

Iran

Status Index (Democracy: 3.75 / Market economy: 4.21) 3.98		Management Index 3.20	
HDI	0.736	Population	68.2 mn
GDP per capita (\$, PPP)	6,995	Population growth¹	2.6 %
Unemployment rate	14 %* (2000)	Women in Parliament	4.1 %
UN Education Index	0.74	Poverty²	7.3 %
		Gini Index	43.0 (1998)
<small>Source: UNDP: Human Development Report 2005. Figures for 2003 unless otherwise indicated. ¹Annual growth between 1975 and 2003. ²Population living below \$2 a day (1990- 2003). *acc. to Iranian central bank, unofficially much higher.</small>			

A. Executive summary

The victory of the conservative faction of Iran's power elite in the February 2004 election to the Majles (parliament), resulting from the sweeping disqualification of reformist candidates, marked the end of the seven-year reform project led by the president, Mohammed Khatami, to implement widely demanded political and social liberalization through elected reformist institutions. Parliament and the presidency have been powerless to advance their agenda in the face of an intransigent conservative minority that controls powerful unelected institutions.

The new conservative majority in parliament is likely to focus on raising living standards, the main item of its election campaign. Any hopes that this could imply efforts to attract foreign investment seem to be forlorn since the Majles has rejected the economically liberal elements of the 2005-09 five-year plan passed by the outgoing reformist parliament, and has adopted a belligerent stance towards existing high-profile investment projects. Concerns are mounting over Iran's nuclear ambitions. If European states conclude that their non-confrontational approach is failing, they may cease to resist long-standing U.S. calls for the issue to be referred to the United Nations (UN) Security Council, which could impose sanctions.

The victory of the opponents of reform in the elections to the Majles in early 2004 was a watershed in Iranian domestic politics, bringing no hopes that Iran's Islamic system of government will be, in the near future at least, capable of evolving to better serve the aspirations of its frustrated citizens. The election marked the irrevocable ascendancy of the conservative camp, whose influence has stemmed from its control of powerful unelected institutions. These institutions, accountable only to the revolutionary leader who represents the single most powerful institution in Iran, were able to constrain democratic institutions that had attempted to effect widely demanded political and social liberalization.

A sweeping ban by the Guardian Council, a conservative vetting body, on candidates of the reformist movement (led by President Khatami) guaranteed victory for the conservatives in the election. This marks a major advance in the creeping coup, which reformists believe has been pursued by their opponents since President Khatami was first elected with an overwhelming mandate in 1997. The conservatives now exert control over all levers of government except the executive. Now the executive has no further opportunity to advance its legislative agenda before Khatami is required to leave his office in middle of 2005 at the end of his constitutionally mandated limit of two terms in office.

B. History and characteristics of transformation

Born in the 1978–1979 revolution, the theocratic government of the Islamic Republic of Iran not only experienced significant domestic upheaval and power struggles until 1982, but also waged a war against neighboring Iraq from 1980 to 1988. In the era of Ayatollah Ruhollah Khomeini, founder of the republic and its first revolutionary leader, domestic power struggles and war with Iraq facilitated the formation of an Islamic-authoritarian system. However, absolute theocracy was moderated by the continued existence of parallel republican elements such as the parliament (which had considerable authority), parliamentary and presidential elections held every four years, and a limited pluralism. Parliamentary representation is limited because persons judged to have questionable loyalty to the theory of *velayat-e-faqih* (rule of the Islamic jurist) are excluded from candidate lists for parliamentary elections. On the other hand, the Iranian Parliament exhibits an unprecedented vitality among Islamic states in terms of how debates are held, the capacity for legislative initiative and, if necessary, the power to stalemate executive authority.

Between 1979 and 1980, the entire banking and foreign trade sectors and approximately 80% of Iranian industry, was either directly nationalized or transferred to the hands of revolutionary foundations, which are, to some extent, government-subsidized to this day. During the war years, the Iranian economy was planned and centralized. After the death of Khomeini in 1989, the somewhat pragmatically oriented wing of the power elite surrounding President Hashemi Rafsanjani (1989–97) took over the executive branch and introduced policies focused on liberal economic reforms. However, they were only minimally successful. The Iranian presidential elections of May 1997 saw the liberal Shi'a cleric Mohammad Khatami emerge the winner.

After his inauguration in August 1997, Khatami initiated a cautious policy of state and social reform within the framework of the 1979 constitution of the Islamic Republic. The reform process was initially successful but faced varied and increasing challenges from the dominant conservative wing of the Iranian power-elite, and since Khatami's re-election in June 2001, it has stagnated. The main obstacle to transformation toward democracy and a market economy is the

constitutional dualism between theocracy, as represented by a revolutionary leader whose legitimacy derives from Islam, and republicanism as represented by a president elected directly by the people.

