

Iran's Presidential Election: The Economic Situation

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May 3, 2017

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Brief Analysis

Despite some positive growth indicators, Rouhani faces an uphill struggle to convince voters that his economic plan is truly best for them.

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This PolicyWatch is the second installment in a three-part series on Iran's upcoming election. [Read part one \(http://www.washingtoninstitute.org/policy-analysis/view/irans-presidential-election-balancing-diplomacy-and-confrontation\)](#) (on differentiating between Tehran's elected and revolutionary power centers) and [part three \(http://www.washingtoninstitute.org/policy-analysis/view/irans-presidential-election-the-clergys-political-irrelevance\)](#) (on the clergy's role).

In the lead-up to the May 19 election, President Hassan Rouhani's team has changed its message about Iran's economic performance. Instead of blaming Washington for blocking the nuclear deal's expected benefits, his camp is now bragging about how well the economy is doing. How accurate is that claim, and why are so many Iranians discontent with the economic situation?

MACRO INDICATORS ARE EXCELLENT

GDP growth has been accelerating, with the IMF predicting that real growth in the Iranian year 2016/17 (which ended March 21) would be 6.6%. Central Bank governor Valiollah Seif stated on March 16 that the inflation-adjusted GDP for the first nine months of 2016/17 was 11.6% compared to the same period the previous year. He has since forecast that this rate will be sustained in 2017/18, though the IMF offered a more cautious prediction of 3.3%.

Inflation is down dramatically. The IMF forecast that the consumer price index would be up 8.9% in 2016/17, the first single-digit rate in decades; in contrast, consumer prices rose more than 20% in three of the eight preceding years. Although the IMF predicts inflation will go up again in 2017/18, the Rouhani team is confident they can keep it under 10%.

For the second year in a row, Iran's imports (\$43.7 billion) were less than its non-crude oil exports (\$43.9 billion). To be sure, the latter figure is somewhat misleading because \$7.3 billion of the non-crude exports were condensates, which are essentially oil even if Iran, the United States, and the World Trade Organization do not classify them as such. Still, \$36.6 billion in non-oil exports is a lot.

HARD CASE FOR ROUHANI TO MAKE

Despite this upbeat data, Rouhani is having great difficulty selling the Iranian people on the notion that the economy is doing well. GDP and associated indicators are still well below their 2011/12 peak and have never been particularly good since the 1979 revolution. Unemployment remains a daunting problem as well.

Indeed, Iran's economy has not recovered from the twin shocks of extensive international sanctions and the oil price collapse. IMF reports list the 2011/12 GDP as \$541 billion and the 2016/17 GDP as \$377 billion, or 30% less. What makes this gap even more painful for Rouhani is that the economy soared during his predecessor's term -- GDP was \$161 billion in 2004/05, just before Mahmoud Ahmadinejad was elected, so it essentially tripled while he was in office. Under Rouhani, however, GDP has still not recovered to those heights. He can point to several accurate reasons why this is not his fault -- the decline began under Ahmadinejad, the oil price collapse was out of Iran's control, and the Supreme Leader's protracted nuclear standoff with the West hurt the economy badly. Yet the bottom line is that life is tougher for most Iranians today than it was under Ahmadinejad, at least in economic terms.

Compounding the problem is the country's relatively poor economic record over the course of the Islamic Republic. Today's per capita income, adjusted for inflation, is below the 1979 level. Iran has still not made up for the huge hit it took during the first decade of revolutionary ardor and unnecessarily prolonged war with Iraq, which cut per capita income by more than half. Regional comparisons are similarly depressing. In 1979, Iran's GDP was larger than Turkey's, but today it is half as big as its neighbor's. The United Arab Emirates has raced past the Islamic Republic as well: in 1979, Iran's GDP was three times larger than the UAE's, but today they are about equal. To be sure, income is an imperfect measure of well-being; social indicators such as life expectancy and literacy have improved dramatically since the revolution. But still, the Islamic Republic is far from the goal the shah envisioned before he was ousted -- that of Iran achieving European standards of living.

Another problem for Rouhani is unemployment: Iran has been unable to find sufficient work for the "baby boomers" who have sought to join the labor force over the past decade. During each of the five years leading up to the 2011/12 census, 1.8 million Iranians turned 22 years old, compared to 1.2 million in 2016/17. Moreover, Iranian universities awarded 438,000 bachelor's degrees and 218,000 associate's degrees in 2011/12, according to the Iran Statistical Yearbook. Not enough jobs could be created for this burst of highly educated labor, even though relatively few young women look for work -- the share of women who join the Iranian labor force is 16%, compared to 23-25% in Egypt and 30% in Turkey. According to Rouhani, some 700,000 jobs were created in 2016/17, and he has made similar claims in years past, but that is not enough to employ all of the new baby boomers. Yet with the boom tapering off, such figures may be adequate in the coming years -- at least as long as women stay out of the labor force in droves.

ROUHANI'S PLAN IS NO BETTER THAN KHAMENEI'S

The core of Rouhani's plan is to revive the economy through foreign investment and foreign inputs. But too many of the foreign investments that Iran is capable of attracting are high-capital projects that create few jobs. What would suit the country better is making more effective use of its highly educated young workforce, not spending billions to import passenger jets or build new nuclear power plants.

It is easy to ridicule Supreme Leader Ali Khamenei's frequent calls for a "resistance economy." For instance, he often talks about "economic self-sufficiency," which is absurd for a country whose economy rests on oil exports. Yet he sometimes advocates the same kind of growth policies that have worked well in East Asia, namely, promoting exports and discouraging imports. Mainstream Western economics rejects this approach, seeing it as a throwback to eighteenth-century mercantilist views, but it has worked well for Japan, South Korea, Taiwan, Hong Kong, and, on the grandest scale, China. Likewise, Iran has made striking progress in improving its foreign trade balance and developing industry -- diversification, rather than foreign investment, has been the driving engine of its economic growth.

Khamenei's call for a resistance economy has been picked up by Rouhani's challengers, especially Ebrahim Raisi. Even if the president's focus on foreign investment were a better approach than that of his populist critics -- a big "if" in Iran's case -- the hardliners' narrative may play better with the public, particularly given the onslaught of criticism about the unemployment problem.

Some Iranian critics also claim that persistent U.S. sanctions are hindering the economy. Yet what would really boost growth is structural reforms to reduce cronyism, corruption, and interference by revolutionary institutions. In the World Bank's *Doing Business 2017* report, which ranks the ease of making deals in countries worldwide, Iran dropped to 120th out of 190 nations this year. None of the presidential candidates has made structural reforms a central issue, however, perhaps because the public is jaded about the ability of any elected official to affect entrenched revolutionary interests. Consider that on April 9, more than three years after he made attracting foreign investment his top priority, Oil Minister Bijan Zanganeh acknowledged the snail's pace of finalizing new oil contracts, noting that they were still being reviewed by the Supreme National Security Council. Even in areas where progress has been less slow, such as the government's modest steps to bring banks up to international standards, **so much remains to be done (<http://www.washingtoninstitute.org/policy-analysis/view/irans-economy-post-nuclear-deal-a-misleading-imf-scorecard>)** that Iran has seen limited benefits so far. These structural impediments hold the economy back far more than any international restrictions.

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