme Leader and the Revolutionary Guards, Ahmadinejad implemented the price subsidies reform in December 2010. Despite record high oil revenues, however, Iran's economic growth during Ahmadinejad's presidency was no better than in the Khatami or Rafsanjani eras.

Introduction

Iran's sixth president since the 1979 revolution, Mahmoud Ahmadinejad, began his presidency in June 2005 as a populist champion of poor and working-class Iranians. Ahmadinejad's populist promises to redistribute economic opportunities and fight against corruption played an important role in his 2005 electoral victory. And during his two terms in office, Ahmadinejad implemented a number of important economic policies that had a profound effect on socioeconomic conditions in Iran. His presidency also coincided with the expansion and intensification of international sanctions against Iran. This essay analyzes President Ahmadinejad's economic policies and their implementation since August 2005, considers the interaction of the sanctions with these policies, and examines the impact of both the policies and the sanctions on the economy of Iran. Hopefully this analysis will help us develop a better understanding of the long-term strengths and weaknesses of the Iranian economy.

Ahmadinejad's economic policies are rooted in his perceptions of the requirements of fairness, justice, development, and progress—which, in turn, have been influenced by his life experience. Ahmadinejad grew up in a religious lower-middle-class rural family that migrated to Tehran when he was only one year old. He was politicized in college during the final years of the Shah and cooperated with the Revolutionary Guards and Basij as a volunteer during the Iran-Iraq war in the 1980s. That cooperation paved the way for several political administrative appointments for Ahmadinejad, and when the conservative opponents of President Khatami won a majority in Tehran's city council, they appointed Ahmadinejad mayor of Tehran in 2003. (In turn, Ahmadinejad appointed many of his

wartime comrades in the Basij and the Revolutionary Guards to key positions in the Tehran municipality.)

Ahmadinejad's economic views soon manifested themselves in the manner in which he managed the capital's municipal affairs. As mayor of Tehran, he redirected a portion of the capital's financial resources toward income support programs, such as marriage assistance loans, for the poor. He also adopted an informal approach to bureaucratic affairs and showed a lack of patience for financial and budgetary oversight, which together resulted in financial irregularities and a lack of transparency in his governance. Both continued after Ahmadinejad became president.¹

During the 2005 presidential election and throughout most of the years of his presidency, Ahmadinejad received crucial support from Ayatollah Ali Khamenei, Iran's Supreme Leader, and from the revolutionary armed forces (the Basij and the Revolutionary Guards). His close connection with these two institutions played a crucial role in the formulation and implementation of his economic policies, as will be demonstrated in subsequent sections of this paper. The Guards and the Supreme Leader were troubled by the defiance shown by President Khatami and threw their support behind Ahmadinejad because they believed that he shared their values and was unlikely to deviate from their policy recommendations.

Some have described Ahmadinejad as a protégé of the Supreme Leader.² There are many indications that Khamenei indeed approved of Ahmadinejad's populist economic views,³ and his support helped Ahmadinejad overcome resistance in the parliament to some of the programs he sought to institute.

Ahmadinejad's Economic Ideology

Ahmadinejad's economic policies, and the multitude of speeches that he has delivered on economic issues,⁴ reveal several core economic values that dominate his thinking about economic issues.

- Ahmadinejad believed that the distribution of economic wealth and opportunities prior to his presidency was unjust and required redistribution. He was particularly mindful of underdeveloped regions of the country. This belief was the main motivation behind his frequent visits to provinces and remote areas as president. On average, Ahmadinejad

1. In 2009, Gholamhosein Karbaschi, a former mayor of Tehran, pointed out that more than \$3 billion of the municipality's budget during Ahmadinejad's mayoral term was yet to be accounted for. "Nagoftehaye Karbaschi az Ahmadinejad" [What Karbaschi has not revealed about Ahmadinejad], *Ommid.com*, June 6, 2009 [in Persian].

2. Ahmadinejad was referred to Khamenei by Ayatollah Khomeini in the early years of the Islamic revolution when he and a number of other students approached Khomeini seeking to strengthen the bond between the universities and the centers of religious learning (*Hozeh*).

3. "Ali Mohammad Shams, che kassi mas-oule bohraan eghtesaadi v hasteie keshvar ast?" [Who is responsible for the country's economic and nuclear crisis?], *rahesabz.net*, March 28, 2012 [in Persian].

4. An archive of Ahmadinejad's speeches and press conferences is available on the [Islamic Republic of Iran's Presidency website](#), [in Persian].*

visited a province every twenty-three days.⁵ He used these visits to deliver funds for thousands of development projects in small towns and villages.

- Ahmadinejad blamed the unfair economic conditions on corruption and on the economic reform policies of his predecessors, Khatami and Rafsanjani. He believed that reforms such as privatization and price deregulation had been exploited to benefit a small group of powerful businessmen and politicians. He criticized large private corporations and large public enterprises alike for inefficiency and for abusing monopoly powers.
- Regardless of their Left or Right orientation, Ahmadinejad viewed Western economic ideologies as alien, and as incompatible with Iran's economic institutions. Accordingly he often accused the reform-oriented economists who had influenced President Rafsanjani's economic policies of being misguided, as well as subservient to Western ideologies.
- Ahmadinejad refused to accept the mainstream economic view that excess liquidity would result in inflation, even when his own trusted economic advisors presented that view to him.⁶ He also showed little regard for the country's five-year plan, or for its formal budget guidelines for fiscal spending. The Planning and Budget Organization of Iran (BPO) became a vocal critic of Ahmadinejad's economic policies, and he reacted by reducing the BPO's independence and transforming it into two vice-presidential offices under his direct control.
- Ahmadinejad believed that people deserved to gain tangible economic benefits from the government's oil revenues, and that this could be accomplished only if a portion of those revenues was either distributed as cash payments or else spent on goods and activities that produced short-term tangible benefits for the people. Ahmadinejad held this view in common with the Supreme Leader, who believed that Rafsanjani and Khatami focused disproportionately on long-term development and infrastructure projects.

Ahmadinejad's Economic Policies

The populist economic views described above were the main drivers of Ahmadinejad's economic policies. As mentioned earlier, however, he was also influenced by the economic interests and views of the Supreme Leader (Khamenei) and the Revolutionary Guards. The influence of both factors is evident in most of the economic policies that he initiated. In the case of policies such as privatization, for example, implementation was modified to serve the strategic goals and interests of the Revolutionary Guards.

Another important factor that influenced both the implementation and the outcome of Ahmadinejad's economic policies was the fragmented nature of political power in Iran.

5. These visits were carried out in rotations; in each rotation, Ahmadinejad visited all of the provinces. On average he visited each province three or four times during the first seven years of his presidency.

6. Ahmadinejad explained his views on how liquidity is related to inflation in a speech on the achievements of the first year of his presidency on October 8, 2006. See <http://www.president.ir/fa/2665> [in Persian].*

Since the beginning of his presidency, Ahmadinejad was a polarizing factor within the ruling regime, and many powerful politicians opposed him; on some occasions, factions opposed to Ahmadinejad in the parliament or the judiciary blocked or modified his economic policies. In the early years of his presidency, the Supreme Leader frequently supported Ahmadinejad against his opponents; in later years, however, these opponents became more effective in blocking his policies as the Supreme Leader reduced his support for Ahmadinejad.

Four of Ahmadinejad's more significant economic policies will be discussed below.

Privatization: Ahmadinejad inherited a privatization program that was initially launched during Rafsanjani's presidency. Ahmadinejad sharply criticized this program during his 2005 election campaign, and with the backing of the Revolutionary Guards, he appealed to the Supreme Leader to modify the privatization program in order to make it more equitable, and to prevent corruption in the sale of public assets.

The Supreme Leader ended the intense debate between supporters and opponents of privatization by endorsing Ahmadinejad's revisions to the privatization law. The revised law set aside 40 percent of the shares of privatized firms for distribution among low-income households at highly discounted prices. These shares were labeled "justice shares [*Saham Edalat*]." As many as two thousand public enterprises were targeted for privatization under the revised plan, their value estimated at between 100 to 140 billion dollars.

The distribution of justice shares also served as an indirect mechanism to reward low-income supporters of the regime, particularly the Basij militia, for their loyalty and support. The veterans of the Iran-Iraq war, the families of war martyrs, and households that received income support from government welfare agencies were all declared eligible to receive justice shares.