Ayatollah Ruhollah Khomeini, founder of the republic, developed the *velayat-e faqih* or “rule of the Islamic jurist” theory of the theocratic state and established it as the central element of the new constitution of 1979. The term revolutionary leader is synonymous with the Ruling Jurist (*vali-ye faqih*). The constitutional authority of the revolutionary leader, who is also commander-in-chief of the military and police forces, is greater than that of the president. Roughly speaking the power elite splits into reform and conservative ministers of parliament, with the current revolutionary leader Ali Khamenei leaning toward the conservatives. Economically, Iran holds an advantageous position vis-à-vis most other Middle Eastern states because of its rich natural resources. Iran is OPEC’s second largest producer with 9% of proven global oil reserves and holds the world’s second largest natural gas reserves.

C. Assessment

1. Democracy

After beginning the reform process in 1997, Iran has made, for the first time since 1979, progress toward transformation of the political order in some evaluated areas. Freedoms of speech and the press, for example, have been expanded considerably, although both were curtailed again in 1999 by reactionary mandates from the judicial branch. Important power centers, including the judicial branch and the Council of Guardians (composed of lawyers and effectively functioning as the upper parliamentary chamber), are dominated by conservatives who fight reforms connected to the rule of law and representation. The Council of Guardians, which has veto powers: examines all adopted legislation for compatibility with Islamic law; interprets the constitution; and selects candidates for presidential and parliamentary elections based on loyalty to the system and to the theory of *velayat-e faqih*.

1.1. Stateness

With over 2,500 years as a nation-state, Iran has a strong sense of national identity. A state monopoly on the use of force does exist, but is limited to the extent that the elected, pro-reform executive exercises only minimal control of the military, intelligence, security and police forces; these key positions are mostly in the hands of conservative partisans of revolutionary leader Khamenei. Although

Iran is an ethnically and linguistically fragmented country in which only 50% of the population speaks Persian as a native language, the requirements for citizenship are not significantly politically charged at the time of this writing.

The link between most of the various ethnic groups and the core of national identity is the official state religion, (The Twelve) Shi'a; 85 to 90% of the population are Shi'a members. Constitutionally all citizens have the same civil rights, but political reality demonstrates that members of the Sunnite minority and other non-Islamic religions, such as Christians Jews, Bahais, are discriminated against when senior appointments are made to the government, judiciary and army. The revolution of 1979 succeeded in fusing religion with the state, and pushed back secularization in the political, judicial, social and cultural spheres. Public safety and order are guaranteed largely, as is efficiency in the administrative system, although it suffers from mismanagement and corruption.

1.2. Political participation

Universal suffrage is only partially present and the proper conduct of elections is not completely assured. The pro-reform government in power since 1997 has attempted to implement open and competitive elections: however, a lack of effective governing power has markedly limited the success of these efforts. The main obstacles are the constitutionally embedded imbalance of authority between the revolutionary leader and the president, as well as a varied and complex array of additional power centers—the majority of which are conservative. The most important of these centers including the judiciary, the Council of Guardians, the Assessment Council, the Assembly of Experts, the Revolutionary Guardian Army and the revolutionary foundations, have effective veto power and are distinct political entities. They work against executive and legislative branches that have been controlled by reformers since the parliamentary elections in 2000.

Implementation of the constitutional right to political organization and communication has been problematic. State broadcasting, television, and a part of the press are in the hands of the conservatives. In addition, significant opposition parties are forbidden. Political and civic organizations are restricted because a basic requirement for admission is loyalty to the system and the rule of *velayat-e faqih*. Islamic trade unions are permitted as long as they demonstrate loyalty to the system. Public debate and freedom of opinion exist in a basic sense and they have been officially upgraded by the executive branch since 1997. However, these rights are subject to massive distortion and manipulation by the conservative judicial system, and are substantially limited when it comes to criticism of the concept of *velayat-e faqih* or the revolutionary leaders.

1.3. Rule of law

Checks and balances are partially restricted because the three branches are entangled in the high-level power struggle between conservatives and reformers. From 1997 to 2000, the scope of action of the pro-reform executive was severely restricted by the conservative-controlled legislature and judiciary. Although the reformers won control of the legislative branch in the parliamentary elections of 2000, the judiciary whose head is nominated directly by the revolutionary leader continues to obstruct elected officials.

The judiciary has partially usurped executive authority (for example by appointing a judicial commissioner for foreign affairs) and has denied the presidential right to implement the constitution. It has ignored the constitutionally guaranteed immunity of elected parliamentary officials by bringing accusations against ministers of parliament over allegedly counter-revolutionary statements. The judiciary is institutionally separate, but it often acts through its decisions and doctrines as the *de facto* executive body of the revolutionary leader (the ultimate political authority in Iran), even though this function is sometimes obscured.

