

BTI 2008 | Iran Country Report

Status Index	1-10	3.96	# 100 of 125	
Democracy	1-10	3.73	# 100 of 125	➔
Market Economy	1-10	4.18	# 96 of 125	➔
Management Index	1-10	2.81	# 112 of 125	

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

This report is part of the Bertelsmann Transformation Index (BTI) 2008. The BTI is a global ranking of transition processes in which the state of democracy and market economic systems as well as the quality of political management in 125 transformation and developing countries are evaluated.

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Key Indicators

Population	mn.	68.3	HDI	0.75	GDP p.c.	\$	7,089
Pop. growth ¹	% p.a.	1.4	HDI rank of 177	96	Gini Index		43.0
Life expectancy	years	71	UN Education Index	0.75	Poverty ³	%	7.3
Urban population	%	66.9	Gender equality ²	0.33	Aid per capita	\$	1.5

Sources: UNDP, Human Development Report 2006 | The World Bank, World Development Indicators 2007 | OECD Development Assistance Committee 2006. Footnotes: (1) Average annual growth rate 1990-2005. (2) Gender Empowerment Measure (GEM). (3) Percentage of population living on less than \$2 a day.

Executive Summary

The surprise election in 2005 of hardline ideologue Dr. Mahmoud Ahmadinejad to the presidency marked a significant shift in Iranian politics at a time when regional tensions and conflicts with the West over the nuclear issue were seriously escalating. Ahmadinejad, the first layman to hold the post for over 20 years, promised upon his election to usher in a “Third Islamic Revolution,” returning Iran to its original revolutionary values as outlined by Ayatollah Khomeini, a project which he claims that the reformists under his predecessor, President Mohammad Khatami, derailed. This has caused severe political rifts among the ruling conservative ranks, who share concerns about Iran’s interests at home and image abroad but differ on strategies. However, Ahmadinejad, a charismatic and highly popular figure, has strengthened the otherwise weak office of the presidency, making inroads into the foreign policy arena, as well as in various areas that touch upon the central ideological pillars of the state. In this regard, his presence has widened the pool of consensus-building within the political elite.

Although Ahmadinejad was elected at least partially on his promises to share the oil wealth more widely with the disenfranchised and to improve standards of living for the poor, the country has not prospered over the past two years. On the contrary, inflation has risen and the president’s revenue-sharing plans have largely failed. Additionally, his strident tone on the nuclear issue has raised concerns in the European Union and many U.N. nations over Iran’s weaponization agenda. Nonetheless Iran, partially due to the spike in oil prices in 2006, has performed better than expected economically, especially in light of the constraint U.N. sanctions has placed on its banking activities abroad, as well as mounting U.S. pressure on its allies to eschew doing business with Iran. In March 2007, in the face of these obstacles, Ahmadinejad announced that nuclear power was being produced in industrial quantities, and the current account for

the fiscal year ending 20 March 2007 was in surplus. Two other players on the Iranian political scene, Supreme Leader Ali Khamenei and Hojat al-Islam Ali Hashemi Rafsanjani, both with respected legacies in the development of the Islamic Republic, have, if anything, gained power over the past several years, even as Ahmadinejad has kept Iran in the international headlines. Khamenei is the greatest single beneficiary of the “Second Revolution,” which took place at the time of the American hostage crisis and served to centralize power in clerical hands. He has systematically transformed the Iranian system – albeit within existing constitutional structures — into an increasingly authoritarian model. He has woven a number of ideologically driven factions – such as the Islamic Revolutionary Guard Corps (IRGC) and conservative clerics – into a system of parallel institutions providing a tight nexus of control.