In the first phase of this process, justice shares were distributed to 4.6 million eligible individuals; the value of these shares was assessed at \$2.3 billion. As envisioned in the privatization law, the government tried to sell another 40 percent of the shares of privatized enterprises in the stock market. In many cases, however, these shares were purchased by semi-state agencies and by government-affiliated charity foundations (*bonyads*). These purchases were partly justified by the lack of adequate demand from private investors, who were deterred both by the adverse impact of sanctions and economic mismanagement on the business environment in Iran and by their lack of full managerial control (since they could purchase no more than 40 percent of the shares). Consequently most shares of privatized firms were purchased either by semi-governmental enterprises or by investors who had close ties to security forces or government officials.

Subsidy Reforms: Ever since the 1979 revolution, large price subsidies on energy products such as gasoline, natural gas, and diesel fuel have constituted a heavy fiscal burden, and the artificially low prices of subsidized products have led to considerable waste and overconsumption. Both Rafsanjani and Khatami tried to reform these subsidies, with very limited success. Ahmadinejad was initially opposed to the removal of these price subsidies. He believed that, to prevent hardship, the government should first expand public

transportation services and only then raise the price of fuel. However, as the fiscal cost of subsidies continued to grow and Iran became more dependent on imported gasoline, which in turn was becoming more vulnerable to widening economic sanctions,⁷ Ahmadinejad shifted his position. He submitted a subsidy reform bill to the parliament in December 2008, which was debated for nearly a year and was finally approved in January 2010.

The approved Subsidy Reform Law called for the removal of price subsidies over a five-year interval and required that the domestic prices of gasoline and other refined oil products be raised to within 90 percent of the international prices for delivery of these products to Persian Gulf destinations. To ease the burden of higher prices, the law called for offering cash subsidies to low-income households. In order to identify eligible households, the Statistical Center of Iran conducted a comprehensive household income survey. But it soon became clear that accurate data about household incomes was hard to obtain. Many politicians and Parliament members were also worried that denial of cash subsidies to middle- and upper-income households might lead to political backlash and social unrest.

In light of these concerns, cash subsidies were offered to all citizens as per capita monthly payments.⁸ A combination of loans and financial supports was also approved for businesses, as an incentive to improve their energy use efficiency. Consequently, 50 percent of the revenues generated by the sales of energy products (by the government) at higher prices after the removal of subsidies was allocated to direct cash transfers to households; 30 percent was allocated to financial support for industrial and agricultural units as producer subsidies; and the remaining 20 percent was set aside for the higher energy costs incurred by government enterprises and ministries.

After several months of preparation, the plan was finally implemented on December 19, 2010. In order to prevent any public disturbances, the police, the Basij militia, and the Revolutionary Guards were positioned in gas stations and at major intersections, while the first monthly cash subsidies were simultaneously deposited into households' bank accounts. These measures were largely effective in preventing unrest. With the exception of a few isolated attacks on gas stations, the sudden price rises did not result in significant social or political disturbances.

As anticipated, the higher fuel and utility prices reduced consumption of these products during the next twelve months, but they also led to higher prices for many goods and services. Soon after the subsidies were removed, the government was alarmed by these large price increases; it reacted by imposing price controls on domestic producers and wholesale retailers, without taking into account the higher costs of production. The combination of price controls and higher production costs occasioned severe financial stress for many private industries: Many firms had to cut back on their output and lay off workers. The parliament reacted to these developments by forcing the government to maintain a large portion of the subsidies for agricultural and industrial units.

7. Iran's refineries were damaged during the Iran-Iraq war, and reconstruction efforts were slow because of Western sanctions on oil technology. In 2007, Iran was dependent on imports for one-third of its domestic gasoline consumption.

8. The per capita cash subsidy was set at (approximately) a modest \$45 per month, which amounted to a significant income support for low-income families in rural areas and poor urban neighborhoods.

Eventually, price controls were lifted, and producers were allowed to raise their prices. Overall, however, the course of subsidy reforms has deviated from what was initially intended because of the occasional interventions of the parliament. These modifications were partly a result of the parliament's concern about the economic and political consequences of reforms, such as inflation and loss of jobs; they were also motivated in part by factional rivalries, as well as fears on the part of Ahmadinejad's opponents that he might exploit the reforms (particularly the cash payments) for political purposes. The resultant ad hoc implementation of the program has led to a sharp increase in its fiscal burden. The cost of cash subsidies has far exceeded the higher sales revenues resulting from less subsidized fuel prices, and the periodic adjustment of fuel and utility prices has not kept pace with inflation.

While removal of price subsidies has been painful for many social groups, the government and the political elite have reluctantly pushed it forward because of a growing awareness on the part of all political factions that the fiscal burden of the subsidies was not sustainable. Nevertheless, political rivalries and strategic considerations are likely to cause modifications and delays in its implementation. In 2012, for example, the government's plan to implement the second phase of subsidy reforms faced political opposition from the parliament. Regardless of how the subsidy reform program evolves in the future, it is likely to be remembered as one of the most important economic programs of the Ahmadinejad presidency.⁹

Monetary Policy and Banking. President Ahmadinejad viewed the state-owned commercial banks as instruments of government policy, and his administration allocated a large portion of bank credits administratively.¹⁰ He was highly skeptical of the management and lending policies of banks and initiated two important interventions in the banking system. First, he ordered state-owned commercial banks to direct financial resources toward preferred geographic areas and economic sectors at low interest rates. At the same time, he substantially increased the volume of loans that government agencies and state-owned enterprises received from commercial banks. As a result of this strategy, the public sector's debt to commercial banks grew substantially under Ahmadinejad, at the same time as it borrowed less from the Central Bank (Figure 1).

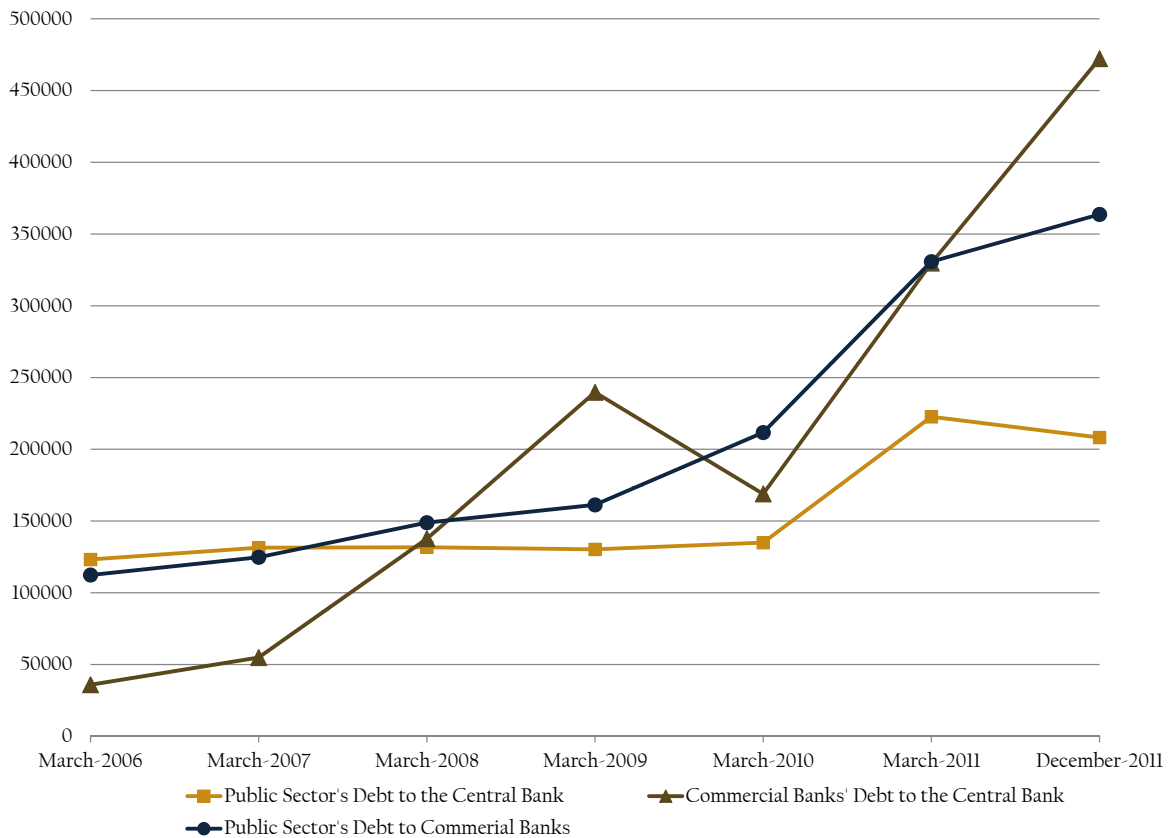
These mandatory loans to the public sector drained the financial resources of state-owned commercial banks and forced them to borrow substantial sums from the Central Bank. According to the most recent financial statistics of Iran's Central Bank, the government's debt to the domestic banking system rose by 400% from 2005 to 2011. During the same period, the debt of state-owned commercial banks to the Central Bank rose more than twelvefold.¹¹

