

Failed Promises in Iran's Free Trade Zones

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Brief Analysis

Iran's free trade zone project was intended to create jobs, boost investment, and integrate Iran's economy. Instead, poor infrastructure and corrupt officials turned the zones into monopolized markets that do more harm than good.

Within a couple of decades of the revolution, the Islamic Republic of Iran looked to shift from a centralized economic model with a broad bureaucracy to a model focused on government downsizing and a market economy. In line with this new vision, Iran launched its free trade zones project in the early 1990s, which sought to boost exports via Iran's strategic ports and other trade routes. The Iranian parliament passed the **Free Trade Zones law (<https://rc.majlis.ir/fa/law/show/92283>)** in 1992 and designated three zones in the vicinity of the Persian Gulf for the project: Kish and Qeshm islands, as well as Chabahar port.

There are currently some seven free trade zones across Iran, yet the first three are perhaps of most strategic significance, especially the zone in Chabahar. A few years after the project, Iran introduced a similar concept referred to as the "Special Economic Zones," which were created to improve the supply and distribution networks in the country and act as conduits and channels for goods in transit. The Special Economic Zones' efficacy, however, was incumbent on the success of the free trade zones. These free trade zones were part of a larger political-economic strategy, but from the very beginning, the goals set for these zones did not correspond to reality.

National Politics Sets the Stage

The initial formulation of the free trade zones emerged along with the election of Akbar Hashemi Rafsanjani—a right-wing politician eager to implement economic liberalization—to the presidency. With his vote, the table was set for a right-wing banquet. The government quickly prepared for change and put a list of programs on its agenda immediately—privatization, deregulation, and price liberalization. Gone was the government that had sought in previous years to take over the economy, nationalize industries, provide social services, and maintain subsidies.

Westerners also welcomed the bold economic policies of Hashemi's newly formed government. As the former

communist regimes of Eastern Europe and the former dictatorships of Latin America and Africa moved toward liberalizing their markets, Iran appeared to be following this global trend of major reforms. Rafsanjani personally embodied this notion; the son of a pistachio gardener and a pro-free market cleric, he was insistent on private ownership of the economy and reduced government subsidies.

At Rafsanjani's behest, several companies that had been nationalized after the revolution were re-privatized, the stock market was revived, and he even successfully solicited multimillion-dollar loans from western countries—including those Tehran once condemned—and from the World Bank. Foreign investment laws were gradually amended, and these laws now catered to the interests of foreigners more than in the past.

Some Western analysts were optimistic that if Iran could not be integrated into the world system through its ideological policies, it would be integrated through the implementation of these economic policies. Indeed, the Rafsanjani government's policies closely followed the World Bank's precise plan. The privatization of inefficient state-owned companies, the elimination or reduction of price and subsidy controls, free trade, the end of the multi-currency system, and the support of private and foreign investment were the same recommendations included in the reform programs proposed by the World Bank and the International Monetary Fund.

According to parliament archives (1368-1372 شمسی شورای اسلامی November 22, 1989), Mohammad Baqer Nobakht—one of the first advocates of the free zone plan—championed this model as aligning with these broader free-market goals. Nobakht argued: "Free ports create jobs, free ports generate high foreign exchange earnings, free ports increase exports, stagnate liquidity, absorb technology rapidly, increase domestic production and relative prosperity... It creates, it facilitates marketing and dozens of other benefits that we now need a lot of." In other words, the advocates of the free zone defended the bill around three main axes: first, job creation by removing the provisions of the labor law and deregulation of other laws, second, attracting foreign investors and third, increasing exports. They later [summarized \(http://ensani.ir/file/download/article/20101229154457-6.pdf\)](http://ensani.ir/file/download/article/20101229154457-6.pdf) the goals: "The main goal of the parliament in passing this law was to increase the country's non-oil exports, as Iran's non-oil exports between 1983-1988 did not exceed 3.8 billion dollars, which wasn't enough to help with the funds needed for imports."

The policy of creating and establishing a free zone should also be understood as an attempt to promote the integration of Iran's economy into the heart of the world economy. With the establishment of two free trade ports in the Persian Gulf and several other free trade zones in the north, east, and southeast of the country, the process of internationalizing Iran's economy and industry began. Economic legislation seriously deregulated these free zones—tax elimination and reduction, labor contract temporization, removal of environmental regulations, reduction of legal oversight, and other pieces of legislation that favored investors.

The Reality of Implementation

The free zones' primary goals centered around creating jobs, boosting exports, and attracting foreign and domestic investors by providing a more favorable economic environment through deregulation and concessions. In the case of the Chabahar port, the regime also sought to stabilize Baluchistan by generating employment opportunities for the Baluch locals, who had previously been systemically neglected. However, these concessions did not address the main challenge that domestic investors faced: regardless of legal restrictions and regulations, Iran's industrial bourgeoisie were not able to compete with its foreign competitors. This inability rested on the very realities of the Iranian economic system and its weak foundation for industrial capitalism relative to other regional powers.