The strengthening of Khamenei’s position, dubbed by some analysts as a “clerical coup,” has re-cemented the theocratic basis of the state and fractured the debate over democracy that flourished under President Khatami. This marginalized secularists and constitutional reformists while circumscribing all forces for social and economic reform into Khamenei’s sphere of influence. One further result of this movement toward centralization has been to ensure the delegitimization of outside reformist interference, particularly from the United States and other Western sources, whom Khamenei and his supporters brand as irrelevant to Islamic and Iranian ideals. The third figure is Hashemi-Rafsanjani, the president preceding Khatami and the main candidate against Ahmadinejad in Iran’s first-ever presidential runoff. Although he was at first seen as the political loser in that campaign, he has risen to become the second most powerful politician in Iran. The Expediency Council (also known as the Council of Experts), which he chairs, had its mandate extended only weeks after the election to include supervisory powers over the entire government – that is, the presidency, the judiciary, and parliament. In December 2006, elections for the Assembly of Experts, a body established to appoint (and remove, if necessary) the Supreme Leader, favored the conservative pragmatists among whom Hashemi-Rafsanjani is a leading figure. Subsequently he became its deputy chairman. The Ahmadinejad camp meanwhile suffered severe setbacks. In addition, Hashemi-Rafsanjani represents the cadre of clerics that has effectively encouraged expansion of the private sector through government patronage, thereby establishing a symbiotic relationship between business and politics that has managed to encourage growth within an authoritarian structure. Some observers of Iran have likened this development to “the China model.”

Analysts of Iran’s governmental structure struggle to discern amidst the shadowy echelons of institutional power how exactly these three political leaders cooperate, and how their powers eventually translate into action. Moreover, Iran’s important strategic role in its geopolitical arena, makes “Iran-watching” today almost as common an activity for foreign observers as “Kremlin-watching” was in its day. Iran’s pivotal position as a relatively weak but critical military force in the Persian Gulf, particularly in the context of what the U.S. administration regards as a “Shi’a Arc of Crisis.” On

top of this, its role in the upheavals of its neighbors Iraq and Afghanistan, not to mention its clout within OPEC, render it a critical foreign policy concern not only for Western states but also for Russia, Turkey, India and Pakistan, all of which share economic ties and ambivalent political relations with Tehran. Perhaps with the exception of its close ally Syria, Iran is regarded almost universally with both suspicion and respect. Not only does Iran enjoy a unique position as a countervailing force against the univocal power and ideology of the United States, but also it is recognized to be a past master at “soft” power – that is, able consistently to use, often in surprising ways, diplomatic and rhetorical moves to achieve its strategic interests. This was clearly illustrated by Iran’s seizure of British marines in the Shatt-al Arab in April 2007. Its subsequently freeing of the hostages as a token gesture of goodwill coinciding with the celebration of Easter flummoxed observers, revived international awareness of the Iran’s disputed borders with Iraq and reminded Western governments how worrisome any breakdown of relations with Iran could be.

History and Characteristics of Transformation

The Iranian government is based on a complex mixture of constitutional concepts incorporating themes of French constitutionalism such as democratic participation and the ideas of Ayatollah Ruhollah Khomeini. The latter, a notorious cleric, developed his theory of government in a series of lectures that he gave in Najaf when Shah Mohammad Reza Pahlavi had exiled him there between 1964 and 1979. The current constitution is designed around the concept of *hukumat-i Islami* (Islamic government) under the guidance of a specially qualified leader versed in *Shari’ah* (Islamic) law of the Jafa’ari (twelver Shia) school of jurisprudence. Khomeini dubbed this form of government the “*Velayat-e Faghih*” (Supreme Jurisprudence).” The constitution also guarantees participatory government by providing for an executive and a legislative branch. Sovereignty itself, however, is formally a divine attribute and therefore it is the jurisconsult (*faghih*) and not the president who ultimately governs because of his supreme capacity to interpret laws according to divine precepts (i.e., the Quran). Public loyalty to the state of Iran is therefore systemically equated with the support of Islam and its guardianship by the supreme jurisconsult.