9. The IMF reviewed Iran's subsidy reform program in 2011 and gave it a favorable assessment. [Dominique Guillaume, Roman Zyteck, and Mohammad Reza Farzin, "Iran: The Chronicles of the Subsidy Reform," IMF Working Paper WP/11/167 \(International Monetary Fund, July 2011\).](#)*

10. Iran's commercial and private banks were nationalized after the 1979 Islamic revolution.

11. Central Bank Quarterly Report on Economic Indicators (*Namaagar-haye Eghtesaadi*), No. 66, 4th Quarter, 2011.

**Figure 1. Public Sector Debt to the Banking System
(In Billion Rials)**



Source: Iran Central Bank Annual and Quarterly Reports

Ahmadinejad's banking policies led to substantial losses for state-owned banks and drew considerable criticism from banking experts and economists, but he remained defiant. He replaced top bank managers with his own supporters (mostly former members of the Revolutionary Guards and Basij militia) to ensure the full cooperation of the banking system with his policies.

A second banking policy implemented by Ahmadinejad was that, after freezing the establishment of private banks in his first term, he facilitated the establishment of non-bank financial institutions (NBFIs) in his second term. Most of these NBFIs were affiliated with Islamic Charity Foundations and military establishments such as the Revolutionary Guards and the Basij militia. The NBFIs were subject to fewer regulations than state-owned banks and hence were able to attract more investment funds. In addition, the government forced the state-owned banks to provide funding to some of these NBFIs. By 2008 the NBFIs had as a result accumulated considerable financial resources, while the banks were in financial distress.

After the government lifted the freeze on the creation of private banks in 2009, several NBFIs that were connected to the Revolutionary Guards and Basij militia changed their

status to that of private banks.¹² The NBFIs also bought large blocks of shares in the four state-owned banks that were privatized. The net effect of these developments was a massive reallocation of financial power and resources to a segment of the leadership, as well as to the rank and file of the Revolutionary Guards and Basij militia.

Economic Empowerment of the Revolutionary Guards and Basij Militia.

Although the active participation of the armed forces in economic activities began in the Rafsanjani era, it enjoyed a noticeable acceleration during Ahmadinejad's presidency. Iran's Islamic Revolution Guards Corps (IRGC) and other armed forces were authorized to participate in economic and commercial activity under Article 147 of Iran's constitution.¹³ Overall, five government policies under Ahmadinejad contributed to the economic empowerment of the IRGC.

- Preferential awarding of government contracts to IRGC-affiliated firms. In many public tenders and procurement activities, the Ahmadinejad government openly or implicitly discriminated in favor of providers that were affiliated with the IRGC, the Basij, or former members of these organizations. The largest and most resourceful IRGC economic unit is the Khatam al-Anbia construction and engineering company. As of October 2007, Khatam al-Anbia owned 812 corporations and took credit for having completed 1,500 construction projects between 1990 and 2007.¹⁴ At the same time, international sanctions also led to the increased participation of IRGC firms in industrial activities, particularly in the oil and gas sector. As international firms abandoned some projects in response to the sanctions, Khatam al-Anbia stepped in as a substitute contractor.
- Governmental and quasi-governmental appointments. Ahmadinejad appointed a record number of current and former members of the IRGC and the Basij to key government positions and to the upper management of public enterprises. When he appointed the former IRGC commander Gholamreza Rostami oil minister in July 2011, the number of ministers with an IRGC background in his cabinet rose to twelve. He also availed himself of every opportunity to appoint former IRGC and Basij officials to lower-tier government posts and to positions in state-owned enterprises.
- Preferential treatment of IRGC- and Basij-affiliated investors in the privatization process. When Ahmadinejad reactivated the privatization drive in 2006, his government actively promoted the sale of privatized assets to financial and investment firms that were affiliated with the IRGC or the Basij.¹⁵

12. These include Sina Bank (formerly the Bonyad Financial Institution), Ansaar Bank (formerly Ansaar al-Mojahedin Interest-Free Lending Fund), and Bank Mehr Iranian (formerly Mehr Iranian Interest-Free Lending Fund). For more details on this issue, see [Khaki Pirooz, and Mohammad Adli, "Bankhaye Khosusi Che Ghard Sood Midahand?" \[How much interest do private banks pay?\], *Shakhes Online*, September 12, 2012, \[in Persian\].*](#)

13. [Constitution of the Islamic Republic of Iran, Chapter 9: The Executive Power, Articles 143-151, October 24, 1979.](#)*

14. [Masoud Behnood, "Hadafe tahrir AMrica, Gharargah-e saazandegi khatam al-anbia-ye sebaah" \[Target of American sanctions: The Guards' Khatam al-Anbia construction company\], *BBC*, October 26, 2007, \[in Persian\].*](#)

15. For a detailed list of financial and investment firms that are owned by the IRGC or the Basij militia, see

- Preferential bank loans and financing. Ahmadinejad used his control over state banks to force them into providing preferential loans to financial and commercial units of the IRGC and the Basij. These loans played an important role in enabling the expansion and empowerment of both groups. They used these resources to increase their political patronage by offering interest-free loans to families of veterans and war martyrs (which are overwhelmingly affiliated with the IRGC or the Basij).
- Foreign trade privileges. Participation of the IRGC in foreign trade began in the 1980s during the Iran-Iraq war and has continued ever since. In response to worsening sanctions in recent years, the IRGC has expanded its efforts to smuggle sanctioned goods and to use front companies in other countries to procure imports of essential goods. It has carried out these activities in an attempt to bypass the sanctions and preserve the flow of imports and exports.

While these activities are primarily motivated by strategic and national security considerations, the IRGC has also engaged in conventional foreign trade activities for financial gain. During Ahmadinejad's presidency, participation of IRGC- and Basij-affiliated firms in Iranian foreign trade rose sharply. The government granted many import and export privileges to IRGC-affiliated companies. The Mehr Credit Union (*Sandough-e etebaraat mehr*), for example, which is the main financial arm of the IRGC, is involved in importing a wide range of goods.