Political and bureaucratic corruption is perceived as widespread by the Iranian people and is continually condemned by Khamenei. The judiciary, permeated by corruption itself, uses the fight against corruption as a tool against pro-reform opponents who are the targets of most accusations of corruption; meanwhile corrupt conservative officials escape charges, or they are at best inadequately prosecuted. Civil liberties have been massively violated over a long period. From 1998 until the beginning of 2003, the judiciary closed more than 50 reformist newspapers. In addition, a large number of critical journalists, student leaders, clerics, authors, intellectuals, lawyers and even high-ranking officials from the executive and state administration close to President Khatami have been indicted and imprisoned under dubious charges. Several trials against leaders of national-religious opposition parties loyal to the constitution, but opposed to the power monopoly of the politicized Shi'a clergy, are still in progress.

1.4. Stability of democratic institutions

The constitutional authority of the executive, legislative and judicial branches is functional within the restrictions of the rule of law, and the most important institutions are held to be legitimate by those actors with influence in the political and social arenas. There are, however, considerable barriers to effective interaction between institutions due to the intra-elite power struggle. During particularly critical phases in the internal power struggle, individual ultra-radical conservatives have resorted to denial of the legitimacy of institutions dominated by their opponents. Thus, high-ranking officers of the Revolutionary Guardian Army, which is dominated by the conservatives, have repeatedly threatened to overthrow the president if his reforms would fundamentally change the system.

1.5. Political and social integration

Democratically founded political parties, providing refined ideology and party platforms as in the West, exist only in rudimentary form. Secular parties and parties opposed to the constitution of 1979 are forbidden. Nevertheless, a limited pluralism exists within the revolutionary Islamic power elite that break down into three competitive movements: the left, moderate technocrats, and sociopolitical conservatives. The Islamic left and moderate forces have been united in a coalition since 1997 and they comprise the reform camp. Each movement includes a large number of parliamentary groups that play a role in politics as segmented, hierarchical, though primarily non-class-specific, solidarity groups. These include professional organizations such as the bazaar merchants, clerics, engineers, and journalists; associations such as the student union; and advocacy societies (or non-governmental organizations, NGOs) such as those representing women. Battles are fought over the allocation of power and economic resources by those groups, which, in one form or another, have access to these resources. However, the revolutionary leader and the president have the definitive capacity to determine these allocations. Significant polarization exists between the left/moderate reform coalition and the conservatives.

Nevertheless, a consensus among all members of the power elite has been maintained to ensure a minimum level of cooperation so that internal conflicts do not escalate beyond control. This functions to prevent existential threats to the foundation of the system and thus maintains the position of the current elite. Observers estimate that a maximum of 10% of the population approves of the velayat-e faqih; however, this figure does not indicate disapproval of the system as such, its overall constitution or the achievements of the revolution. The election results for President Khatami in 1997 and 2001, 69% and 77% respectively, reflect a continuing popular desire for reform of the current system, not its abolition through a new revolution.

Since 1997, the organizational landscape of civil society has differentiated considerably. For example, in 1999 Khatami paved the way for the creation of new, participatory and fundamentally democratic structures when he oversaw, for the first time in the history of the Islamic Republic of Iran, the community council elections mandated by the 1979 Constitution.

2. Market economy

Iran has made only minimal progress toward transformation of its economic order. There are major transformation shortcomings with respect to planned economic structures, the sidelining of privatization issues, and the elimination of subsidies.

2.1. Level of socioeconomic development

The level of development of Iran, measured by the Human Development Index, is relatively high compared with most other Islamic states of the Middle East and North Africa. The same holds true for the literacy rate (for 15-year-olds and above), which the UNDP estimated as 72.1% in 1999 and the World Bank estimated at 85% in 2001, based on information from the Iranian Central Bank. However, there is no reliable data on the distribution of income. According to a UN Development Program estimate, approximately 53% of all Iranians lived below the poverty line in 1996.

About 80% of the Iranian economy is nationalized. According to the constitution of 1979, all large-scale industries including oil, steel, chemicals, textiles and raw material processing, as well as banks, insurance, energy, telecommunications, aviation and transportation systems must be owned and managed by the state. State-owned enterprises enjoy preferential treatment, including favorable government loans and exemption from most taxes and import duties. Although not affected by serious private competition, at least 60% of public corporations run high deficits despite their monopoly status, a result primarily of mismanagement and corruption.

In addition, Iran's economy suffers from a one-sided dependency on petroleum, the sale of which generates about 80% of foreign currency income for Teheran. The oil sector accounted for around 40% of the GDP in the 1970s, but it has declined to approximately 20% today. Yet income from oil exports still makes up approximately half of the state budget. While it is true that petroleum exports are a permanent source of income for the government, and that this income enables it to provide enormous energy and staple food subsidies for the population, the economy as a whole is extremely vulnerable to the fluctuation of international crude oil prices. Repeated efforts since the beginning of the 1990s to reduce oil-sector dependency through the diversification of export earning sources have largely failed. In 1998, Iran's financial situation deteriorated dramatically because of a slump in world crude oil prices. Higher oil prices in 1999 and 2000 provided a fiscal break, but did nothing to solve structural economic problems such as inadequate overall conditions for foreign investments.