The structure of the Iranian government has changed substantially since the inception of the Islamic Republic in 1979, as the government has acknowledged flaws in its operation. Overall however, the result has been an increase in bureaucratic bodies that have favored clerical control. Some examples include the establishment of the National Security Council in 2000 as a security advisory, various arms of intelligence operation and parallel structures of government added to the Office of the Supreme Leader to increase his authority, for example, the Foreign Policy Advisory Board formed in 2006. Several, though not all, of these changes have been codified in the constitution, which

is continually being amended; in a recent example, a new law raised the voting age from 15 to 18 years old, a significant development in that it privileges a modernist view of the age of maturity over the traditional Islamic one codified in the Shari'ah.

Establishing the Islamic Republic was intended not only to reconfigure the concept of political sovereignty so as to privilege divine authority, but also to refashion the economic structure of government along ideological lines with the primary motive of protecting the poor. A plan for centralizing economic management was formulated, which involved not only nationalizing the industrial and banking sectors, but also establishing charitable foundations to handle all the investment and distribution needs of civil society. Over time, this design has proven awkward to manage and highly susceptible to corruption, as it relies heavily on subsidies and lacks transparency. Yet, despite the long-term U.S. sanctions against Iran begun at the time of the American hostage crisis and the nine-year Iran-Iraq War, the Iranian economy has grown at a consistent rate since 1991 (the first year after the war), not the least of which due to the country's significant income from both oil and gas exports (Iran is thought to have 9% of the world's oil reserves, and the world's largest natural gas reserves).

Though balancing the budget remains elusive, a growing awareness of the need to liberalize the economy and encourage private investment took hold during the Rafsanjani presidency (1989–1997), and has continued since. The looming specter of an economic squeeze as a result of the nuclear standoff is however causing concern at all levels of government, a fact reflected in the newest budget for 2007–2008, which attempts to reduce important subsidies on oil and kerosene. Additionally, being largely dependent on oil revenues, Iran has traditionally been subject to the "oil curse," that is, the vagaries of the international spot market directly affect its operating budget, which, in good years, provides it with excess revenues for its Surplus Oil Fund (SOF), but which in bad years causes financial distress. Iran's population burst in the aftermath of the revolution, doubling within the span of 15 years. This new generation now dominates (50% of Iranians are under 35), and the need to provide employment is both an economic as well as political imperative. The government appears unequipped to handle this task, and in the case of further sanctions this failure may spiral into significant internal repercussions on the political front.

Transformation Status

I. Democracy

At the time of the Islamic Republic's inception, Ayatollah Ruhollah Khomeini dismissed "democracy" as a Western construct that shared nothing with Islamic values. He understood democracy as favoring the individual over the community and materialism over spirituality, a political system that had enabled the West, and particularly the United States, to impose its will on weaker nations for its own gain. After the draconian years of the Iran-Iraq war, in which centralized planning, martyrdom for the cause, and ideological rigidity for the sake of preserving order against the constant threat of anarchy had ruled the day, the easing of political and economic circumstances under the Rafsanjani presidency, particularly once Khomeini died, opened the door for a reconsideration of the ideas, if not the terminology, associated with democracy. The election of Mohammad Khatami on a reformist platform in 1997 ushered in what would become a vibrant and purely Iranian democracy debate that was neither a Western import nor an elite project irrelevant to the masses. The debate was conducted among several political factions: most prominently the secularists, represented by Abdul-Karim Souroush (and his publication *Kian*), who argued for a separation of politics from religion and the Islamist "pragmatists," who supported a more pluralistic Islamic Republic, that is, liberating government from the oversight of the Supreme Leader. However, Khatami failed to achieve concrete democratic change, perhaps due to his acceptance of the theocratic basis of the constitution, which proved fatally constraining. By Khatami's second term, hardline opponents had ensured that the democracy debate would no longer include secular threats to the management of governance. Instead, it would focus on economic reforms to free the government from its populist agenda and the associated financial constraints. Nonetheless, Khatami's political modus operandi and commitment to civic freedoms did lead to a "Prague Spring" of press freedoms, greater emphasis on human (and women's) rights and lowered restrictions on social conduct. It also had several long-term effects, most recently including a more democratically conducted presidential campaign. Under Ahmadinejad, many of these political freedoms have been reduced, although the press remains active, as do heated debates within the majles and provincial councils. These debates have most recently covered the costs and risks of a nuclear standoff.