Performance of the Iranian Economy under Ahmadinejad

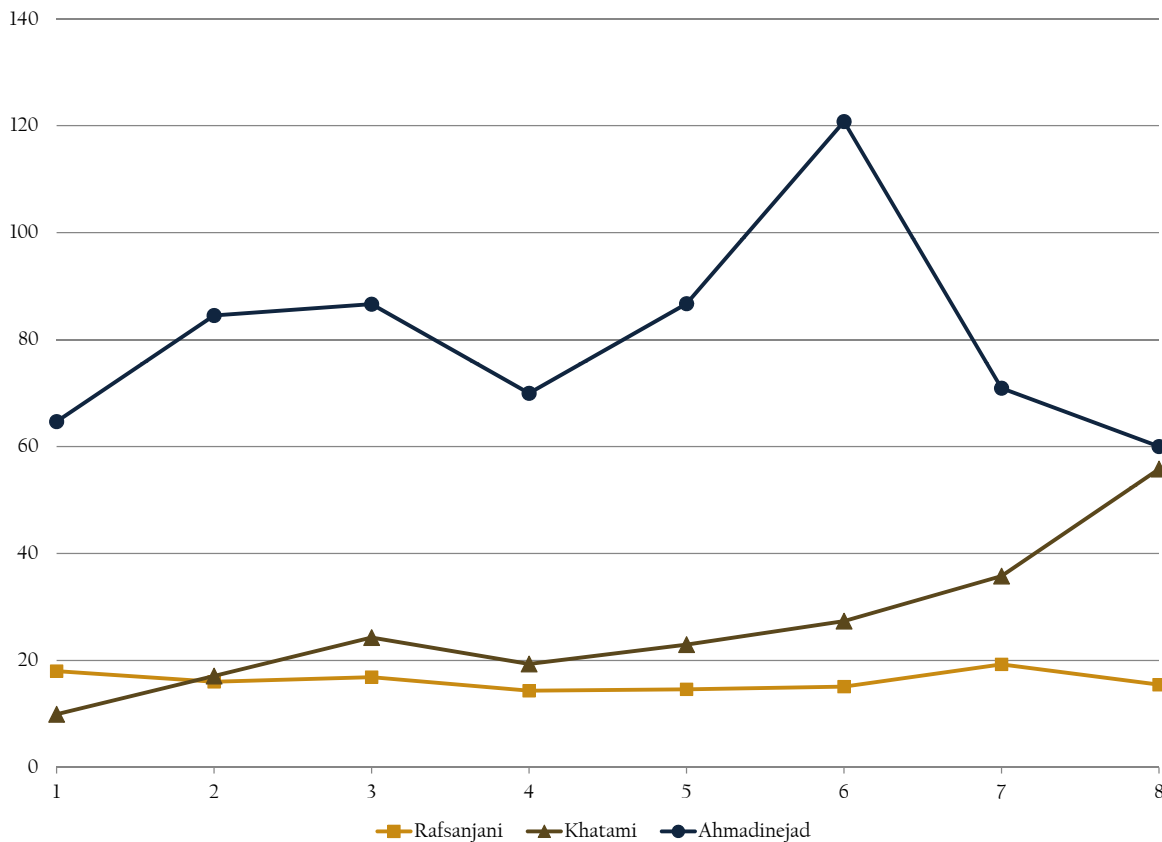
While the economic policies of Ahmadinejad's government have played an important role in the performance of Iran's economy, two other forces have also been influential: Iran's oil revenues, and international sanctions. It is very difficult, therefore, to assess the impact of President Ahmadinejad's economic policies in isolation. Furthermore, government policy did not always go in the direction that Ahmadinejad intended; other centers of political power—the Supreme Leader, the parliament, and the judiciary—were able to alter the course of economic policy on some occasions. In this section, we will compare the performance of Iran's economy under Ahmadinejad with that of his two predecessors, Khatami and Rafsanjani. The comparison will be based on a number of standard macroeconomic and development indexes.

Oil Revenues and Foreign Trade

Whereas Khatami had to cope with record low international prices of crude oil in most of the years of his presidency, Ahmadinejad's presidency coincided with a period of record high crude oil prices, which rose to as high as \$130 for a brief period in the summer of 2007. The high price of oil resulted in record oil revenues during his presidency, up until the introduction of international sanctions against Iran's oil exports in 2012.

Ali Alfoneh, "The Revolutionary Guards' Looting of Iran's Economy," *Middle East Outlook*, no. 3 (American Enterprise Institute, June 2010).

Figure 2. Value of Iran's Oil Exports (\$US Billion)
(X-axis shows the 1st to 8th years of each president's term.)



Source: IMF, World Economic Outlook Database, October 2012, (Author's estimate for the last year of Ahmadinejad's term.)

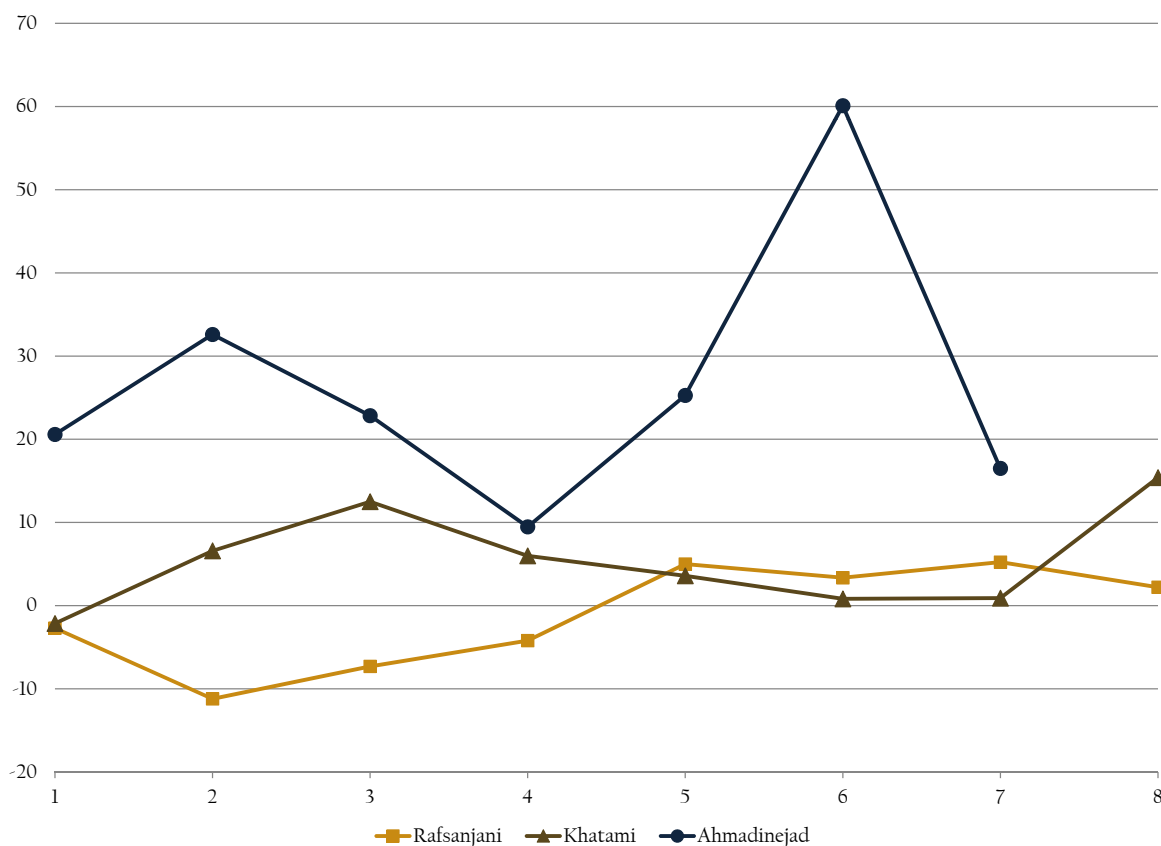
As shown in Figure 2, Ahmadinejad's government had access to significantly larger amounts of oil revenues even in 2009—the fourth year of his presidency—when oil prices suffered a sharp decline as a result of the global financial crisis, and in 2012 (the seventh year of his presidency), when sanctions reduced oil sales in the second half of the year. These high revenues allowed Iran not only to spend more on imports but also to accumulate a large amount of current account surpluses, as shown in Figure 3. During the first seven years of Ahmadinejad's presidency, Iran enjoyed a cumulative current account surplus of \$183.3 billion; the comparable figures for the first seven years of Khatami's and Rafsanjani's terms were \$28.2 billion and -\$11.8 billion dollars, respectively.

The government set aside a portion of this record oil income in an Oil Stabilization Fund (*Hesaab-e zakhirah arzi*), created in September 2000 by President Khatami, to be used in future periods of low oil revenues. The annual withdrawals from the fund were moderate during his presidency but rose sharply under Ahmadinejad, who tapped into this fund to support the numerous development projects that he wanted to finance. He also allocated a portion of this fund to low-interest loans for investment projects and low-income

households. As a result of these excessive and uncoordinated withdrawals, the fund was depleted by 2012.

Ahmadinejad's use of the Oil Stabilization Fund was sharply criticized by some Parliament MPs, but by neutralizing the Budget and Plan Organization and limiting the power of the board of directors of the fund, he was able to utilize it at his discretion.¹⁶ From 2008 until end of Ahmadinejad's term the Iranian government did not release any transparent data on the balance sheet and utilization of the Oil Stabilization Fund. In 2010, however, Ayatollah Khamenei ordered the creation of another fund, called the National Development Fund (*sandough tose-eye melli*), and designated 20 percent of annual oil export revenues to be deposited in this account. The Ahmadinejad government had less discretion with respect to utilization of this fund.

Figure 3. Iranian Current Account Balance (\$US Billion)
(X-axis shows the 1st to 8th years of each president's term.)