2.2. Market and competition

Free-market competition exists only in some sectors and it is poorly regulated by institutions. Within the scope of the trade liberalization initiated by the pragmatic president Hashemi Rafsanjani (1989–97), and continued by moderate-technocrat forces within the reform cabinet of President Khatami, Iran has made a modest effort to introduce uniform rules for all market participants. However, strong state

interventions, regulations and management decisions still dominate the economic arena. Furthermore, the traditional “bazaar capitalism” supported by conservative factions of the elite leads to further distortions of competition.

Foreign trade is subject to the control and direction of either the state or domestically powerful bazaar merchant associations or revolutionary foundations; this has contributed to Iran’s isolation from the world market to a great extent. Except for few recent exceptions, all banks are state-owned. Despite the foundation of the Teheran Stock Exchange (TSE) in 1999, organization of an efficient capital market is still in its infancy.

2.3. Stability of currency and prices

From 1997 to 2001, Iran maintained a split exchange rate system. However, this was abandoned in March 2002 in favor of a uniform exchange rate of 7,900 rials for one United States dollar. In 1996, Iran had a foreign debt of approximately \$22 billion, but thanks to a rapid increase in oil prices to \$30 per barrel beginning in 1999, Teheran was able to reduce its debt to approximately \$7.6 billion by 2001, or approximately 7.5% of the GDP. Iran had taken measures to cushion the effect of a slump in petroleum prices during the most recent “fat years.”

As determined by the five-year plan for 2000 to 2005, approved by parliament in March of 2000, all oil revenues in excess of \$17 per barrel have been paid into a foreign currency reserve fund (the Oil Stabilization Fund or OSF) which holds \$12 billion at present. Inflation, which ran at an estimated 40% in the mid-1990s, was reigned in to 12.6% by 2000. Meanwhile, the government, and in particular the central bank which has been striving for independence, have recognized that controlling inflation is an important building block of economic policy. However, consistent, effective control has only been exercised since 2000.

2.4. Private property

Although the right to property and the regulation of property acquisitions are formally defined by law and by Shariah law, they are not applied consistently; specifically, property rights do not have adequate legal protection against interventions by the state, revolutionary-Islamic foundations or politically influential individuals. In principle, private companies may freely operate as independent entities, but in practice, they are severely limited by political, legal, social and economic obstacles. State companies continue to dominate the strategic economic sectors, and the privatization of state concerns, which began in the 1990s under Rafsanjani and has continued under Khatami, has yet to achieve any lasting success.

2.5. Welfare regime

Social networks are well established to a certain extent, though they cannot ameliorate risks for all strata of the population. Poverty remains a risk for important segments of the population, but the majority of Iranians take advantage of state jobs and exorbitant direct and indirect subsidies for gasoline, heating oil and staple food items, which include bread, rice, sugar and many more. In addition, through institutions close to the regime, millions of Iranians receive social and financial benefits such as employment, medical services, and school and university admissions. Institutions, such as the Islamic Friday Preachers and other revolutionary foundations, maintain networks all over the country, providing social control and stabilization for the regime by influencing the well-being and loyalty of broad groups of the population vis-à-vis the system.

2.6. Economic performance

Since the re-election of Khatami in 2001, the Iranian government has made an effort at crisis management geared toward macro-economic stabilization. In the course of these actions, the government drastically reduced foreign debt to \$7 billion and initiated a prudent fiscal policy that contributed to the maintenance of a 4.8% average growth in the GDP between 1999 and 2002, despite a slight drop in world crude oil prices at the beginning of 2001.

The IMF expressed cautious praise in 2002 for this slight improvement in Iran's economic situation. However, praise was linked with insistent admonitions that Teheran not delay radical reforms in key areas, warning that a complete economic recovery would be impossible without them. Some of the recommended reforms include measures to fight unemployment, privatization, ending the squandering of state resources on energy subsidies, and reform of the inefficient state sector which absorbs the largest portion of the state budget (an estimated 60%).

2.7. Sustainability

Iran has a basic, organized social network to alleviate poverty and societal risks that is partly based within families, and partly organized by the state or institutions close to the regime. The concept of environmental consciousness is little known in the overall population, despite the fact that Iranians are increasingly aware of the negative consequences of environmental degradation. An example is the auto and industrial exhaust in Teheran, one of the most polluted cities in the world, and its considerable health hazards to residents. For the first time in the history of Iran, political consideration was given to the idea of ecologically sustainable growth through the creation of an environmental authority within the executive branch in 1997. So far, though, the authority has been relegated to a subordinate position in the push for economic growth.