Moreover, the areas chosen for Iran's free zones—the Kish and Qeshm islands located in the Persian Gulf—did not possess the sufficient infrastructure to become industrialized. In Chabahar, the surrounding terrain limited access to suitable transit routes. In addition, due to sanctions and ideological problems, these companies continue to face

major operational problems within Iran, even after three decades of free zone law.

As these limitations became apparent, the free zones project shifted away from previous expectations, and these regions transformed into consumer markets and import destinations. Instead of industrializing these regions for increased manufacturing to boost exports, the establishment of large malls, shopping centers, and other tourist attractions transformed the local urban architecture in the process. Given the deregulation and autonomization of the zones, large corporations with ties to the local free zone administrations were permitted to import commodities without paying substantial customs tax and eventually monopolized the market. An increased focus on imports both changed the economic direction of the free zones and produced new cities. This shift, caused by the lack of industrial infrastructure in the free zones, increased the flow of cheaper foreign goods inside Iran and consequently wiped out Iranian businesses that couldn't keep up with the prices.

The process of creating the free zones also led the corrupt policy makers to discover another commodity: land. The autonomous nature of the zones meant that the local free zone administrations had the authority to confiscate land to sell to developers. Thus, the administrations became the main player in land confiscations, especially in Chabahar. The fact that the free zones were exempt from many domestic regulations further enabled kleptocratic networks to use corrupt means to push the locals out of the area.

The Kish Free Trade Zone became Iran's first experiment in free trade economic activities. This region, like other free trade zones around the world, was designed to attract both Iranian and foreign investment in industrial and non-industrial sectors. These areas have income tax exemptions, customs exemptions, and subsidies for the welfare of residents' services, transportation costs, and other public services.

Yet even as Iran began to actualize their free trade zone policies, the government realized they faced a major regional competitor in Dubai. The port of Jabal Ali and the enviable Dubai Stock Exchange had surpassed their Iranian counterparts in Qeshm, Kish, and Chabahar by the early 90s. Iranian policy makers frequently questioned how a country without significant water resources or sizable land or population is now excelling on all fronts. Deputy director of the Program and Budget Mohammad Jafar Eslami put it this way: "Dubai itself might not have reached this stage if it were not for Iran's facilities and Iranian demands to buy their goods, and so we believe that instead of giving this opportunity to outsiders and other countries to use it, we should be able to have it for our domestic needs."

However, several of the domestic aims of the free zones also fell short in the implementation stage. The free zones came with the promise of developing several of Iran's economically depressed areas, especially in Sistan-Baluchistan. Defenders of this plan, such as Mohammad Jafar Eslami, emphasized that the creation of employment opportunities was one of the principle reasons for the free trade zones: "We in the country need this mechanism to develop some of our deprived areas, such as the Baluchistan region and [within it] the Chabahar region, for example, to become a free trade zone."

Job creation in the Chabahar region was also, however, designed to eliminate smuggling at the Chabahar port. In fact, many Chabahar locals capitalized on the price difference between Chabahar and abroad for part of their livelihood. Because most did not pay customs duties, this discrepancy between the import price of goods and the center provided a good source of income. Now, part of the customs revenue is to be allocated to the free zone.

The free zone was likewise supposed to attract Iranian investors with various deregulations and concessions to boost exports of manufactured commodities. However, economic laws and regulations were investors' main concern to begin with; Iranian industrial bourgeoisie could not compete with their foreign competitors. Even assuming that some Iranian companies had the capacity to compete with foreign products, Kish and Qeshm islands did not possess the necessary prerequisites and infrastructure for industrialization. Nor could Chabahar be suitably industrialized

due to the lack of suitable transit ways.

From a job-creation standpoint, the initial aim was to employ locals once the region industrialized. Yet the reality did not correspond with these goals. Although the region's urban infrastructure transformed, no factories or manufacturing enterprises were established. Instead, the free zones turned into hubs with upscale shopping centers that offer luxury goods at prices cheaper than other provinces. Large companies with ties to local free zone administrations have monopolized the market via deregulated tax-free imports, a move that not only failed to create employment opportunities for Iranians but also wiped out local business that couldn't compete with these lower prices.

Although the Islamic Republic aimed to integrate its economy with the rest of the world in the early 1990s through free trade zones under President Rafsanjani, severe miscalculations at the hands of Iranian officials prevented this goal from becoming a reality. With non-existent infrastructure and no target market in mind, the zones instead became yet another source of profit for kleptocratic administrators, ultimately feeding into an ongoing system of corruption in Iran.



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