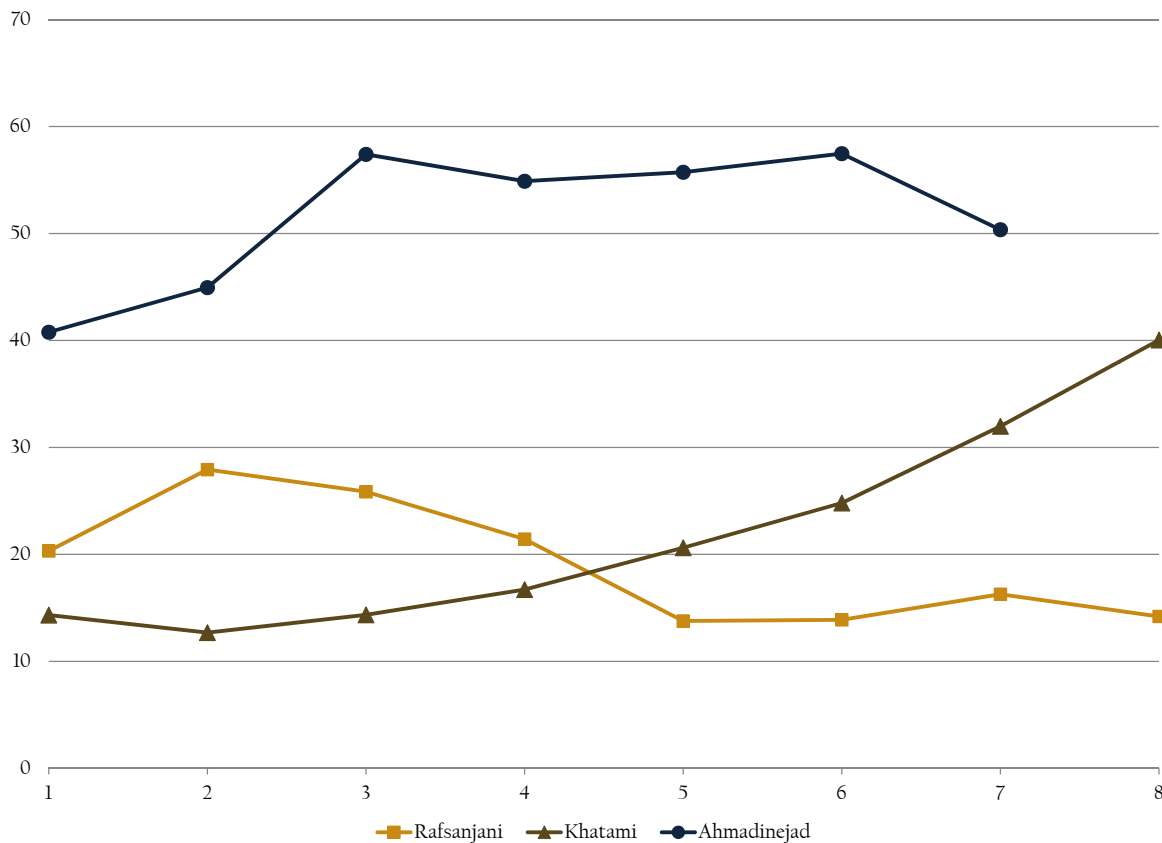
Source: IMF, World Economic Outlook Database, October 2012. The current account balance measures the difference between the export and import values of goods and services plus the net transfer of income.

Large oil revenues enabled Ahmadinejad to allocate more foreign currency for imports of goods. This was done both directly, by making more foreign currency available to

16. See "Hesab-e zakhireh arzi cheguneh sefr shod?" [How did the currency fund get depleted?], *Tabnak*, March 15, 2011.*

government agencies, and indirectly, by supporting an exchange rate that made imports profitable for businesses and affordable for consumers. The rationale for this policy was twofold: to reduce inflationary pressures by means of cheap imports, and to improve the living standards of ordinary people, thereby fulfilling the president's campaign promise to bring oil money to people's dinner tables. More significantly, Ahmadinejad enjoyed the backing of the Supreme Leader with regard to this policy. The net result was a sharp increase in the value of imports compared with previous years (Figure 4).

Figure 4. Value of Iranian Imports of Goods (\$US Billion)
(X-axis shows the 1st to 8th years of each president's term.)



Source: Direction of Trade Statistics and Tehran Chamber of Commerce.

The increased availability of affordable imported goods benefited consumers by enabling them to purchase automobiles, electronic goods, appliances, and clothing at affordable prices, but it put pressure on many domestic industries. Manufacturers of light consumer electronics, textiles, shoes, and many other products who were already suffering from the impact of sanctions were now also losing customers to imports. As a result of this short-sighted policy, many businesses were forced to lay off employees, and many others faced bankruptcy. Protecting the purchasing power of consumers was a higher priority for the government, however, than the survival of some domestic industries. And these import policies were also supported by some powerful commercial interests, which had obtained exclusive import licenses through political influence.

Iran's trade boom coincided with a shift in the identity of Iran's leading trade partners, owing to international sanctions. One of the major challenges for Iran's foreign trade during Ahmadinejad's presidency was the growing pressure exerted by the United States on Iran's major trade partners to cut back their transactions with Iran. Some of the larger European countries that made up Iran's largest trade partners in the 1980s and 1990s gradually cut back on their transactions with Iran after 2000 (Table 1).

Table 1. Countries with Largest Volume of Exports to Iran

Rank	2001	2005	2008	2012
1	Germany	UAE	UAE	UAE
2	UAE	Germany	Germany	China
3	Japan	France	China	South Korea
4	France	Italy	Switzerland	Turkey
5	Italy	China	South Korea	Switzerland
6	South Korea	South Korea	UK	Germany

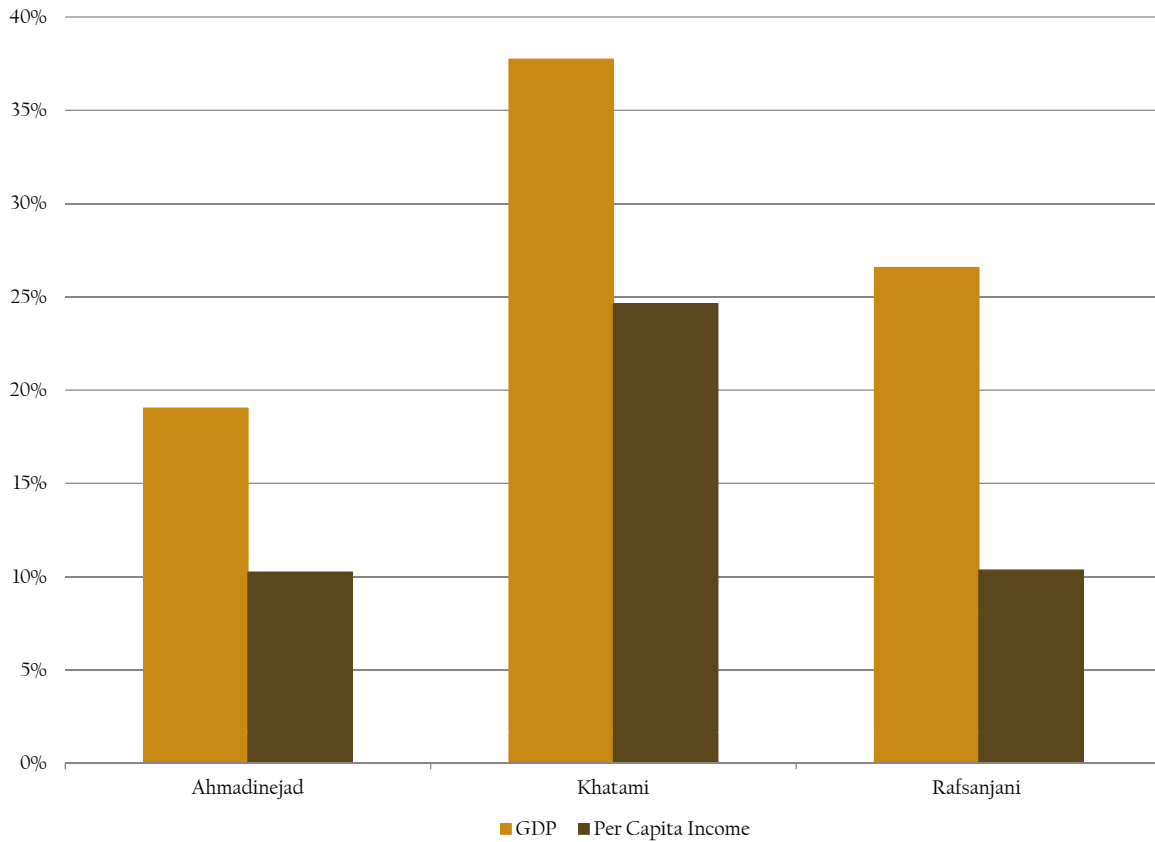
Source: Tehran Chamber of Commerce, Industries and Mines.