Compared with most other states in the Middle East, Iran's health care system is satisfactory. According to UNDP estimates from 2002, 94% of Iranians have access to health care institutions, 95% have access to clean drinking water and 86% to sanitary facilities. There are institutions for education, professional training and research in important sectors. On the other hand, these institutions are very heterogeneous and show significant deficiencies, particularly within secondary and tertiary educational institutions. While the Iranian Central Bank gives the figure of 84% literacy at the primary level, government investment in secondary and tertiary education, professional training, and research are considered low to average.

3. Management

3.1. Level of difficulty

The structural constraints on the Iranian government are relatively high. Although Iran is, from a regional perspective, well-off regarding the rate of education of its labor force and the ability of its state institutions to cover most of its territory, on the other hand Teheran faces a number of growing and serious social ills. Among the most grave is the unemployment crisis, which is the weakness of the regime. Private estimates show that as much as 40% of the population is under absolute or relative poverty lines, with unemployment often cited as the major contributing factor. In turn, jobless-related poverty is the main cause of the above-mentioned social ills; these include suicides, dysfunctional families, high divorce rates, drug addiction, illegal underground activities, violent crimes, prostitution and corruption. In addition to this, Iran is not only plagued by the growing social and economic burden of about 2 million refugees from Afghanistan and Iraq but also with the negative effects of regularly returning earthquakes thus causing enormous material and human losses. The most recent big earthquake, which hit the south-eastern region of Kerman and Bam killed about 60,000 people and made several hundred thousand homeless.

Iran has weak traditions of civil society. Only in one brief periods of its modern history did the country experience numerous, flourishing liberal and left wing groups and parties. This was the twelve years between the removal of the authoritarian Reza Shah 1941 at the hands of the allies and the downfall of the freely elected liberal, nationalist prime minister Mosaddeq 1953 resulting from a coup d'état by conservative militaries and the American CIA. After having restored his authoritarian rule, Shah Mohammad Reza Pahlavi successfully crushed all free, democratic parties and institutionalized state control over society as did Imam Khomeini who overthrew the Pahlavi monarchy in 1979. After Khatami's victory in the presidential elections of 1997, the reformist wing of Iran's power elite repeatedly claimed in public that they invigorated Iran's civil society. However, because of counter-attacks by conservatives and the mistrust

harbored by many reformers against civil society (organizations that were fully independent of the state) civil society remained weak.

Profile of the Political System

Regime type:	<i>Autocracy</i>	Constraints to executive authority:	1
System of government:	<i>Presidential</i>	Electoral system disproportionality:	49
		Latest parliamentary election:	20.02.2004
		Effective number of parties:	2.1
1. Head of government:	<i>Mohammad Khatami-Ardakani</i>	Cabinet duration:	06/01-06/05
Type of government:			
		Number of ministries:	21
		Number of ministers:	21
<p>Source: BTI team, based upon information by country analysts, situation in July 2005. Constraints to executive authority (1-6 max.) measures the institutional constraints posed by a federal or decentralized state, a second parliamentary chamber, referenda, constitutional and judicial review and the rigidity of the constitution. Electoral disproportionality (Gallagher index) reflects the extent to which electoral rules are majoritarian (high values) or proportional: $\sqrt{\frac{1}{2} \sum (v_i - p_i)^2}$; v_i is the share of votes gained by party i; p_i is the share of parliamentary mandates controlled by party i. For presidential/ semi-presidential systems, the geometric mean of presidential election and parliamentary election disproportionality is calculated. Effective number of parties denotes the number of parties represented in the legislature, taking into consideration their relative weight (Laakso/Taagepera index) = $1 / (\sum p_i^2)$; p_i is the share of parliamentary mandates controlled by party i. Number of ministries/ ministers denotes the situation on 1 January 2005.</p>			

Iran is the only state in the Islamic world in which Shi'a Islam is not only the sect of the majority of its people but also, according to its constitution, the faith of its most powerful political representatives. Given this background, there are latent conflicts in Iran along religious lines since the Sunnite Muslims, who pose the country's biggest religious minority, are subject to political and religious discrimination. Although the government has so far chosen either to ignore or to suppress the demands for equality of the Sunnis and other discriminated religious minorities in Iran, nevertheless the existence of these demands indicate growing potential for grave social unrest, which might unfold in the medium term if not addressed properly. Even more worrying for Tehran's rulers, at least in the short-term, is the increasing social polarization arising from the impoverishment of many layers of society because of the unsolved economic crisis.

3.2. Steering capability

Apart from the vehement political conflicts between the reformers and the conservatives, their respective leaders have finally reached consensus on one issue: preservation of the system. However, this consensus has largely been implemented at the expense of the reform program, resulting in the considerable erosion of Khatami's support since 1999. To avoid total loss of credibility among his supporters and to break the effective conservative blockade of the political reform process, President Khatami undertook a risky strategy change in

September 2002 by becoming more confrontational. At that time, he supported two bills, submitted by parliament that would expand his authority at the expense of the conservative-dominated judiciary and the Council of Guardians.