1 | Stateness

The state's authority over the Iranian population, and as their representative on the international stage, is recognized both domestically and abroad. A strong nationalist tradition has characterized the country for hundreds of years. The territorial integrity of the state, established by the mid-19th century, has remained largely unaltered, despite incursions from the Soviet Union in the mid-20th century and invasion by Iraq in the decade between 1980 and 1990. Though linguistically and ethnically fragmented – only about half the population speaks Persian as their first language – the vast majority subscribe to the Shi'a doctrine of Islam, which bonds them to the central government while in many ways isolates them from the majority of the Islamic world.

Monopoly on the use of force

Although a multitude of ethnically diverse tribes populate the Persian plateau, particularly along its long borders, the majority are of Indo-European rather than of Arab background, an important point of distinction in Iranian nationalism. Although relations between Tehran and its ethnic borderlands have been tumultuous throughout the history of the Islamic Republic (and before), calls for separation have been relatively rare; the commitment of such groups as the Kurds and Baluchis to the state overrides their desire for complete independence. The same holds true for the southern largely Sunni Arab minority: their loyalty to Iran was proved at the time of the Iran-Iraq war, when they fought alongside their national compatriots. Moreover, their critical location over the southern oil fields of Khuzestan makes their loyalty to the state more important to Tehran than perhaps any other minority.

State identity

The government retains both a standing army – the Artesh – of 450,000 men and the more ideologically driven Revolutionary Guard of 150,000 men, a product of the revolution itself. The Supreme Leader controls both. The extraordinary complexity of constitutional government in Iran is thus paralleled by the security system, for the Revolutionary Guards and the Iranian armed forces although they ostensibly cooperate, are in reality fundamentally opposed to each other. This is partially due to the direct association of the IRGC with the current Supreme Leader, Ali Khamenei, who has used them to pack parliament, and has assigned them primary responsibility for maintaining ideological order domestically. They fulfill this role by managing two other security bodies, the hezbollah and the basij, both government shock troops, against internal dissent. Mahmoud Ahmadinejad, previously a member of the IRGC, represents perhaps the best example of its rise to political prominence since the Khatami presidency.

No interference of religious dogmas

The merging of religion with politics infuses all aspects of the state and to a large extent grants the state its legitimacy. This means that the state does not guarantee similar rights to all its citizens. Members of other religions do not enjoy the same

Basic administration

constitutional rights as Shi'a Muslims. Members of religions of "the Book," that is, Christians, Jews and Sunni Muslims enjoy greater rights than others, including the right to have a member of parliament for their communities and to maintain religious schools; Zoroastrians, as members of an ancient Iranian religion, enjoy similar rights; the most restricted are the Bahais, who are viewed as heretical. Furthermore, insistence on ideological conformity has led to the rise of a clerical elite that exercises power at all levels of society, often with impunity and frequently through the abuse of human rights.

2 | Political Participation

Political parties exist. However, the current system, which was only formally authorized during the 1990s, requires that parties be approved – that is, deemed to be in conformity with religious principles – before registration. The most important parties now, each associated with a faction within the overall administrative structure, are: the moderate Dovome Khordad (the second of Khordad) movement, the party of previous President Mohammad Khatami, which is traditionally supported by the mutalafat (the moderate clergy association (this party is distinct from the mu'talafe movement discussed below)); the Kargozaran-i Sazandagi (the Construction Workers Movement), which is pragmatic conservative and contains supporters of former president Ali Akbar Hashemi Rafsanjani; and the mutalafe (the Coalition of Islamic Associations) movement, which is conservative and generally supported by the hard-line clergy. President Mahmoud Ahmadinejad ran and won his campaign under the patronage of the mutalafe party. All other parties that enjoy formal existence all have a strong Islamic and pro-regime orientation.