Thus, Iran was forced to switch from predominantly European trading partners to the United Arab Emirates, Turkey, and Asian countries for imports. The growth in imports from China was rapid and was accompanied by the increased sale of crude oil to that country, along with the awarding of investment projects. Iran in fact deliberately expanded its trade and investment relations with China so as to discourage that country from supporting the international sanctions against it. To some extent, Iran also had to switch to Chinese suppliers for some industrial products because other exporters were joining the international sanctions. Nonetheless and despite these incentives, China also cut back its purchases of Iranian oil after July 2012.

Economic Growth

Despite abundant oil revenues during Ahmadinejad's presidency, the Iranian economy did not enjoy a faster growth in overall economic output or per capita income in comparison with earlier periods. As shown in Figure 5, annual level of economic output as measured by Gross Domestic Product (GDP) grew by 19% during the first seven years under Ahmadinejad, which was smaller than in comparable intervals under Khatami and Rafsanjani. The growth in per capita income during the Ahmadinejad presidency was only 10%, which was significantly smaller than in the Khatami era but similar to that in Rafsanjani's tenure. It must be kept in mind, however, that population growth was much larger during Rafsanjani's presidency. If Iran's population had grown at the same rate during Ahmadinejad's presidency, the growth in per capita income would have been smaller.

Figure 5. Growth of Iran's Gross Domestic Product (GDP) and Per Capita Income During First 7 Years of Each President's Term (Real growth rate after adjustment for inflation)



Source: IMF, World Economic Outlook Database, October 2012.

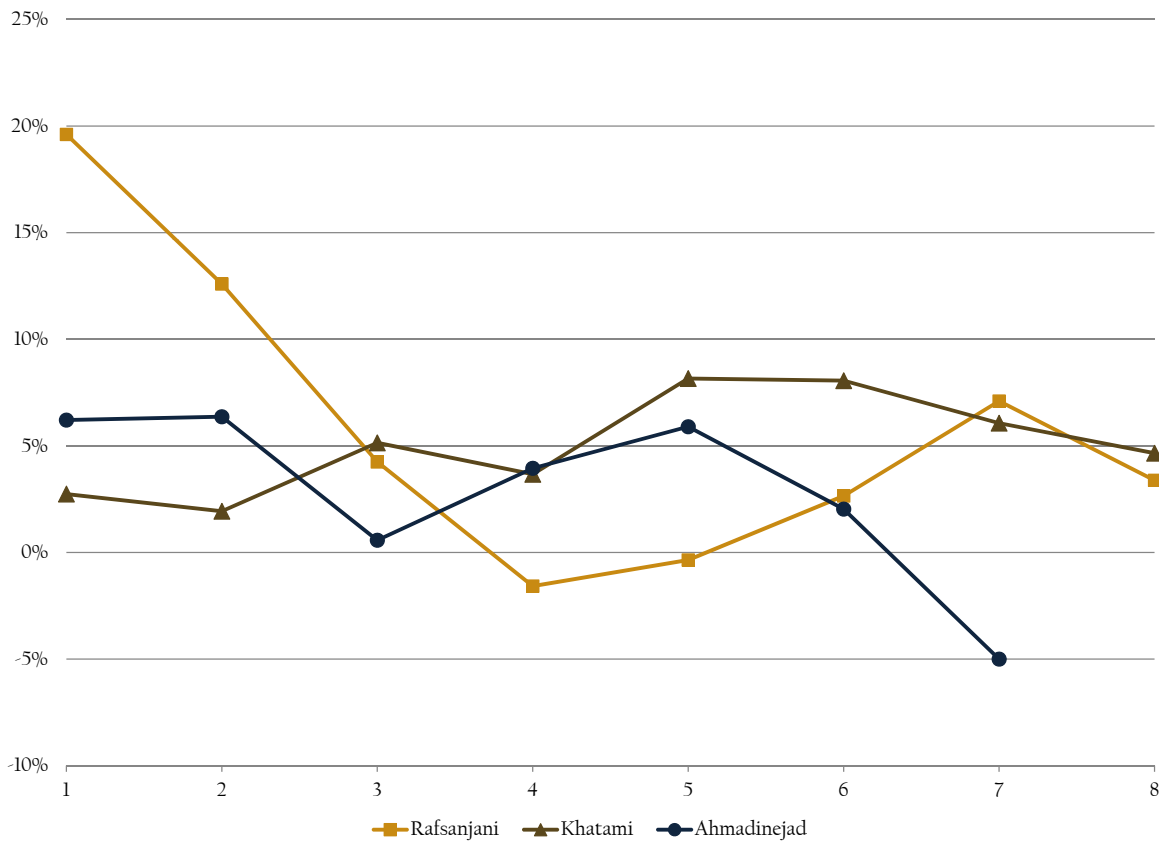
The lackluster performance of the Iranian economy under Ahmadinejad is also evident in Figure 6, which shows the annual GDP growth rate for the three presidents on a year-by-year basis. Under Ahmadinejad, fiscal and monetary expansion was much greater, thanks to his populist spending and credit policies as described above. Under normal circumstances, those policies might have stimulated faster economic growth. Two adverse developments, however, put downward pressure on economic activity during the later years of Ahmadinejad's presidency. First, the sanctions became more intense and inhibited Iran's trade and industrial activities. Second, the inconsistency and irrationality of Ahmadinejad's economic policies had an adverse effect on the business climate for private investors.

As a result, the large number of financial incentives that were offered to the private sector as loans and producer subsidies did not produce any significant increase in output. For example, thousands of investment loans were offered for industrial projects with short gestation delays—that is, projects that were expected to become operational within a short period of time. Ahmadinejad argued that providing credit for these projects would not lead to inflation because such projects would quickly become productive and contribute to the expansion of economic output. In reality, however, the sanctions and

the bad business climate resulted in the failure of many of these projects and the inability of borrowers to repay their loans. The net effect was slower economic growth, higher inflation rates, and a sharp increase in loan defaults.

As a result of a new round of sanctions in mid-2012, economic conditions deteriorated further and there was a sharp decline in industrial production. The preliminary economic growth data for the first half of 2013 points to a severe stagflation with record high unemployment and inflation rates.

Figure 6. Annual Growth Rate of Iran's Real GDP Under Three Presidents
(X-axis shows the 1st to 8th years of each president's term.)



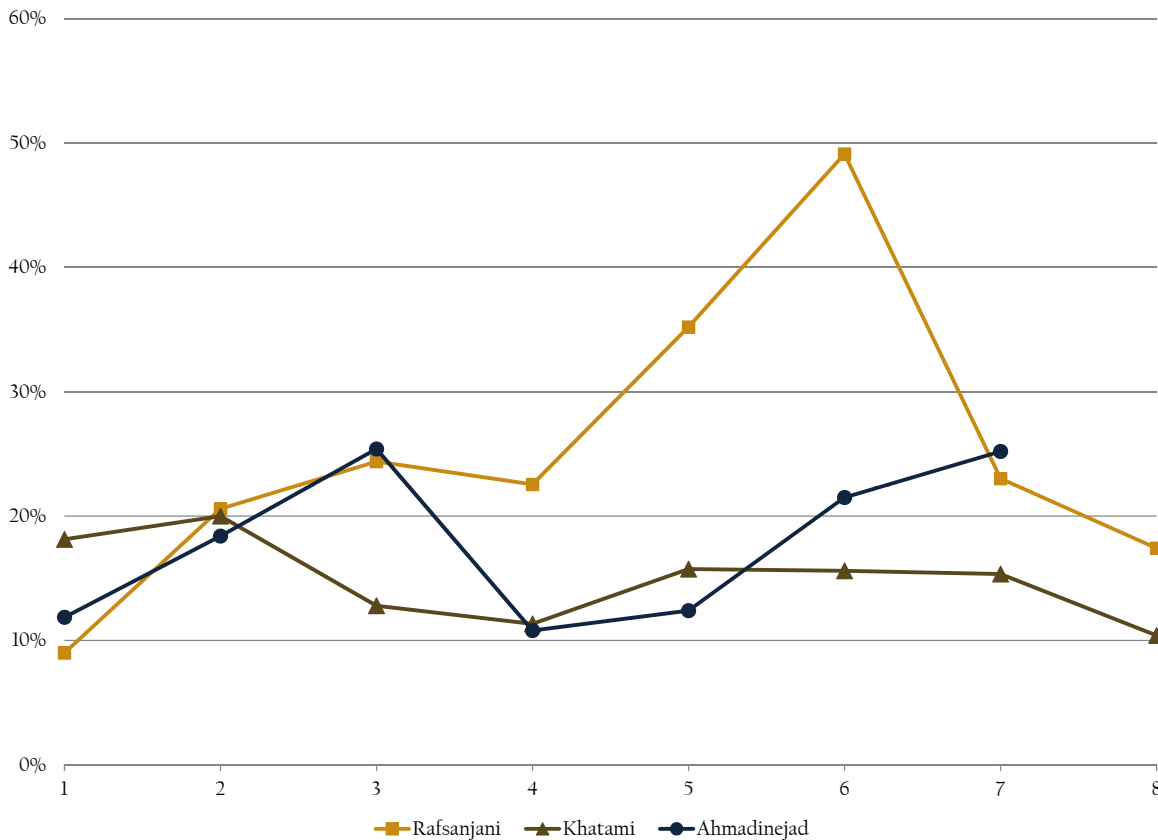
Source: IMF, World Economic Outlook Database, October 2012.