In early April 2003, the Guardians Council rejected the amendment to the election law, citing dozens of violations of the constitution and Islamic law. Subsequent talks between parliamentarians and the Guardians Council were unproductive, as were the meetings of Khatami and Karrubi, the then speaker of the Majles, with the Guardians. In March 2004, two and a half years after submitting the bills, Khatami gave up hope and announced their withdrawal. He expressed concern that the incoming conservative parliament would use legislation to reduce presidential powers. Khatami criticized the Guardians Council's frequent rejection of reformist legislation and conceded his weakness under the current circumstances. "The people should know that, according to certain dignitaries, the President is no longer the second figure after the revolutionary leader who is charged with upholding the constitution and defending the rights of the people," he said.

The entire system, including the reformist wing of the power elite, suffers from a gradual but constantly growing loss of support by the people. This became obvious by the results of the February 2004 parliamentary elections, which ended with the defeat of the reformers, who lost the legislature, their second most important power centre. This defeat was preceded by the February 2003 council elections in which participation was noticeably low; namely 50% nationwide and only 12-20% in Tehran, Isfahan, Shiraz, and Mashhad. The councils had failed to live up to expectations because, in Tehran and some other major cities, they got tangled up in political disputes. Furthermore, their actual duties and powers are poorly defined even though the Iranian constitution calls for councils (Article 100). The outcome was that the reformers lost most of their mandates in the communal elections, indicating the erosion of trust previously held by many Iranians since Khatami's election.

Participation in the February 2004 parliamentary elections was also low. According to official sources, 51% of eligible voters reportedly cast their ballots compared to 69% four years earlier. However, even the 51% figure may not be true as some informed sources from the inner circles spoke off the record about a participation of only 35% of all eligible voters. In any case, this reduced turnout was in part the Iranian public's reaction to the reduced choice of candidates. Even more importantly, the public recognized that the reformist legislators, elected in 2000, had fulfilled few of their promises. The reformists' failure to live up to expectations has a great deal to do with the conservatives' control of several unelected institutions that can counter the elected ones. The Guardians Council has banned from running for office more than 2000 reformist candidates, even including 80 incumbent parliamentarians, and has rejected more than one third of the reformists' legislation. The way the dominant conservatives in the Iranian power elite dealt with the process of the parliamentary election showed their

inflexibility and their lack of policy innovation. This was in spite of the negative consequences on the domestic scene where a considerable part of the population finally lost any hope for a peaceful transition of the system from within.

3.3. Resource efficiency

The government does not make efficient use of Iran's natural and human resources. In a population of around 70m one-third are reckoned to be under 14 years of age and two-thirds under 35. Even though the economy grew by about 6% in 2004, it is still not expanding fast enough to keep unemployment down. While around 16% of the population is officially jobless, the real figure may be higher and is estimated at about 30%. Inflation of about 17% is rising faster than wages. Though the necessities of life such as bread and potatoes are hugely subsidized, the lot of the urban poor, whose minimum wage is around \$12 a month, is dire.

The government failed to reorganize an economy that remains distorted by subsidies, closed to competition within Iran or from abroad, locked in the hands either of the state or of state-connected foundations, known as bonyads, and increasingly reliant on the high price of oil. Iran has about a tenth of the world's known reserves. Barely a fifth of the economy is in private hands. The conservatives have made it hard for the timid president Khatami to sell off state firms or open up to foreigners. The merchants of the bazaar, a longstanding pillar of the ruling elite's power, still protect their own cartels. Capital flight continues apace. Only four private banks exist (three of them linked to the bonyads or to the state), with just 4% of the banking sector's assets. While corruption in every sphere of business stunts growth and puts off investors, people complain about the ruling clerical families' wealth and patronage.

The new parliament, with its conservative majority, has been especially obstructive; preventing, for instance, a Turkish company ("with Zionist links", so it was bruted) from acquiring a mobile-phone franchise in order to break the current inefficient monopoly. It has also prevented the opening of Tehran's new airport, because it would have been operated by a Turkish-led consortium—so, in the conservatives' view, imperiling national security. Most recently, parliament has threatened to unpick a big deal with Renault, the French carmaker, to produce a new car.

Without oil at its present very high price, Iran's economy would be in great problems. Oil provides about half the government's revenue and at least 80% of export earnings. Nevertheless, once again under the influence of the neo-conservative majority in parliament, the oil cash is being spent on boosting wasteful subsidies rather than on much-needed development and new technology. According to unofficial estimates, the government also spends about 60% of its budget to sustain mostly unproductive state enterprises.