Inflation

During the first seven years of Ahmadinejad's presidency, Iran experienced an average annual inflation rate of 17.9%, which suggests a better performance than in the Rafsanjani era—whose annual average rate of inflation was 26.3%—but was worse than in the comparable period under Khatami (15.6% annual inflation rate). Lowering the inflation rate has in fact been a difficult challenge for all administrations after the Islamic revolution. There have been only occasional periods of relative success. Under President Rafsanjani the inflation rate declined from 28% in 1988 to 9% in 1990, but monetary discipline was soon lost, and an uptrend in inflation was experienced from 1991 to 1995. During 1994 and 1995,

Iran experienced record high inflation rates of 35% and 49%, respectively. (See Figure 7.) In those years, Iran also faced a severe foreign debt and exchange rate crisis. After the rial underwent a sharp depreciation in the early 1990s, the government reacted with renewed monetary discipline and austerity measures, which resulted in lower inflation rates in the years that followed.

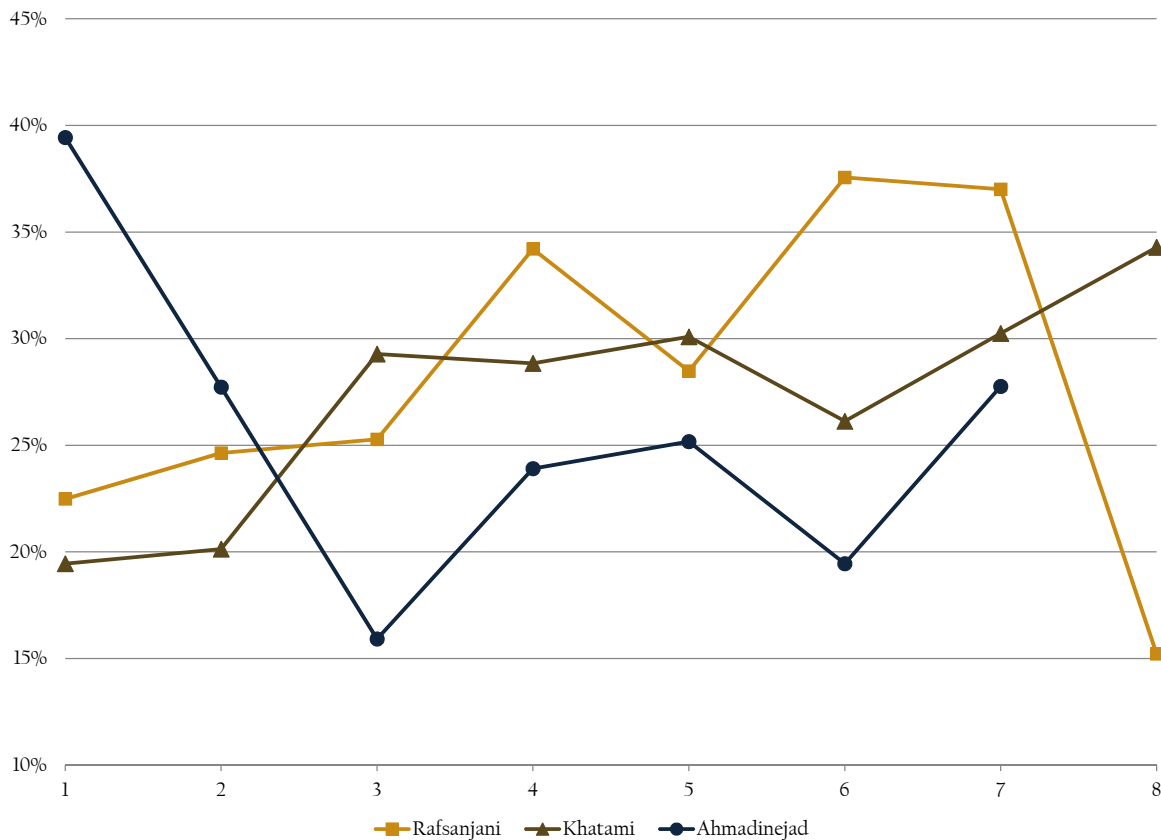
Figure 7. Iran: Annual Inflation Rate (CPI)
(X-axis shows the 1st to 8th years of each president's term.)



Source: IMF, World Economic Outlook Database, October 2012.

Iran experienced lower inflation rates under President Khatami (1997–2005) as the exchange rate remained stable. Higher oil revenues allowed the Ahmadinejad government to support this stable exchange rate, which could have resulted in moderate inflation rates during his presidency if not for Ahmadinejad’s other economic policies. As discussed above, President Ahmadinejad’s easy credit policy and large public borrowing, from both commercial banks and the central bank, led to a sharp increase in liquidity. As shown in Figure 8, the money supply rose by 40% and 28% during the first two years of Ahmadinejad’s presidency, respectively. The average liquidity growth during his first seven years, however, was 26%, which was comparable to the average growth during both the Khatami and Rafsanjani presidencies (28% and 27%, respectively).

**Figure 8. Iran: Annual Growth of Money Supply (Naghdiinegi)
(X-axis shows the 1st to 8th years of each president's term.)**



Source: Central Bank of Iran.

Ahmadinejad's government tried to stabilize prices by preserving the nominal exchange rate and increasing imports of consumer goods. This strategy was partially successful in 2009 and 2010. The excess liquidity continued to grow, however, and eventually resulted in higher inflation rates in 2011 and 2012. In those years, the removal of price subsidies on energy products and utilities also contributed to higher prices for many products.

The introduction of several new sanctions in early 2012 also contributed to higher inflation rates beginning in mid-2012, for several reasons. Sanctions led to a reduction in imports of consumer goods, parts and machinery. The decline in imported parts and machinery had an adverse effect on domestic industrial and agricultural production. In addition, these additional sanctions caused financial panic, as fear of lower oil revenues led to speculation that the government would not have sufficient reserves to support the exchange rate. The resultant anxiety encouraged people to convert their savings into foreign currencies and gold. As a result, the rial lost 75% of its value in 2012, and this decline had an immediate impact on domestic prices. By some estimates, the inflation rate by the end of 2012 had risen to almost 30%.¹⁷

17. "Tavarom dar Iran be marz 29% nazdik shod" [Inflation in Iran approached 29%], *BBC*, February 3, 2013, [in Persian].*

Quality of Life and Standard of Living

Social scientists agree that per capita income is an inaccurate and crude measure of a country's standard of living. It is better to look at a basket of indicators that shed light on different aspects of a society's material well-being. The commonly accepted indicators for this purpose are the so-called Human Development Indicators that are reported annually for a large group of countries by the United Nations Development Programme (UNDP). A select number of these indicators for Iran appear in Table 2. Based on these indicators, the quality of life in Iran continued to improve under Ahmadinejad, although based on some of the indicators the increase was marginal. The overall Human Development Index (HDI) rose from 0.671 in 2005 to 0.707 in 2011. The health index, the mortality rate for children under five, and life expectancy at birth all show moderate improvements under Ahmadinejad.