Iran lacks a coherent policy for the recovery of its ailing economy due to the ongoing power-struggle between the different fractions of the power elite and its various reformist, traditional conservative and neo-conservative mindsets. The level of openness toward IMF policies and emphasis on social justice varies among the sub-factions. The majority of reformists support Khatami's liberalization policies, advocate transparency and endorse IMF guidelines. However, traditional conservatives, affiliated with the bazaar, favor a trade-oriented and protected economy. They are not so hostile to foreign engagement but do not find international commerce and technology particularly significant. This capitalist-mercantilist group seeks rents and monopolies and is open to conditional liberalization policies. As neoconservatives they have a limited and sectarian view of liberalization policies, advocate a state-run economy, over-emphasize social justice (often in a demagogic manner) and are mainly xenophobic. These fundamentalist ideologues, given their power in the new parliament, embrace populist economic policies based on state intervention, price controls and subsidies. Most of them are opposed to reforms by the World Bank and the IMF, and categorically reject globalization as un-Islamic.

Despite the public lip service, many political leaders to combat corruption, the state is unwilling to curb the rampant corruption., This has become a fundamental characteristic of the administrative and state culture, and a factor that deters foreign investors alike.

3.4. Consensus-building

There is no overarching consensus in Iran's leadership about democracy and market-economy since these goals are only pursued by some, but not all, sub-groups of the reformist camp. Given the unequal balance of the power centers, the reformers cannot neutralize their conservative adversaries, who have veto power to slow down the reform process or bring it to a halt. During the years of Khatami's presidency the fierce power struggle has caused the already-existing divisions between conservatives and reformers to have deepened even more; but not to such an extent that a majority of reformers, led by Khatami himself, have decided to reshape the system radically in a democratic manner. This is probably for fear of being persecuted or losing their political and material privileges.

However the reformist government has undertaken some measures to develop social capital. For example, when it asserted itself by enacting elections for local councils held in 1999 for the first time in post-revolutionary Iran's history, and which were held again in 2003. However, since the conservatives adamantly resisted handing over any real competences for decisions on the local or regional level to these councils, this step failed to contribute effectively to the development of social trust among the population.

The actors of civil society are excluded from the political process by conservatives and reformers alike. For example, for the first time in history, an Iranian, Shirin Ebadi the human rights activist and lawyer, received the Nobel Prize in 2003 for human rights. Ebadi was widely disregarded by the Khatami's reformist government, and it did not dare benefit from this issue in domestic policy due to reasons of expediency related to the internal power struggle.

Even under the reformist government of Khatami which brought about a considerable increase in the freedom of press and opinion for the first four years of his tenure, most issues of past injustice in the era of Revolutionary leader Khomeini and president Rafsanjani are considered too controversial to be touched. For example, the mass killing of about 3000 leftist prisoners in Iran's prison, in the summer of 1988 after the cease fire in the war between Iraq and Iran, remains a taboo topic, still officially denied by the Iranian government. Any real initiative for a process of reconciliation between victims and perpetrators of past injustice has not yet materialized.

3.5. International cooperation

For the first time since 1979, there was a sustained effort, during this review period, to end Iran's international isolation and to normalize relations with the outside world. Previously, fluctuations in the domestic climate obstructed the development of a stable and consistent foreign policy. The development of political detente with the West and the Arab world, although only moderately successful when initiated by President Rafsanjani, continued more successfully and it was intensified under Khatami. Thanks to his domestic reform agenda and initiatives for peaceful dialogue between cultures, Khatami has been able to gain international confidence as a credible, dependable partner; also, a majority of Iranian conservatives have both accepted and utilized this success because it benefits the regime as a whole. However, Khatami has not been able to make any progress toward re-establishing relations with the United States, which have been suspended since 1980.

The flawed parliamentary election has been criticized by the United States and the European Union. In addition, measures that would have been interpreted as endorsing the Iranian regime, such as concluding a trade and co-operation agreement with the European Union, were avoided. Notwithstanding this, pragmatic concerns ensured that diplomatic channels remained open. For their part, Iranian policymakers increasingly assessed Iran's regional position to be one of strength, in that sense that the United States needs Iran to bring its influence to bear over the restive Iraqi Shi'a community in the efforts to restore order to post-Saddam Hussein Iraq.

However, Iran's international rehabilitation, in particular a sustainable improvement in ties with the United States, could not be achieved because of

mounting Western concerns over Iran's nuclear ambitions. In late 2003 Iran moved to defuse what was rapidly becoming a crisis by promising full disclosure over its program and total co-operation with the inspectors of the International Atomic Energy Agency (IAEA). Since then, however, IAEA inspectors have made a number of discoveries that have called into question Iran's commitment to its pledge.

Under an agreement brokered by the United Kingdom France and Germany, Iran agreed in November 2004 to suspend all activities related to the enrichment of uranium for use in its nuclear program. This was in return for a resumption of talks with the EU over a trade and co-operation Agreement and European Union's support for Iran's accession to the World Trade Organization (WTO). The deal was sufficient to ward off referral of the issue to the UN Security Council at the IAEA's board meeting later in the month. Irrespective of this accommodating gesture, Iran continued to insist on its right to develop nuclear fuel to produce electricity and has made clear that the latest agreement is a suspension rather than a termination of such activities; it will not be indefinite. In fact, Iran is perfectly entitled under the NPT to develop a nuclear fuel capability, as long as its fuel activities are declared and monitored by the IAEA.