Table 2. Human Development Indicators for Islamic Republic of Iran

	Income Index	Life Expectancy at Birth	Public expenditure on education (% of GDP)	Under-five mortality rate (per 1,000 live births)	Income Gini Coefficient	Human Development Index	Health Index
1960	-	-	-	-	-	-	-
1970	-	51.2	2.9	190	-	-	0.493
1980	0.611	51.1	-	127	-	0.437	0.49
1985	0.611	50.1	3.8	-	-	0.454	0.474
1990	0.592	61.8	-	73	0.436	0.534	0.659
1995	0.604	68.2	-	-	-	0.596	0.76
2000	0.622	69.8	4.4	48	-	0.636	0.785
2005	0.647	71.3	4.7	37	0.383	0.671	0.81
2006	0.653	71.6	5.1	-	0.401	0.684	0.814
2007	0.663	71.9	5.5	34	0.392	0.694	0.819
2008	0.665	72.2	4.8	32	0.379	0.699	0.823
2009	0.665	72.5	4.7	31	0.383	0.703	0.828
2010	0.664	72.7	-	-	0.361	0.707	0.832
2011	0.662	73	-	-	0.345	0.707	0.836

Source: Human Development Indicators, The United Nations, hdr.undp.org. The Gini Coefficient data for 2006-2011 as reported by Statistical Center for Iran.

The data for the Gini Coefficient in Table 2 show a reduction in income inequality between 2005 and 2011. (The Gini Coefficient index is a standardized measure of income inequality that ranges from 0 to 1; the larger the value for a country, the greater the income inequality.) The figures for 2006–2011 were reported by the Iran Statistical Center, and if we accept the accuracy of these figures, they show a reduction in the level of income inequality during the Ahmadinejad presidency.¹⁸ Ahmadinejad's success in directing

18. Ahmadinejad's government has been repeatedly criticized by economic experts and by members of

fiscal resources and bank credit to less developed regions along with the per capita cash subsidies that were introduced in late 2010 in the context of the subsidy reform program have played important roles in the reduction in income inequality. A lower level of inequality, however, has not been accompanied by a lower poverty rate. Indeed, there are some indications that the percentage of the population under the poverty line has actually increased. The high inflation of recent years has eroded the benefits of direct cash subsidy payments for low-income families and has pushed some middle-class families *into* poverty.¹⁹

The sharp decline in industrial activity in 2012 led to large scale job losses which reduced the incomes and living standards of thousands of working class families.²⁰ Unemployment statistics became very controversial during Ahmadinejad's presidency, as the measurement method and the accuracy of employment statistics as reported by the Iran Statistical Center came under sharp criticism. (See note 19.) Official statistics show that the unemployment rate declined moderately to 10.6% in 2007 and 2008 but rose afterward to 12.3% in 2011 before again declining modestly to 12.2% in 2012. Critics of the government however, believe that the actual unemployment rate is larger than indicated by these official rates.

While there may be disagreement regarding the direction of poverty and inequality during the Ahmadinejad presidency, there is no doubt that the access of Iranian households to a variety of durable goods and appliances improved during his tenure. Table 3 offers a comparison of household ownership of and access to various appliances and the like in 2005 and 2010. It shows a significant increase in access to essential appliances and electronic equipment and services in both rural and urban areas. Consistent with the higher priority that Ahmadinejad accorded underdeveloped regions, we observe that ownership of and access to most items listed in this table grew faster in rural areas than in urban regions. As a result, the gap between rural and urban regions in ownership of or access to cell phones, washers, color televisions, landline telephones, and residential natural gas was lower in 2010 than in 2005. The rural-urban gap with respect to personal computers, automobiles, and access to the Internet, however, widened in this period. This widening gap can be partly explained by the fact that there is, in general, less demand for personal automobiles in rural areas where distances are shorter than in urban environments. The cultural demand for personal computers and access to Internet is also stronger in cities than in rural areas.

the Iranian parliament for excessive delays in the release of economic data and for the inaccuracy of some statistics. The most vocal critic of the president on these issues was MP Ahmad Tavkoli, also a former director of the Majles (Parliament) Research Center. Opponents of Ahmadinejad also claimed that the Iran Statistical Center released false economic data during his 2005 re-election campaign in order to help him win. There has been suspicion ever since then about the accuracy of ISC statistics.

19. Hossein Raaghfar, "Afzaayesh shaakhes haaye faghr dar Iran" [The rise of poverty in Iran], *Jahanesanat*, October 28, 2012 [in Persian].*

20. According to the Union of Temporary and Contract Workers of Iran, nearly a million contract employees in industrial units lost their jobs in 2012. See Kaveh Ghoreishi, "Ekhray yek milion kargar dar yek saal" [One million workers laid off in one year], *Roozonline*, December 12, 2012 [in Persian].*

Table 3. Ownership of Durable Goods by Rural and Urban Households (percent)

	Rural Areas		Urban Areas	
	2005	2010	2005	2010
Internet	0.78	2.82	10.04	15.58
Personal Computer	2.45	10.19	21.78	37.02
Cell Phone	8.28	72.83	30.21	88.21
Washer	24.7	37.69	66.3	76.28
Vacuum Cleaner	36.01	53.68	-	-
Kitchen Oven	89.58	94	-	-
Freezer/ Refrigerator	8.28	19.54	20.02	38.84
Freezer	-	-	30.44	28.68
Refrigerator	87.55	80.88	82.49	63.54
Access to Natural Gas Network	18.65	40.46	82.98	91.17
Color TV	79.82	92.67	94.27	97.24
Telephone	58.2	71.05	86.21	87.44
Personal Car	10.92	17.51	26.85	36.89

Source: Household Income and Expenditure Survey, Iran Statistics Center, 2005 and 2010 surveys.

Conclusions

The economy of Iran experienced several important changes during Mahmoud Ahmadinejad's presidency. These changes were in part a consequence of Ahmadinejad's economic policies—though they were sometimes altered or manipulated by other centers of authority—and in part a result of increasing Western sanctions and Iran's countermeasures. Ahmadinejad initially suspended many of the economic reforms of former presidents Khatami and Rafsanjani, but gradually came to embrace them after significant modifications that reflected his ideological beliefs and political interests. Fair and equitable distribution of economic and financial opportunities was a high priority for Ahmadinejad, and he tried to incorporate these concerns in his economic policies. He also tried to empower the social groups that in his view constituted the core supporters of the Islamic revolution (such as war veterans and members of the revolutionary armed forces) and had sacrificed for it. Accordingly, his economic policies simultaneously benefited lower-income social groups and the revolutionary armed forces. His government facilitated the growing penetration of the Islamic Revolution Guards Corps (IRGC) and the Basij into Iran's economy and banking system.

The increasing international and Western sanctions served as both a rationale and an excuse for the economic empowerment of the IRGC. This empowerment will have a long-term impact on economic efficiency in Iran and on the distribution of economic

opportunities. It will be very difficult for future political leaders to scale back the economic reach of the IRGC and the Basij, just as it has proven very challenging for governments to scale back the economic activities of the military in Egypt, Indonesia, and many other developing countries.

Ahmadinejad's attention to low-income households and low-income regions of the country reduced both the development gap and income inequality in Iran. But Ahmadinejad pursued these goals with little regard for macroeconomic stability and long-term development objectives. As a result, general economic conditions such as inflation and unemployment deteriorated in Iran, particularly after mid-2012, and led to hardship for many households.

Though escalating sanctions have clearly played a role in Iran's deteriorating economic conditions in recent years, Ahmadinejad's economic mismanagement is also responsible. His statements on economic issues along with some of his policies revealed some deep misperceptions about basic economic concepts. Yet he was a self-assured politician who rejected expert criticism even from his own economic team. Instead, he remained committed to his populist programs. He devoted a large portion of Iran's record high oil revenues to imports of consumer goods, for example, which benefited consumers but led to loss of market as well as financial pain for many domestic producers. His manipulation of the state-owned banks and administrative allocation of bank loans at low interest rates also resulted in a sharp increase in liquidity and inflation while benefiting a select number of social groups.

Comparing the macroeconomic performance indicators (inflation, economic growth, unemployment) during the first seven years of Ahmadinejad, Khatami, and Rafsanjani does not indicate significant differences in inflation or unemployment rates despite large variations in economic policies. Cumulative economic growth in the first seven years of Ahmadinejad era, however, was smaller than under the previous two presidents. It appears that the economic benefits of the significantly larger oil revenues under Ahmadinejad have been partially offset by the adverse consequences of his economic policies and by more severe economic sanctions.

On a more positive note, Ahmadinejad was finally able to implement the subsidy reform program, which had eluded his predecessors, Khatami and Rafsanjani. His success was partly the result of the support and cooperation of the Revolutionary Guards, whose strong presence and show of force prevented social unrest in the first few days after price increases.

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