Yet suspicions that Iran's nuclear program has military intent could only be definitively allayed if Iran gives up all nuclear-fuel activities, a step Teheran adamantly refuses to do. Overall a peaceful resolution of the issue therefore seems unlikely to succeed without the active participation of the United States, seen by Iran as able to offer both the largest incentives and able to wield the greatest threat. However, it seems questionable whether the administration of U.S. President George W. Bush is ready cut a deal acceptable to the Iranians. If a breakdown of the latest agreement occurs, referral of the issue to the UN Security Council, which can impose sanctions, will become likely. It is not clear that a consensus over sanctions could be achieved. Even an escalation of tensions, though, would cause Iran to become increasingly isolated, thus possibly damaging investment in the oil industry, and therefore economic growth and Iran's fiscal and external position.

4. Trend of development

4.1. Democratic development

The democratic transformation of the theocratic system, to which many Iranians had aspired at the beginning of Khatami's reform movement in 1997, did not happen. The reform movement did change the culture of political debate, somewhat expanding the permissible boundaries in the realm of freedom of opinion, but in the realm of power structures and constitutional reforms no substantial progress was achieved, insofar as the institutionalization of democracy is concerned. The current constitutional distribution of powers clearly favors the

conservative camp of the power elite, whose members in turn are determined to preserve the status quo by all means, and are prepared to accept only minor cosmetic changes. Given the stagnation of the reform process, whose most prominent and radical protagonists are either silenced imprisoned or exiled, the prospects for an evolutionary democratic transformation of the system are bleak, at least in the medium-term.

4.2. Market economy development

The conservatives, who dominate the 2004-2008 parliament, have made raising living standards their main priority and have talked of improving the environment for domestic and foreign investment. However, fundamental reforms will remain difficult to implement, running up against the entrenched interests of the bonyad and the bazaaris whose interests overlap with those of the broad conservative establishment. Fears of the social impact of reform measures, moreover, will continue to restrict the range of issues the government is able to address. With unemployment rising, support for a more radical privatization process, which would inevitably mean the loss of many jobs, is weak. Fiscal reform is likely to remain on hold, with elected officials fearful of the popular response to reduced subsidies or slower public-sector wage growth.

Other than reforms to the exchange-rate system, monetary policy has been static over the past decade, and is unlikely to see significant change in the near future. Trends in foreign investment have proved even more disappointing. The current five-year plan aims to create 760,000 jobs a year to reduce unemployment, but, while job creation has picked up since 2000, most estimates suggest that it has fallen far short of government goals. A recent IMF report estimated that Iran's overwhelmingly youthful demographic profile led the workforce to grow by 3.5% a year over the previous three years, bringing 600,000 new job-seekers onto the labor market every year. However, job creation lagged at some 450,000 new posts. Official data for 2001/02 suggest that of the country's 'active' population of 19.1m, 16m were employed--an unemployment rate of 16.2% compared with 16.1% the previous year and 15.8% in 1999-2000. Officials said the rate had fallen as low as 11.6% in late 2003. Local analysts, however, question these figures and suggest that the real rate of unemployment is closer to 25% or even higher. They stress that unemployment among those under the age of 25 is significantly higher than the national average. This shortage of adequate jobs for the youth is an alarming threat to political stability.

D. Strategic perspective

Despite the failure of the reform movement one would be mistaken to suppose that the conservatives could afford to forever ignore the underlying factor, which was addressed by the movement and accounted for strengths in the first early

years, namely the desire of change in broad layers of society. Demographics are the major factor driving change in Iran. The generation of Iranians born after the revolution in 1979 accounts for a fast growing percentage of Iranian's population eligible to vote. Disappointed with the performance of the Islamic government and because of easier access to information, the population is less amenable to political propaganda than previous generations and calls for economic and political liberalization. With a voting age of 16 and about 60% of the electorate under age 30, Iran's youth constitute a formidable force and the driving engine behind much of the reform movement.

Since 1997, Khatami's government has focused its reform efforts on four primary sets of issues, the first and foremost of which has been the economy. Iranians expect economic reforms that will provide jobs, curb inflation and improve living standards. Second is the relaxing of the strict socio-cultural restrictions that govern the lives of many Iranians, most notably in terms of Islamic dress codes, gender relations and access to Western culture and media. The third focus for many reformers has been the hope that relations with the West, including the United States, can be improved, in order both to ameliorate the current economic situation and to reinvigorate contacts between Iranians and their relatives abroad. Finally, reformers have pushed for political liberalization, including greater public accountability and broader political pluralism.

If a conservative candidate will succeed in the forthcoming presidential elections he must address *nolens volens* all these issues, which nurture the desire for change among the Iranian people, otherwise they will carry a high potential for future social unrest and political instability.