Free and fair
elections

Under the constitution assemblies and marches are permitted "provided they do not violate the principles of Islam." However, government practice is more restrictive as it attempts to prevent any anti-government protest. Gatherings that the government monitors include public entertainment, lectures, student demonstrations, labor protests, funeral processions and Friday prayer assemblies. Parties outside the regime that support a reformist agenda, such as the Freedom Movement and Iran Nation, have either been banned, denied registration, or are so severely restrained that they no longer take part in formal politics. Other illegal parties include the Mojaheddin-i Khalq (MEK), a radical opponent of the clerical regime based in Iraq and now under American control; the Feddayin-i Khalq, previously an anti-Shah guerrilla group now split into pro-and anti-regime factions; and various royalist groupings, many without names. Finally, there are important illegal parties in the ethnic territories giving voice to the tension and disaffection that characterizes these regions, and which often garner support from powers outside Iran. Among the most significant is the long-standing Kurdish

Effective power
to govern

Democratic Party of Iran. Recently new parties and guerilla groups have been forming along the frontier regions.

The revolution in effect never produced significant political parties; instead, post-revolutionary Iran has favored electoral politics as the primary means of involving the public in the political process. Without a ruling party (or parties) through which to distribute power and vet policy, the Islamic Republic itself serves as a party, and its theocratic leadership regards the voters as the party's members. Observers both within and outside Iran alike have condemned restrictions on electoral candidates that tarnish the credibility of the elections. Nonetheless, the regularity of elections has institutionalized the parliament and the many provincial councils, producing a mix of representatives that has radically shifted the political tenor of the government at each election. Turnout has been volatile, with highs of almost 80% in presidential elections to lows of 15% of the electorate in council elections.

Association /
assembly rights

The country is dominated by a regulated media. Radio and television is largely state-controlled and independent newspapers (in terms of their political standing) find it almost impossible to function, even when they manage to secure a license to publish. In a classic example, during the Khatami era the right-dominated judiciary closed down over a dozen independent newspapers and magazines in one fell swoop, practically strangling the pro-reform voices of the country.

Freedom of
expression

3 | Rule of Law

The constitution was constructed to give primary power to the “Velayat-e Faghih” (Supreme Jurisprudence), which is now embodied by Supreme Leader due to his superior Islamic expertise. At the same time, the public was awarded the right, through the election of representatives and the executive, to have significant input in government. A Guardian Council of religious jurists was established to oversee the Islamic purity of legislation, and the Judiciary was organized according to Shari’ah law, which were conceived together to provide a system of checks and balances.

Separation of
powers

A fundamental contradiction within the constitution sets the primary position of Islamic law at odds with republicanism. Article 4, for example, establishes Islam as the basis of the Iranian system—that is, no laws or regulations may contravene Islamic precepts. In addition, Article 177 states that this aspect may not be changed and is not amendable. However, a second legal principle is codified in Article 6, which establishes the Iranian polity as based on public opinion. This is further guaranteed by Article 56, in which self-determination is granted by God as a divine right. The immutability of these two pillars, Islamism and republicanism often leads to conflicts in practice and is the basis of intense debate

Independent
judiciary

concerning the maximalist view of Islamic legal rules (based on believers fulfilling their duties) versus the maximalist view of the state (based on granting citizens their rights). The culture of political discourse is thus ongoing, which provides an opportunity to advance republicanism as a legal framework for ensuring principles of social justice, minority rights and the role of representative decision-making.

The judiciary is not in fact independent, but rather is supervised by the Expediency Council and ultimately, the Supreme Leader and as a result, it operates in collusion with the high office. In 1983, *hūddūd Shari'ah* lawpunishments were introduced along with a penal system based on retribution (*qisas*). The Ministry of Justice administers the court system under the authority of the Supreme Judicial Council, which appoints and dismisses judges and selects the minister of justice. Since 1993, judges have also filled the function of prosecutor. Reformers around previous President Khatami swore to change that feature, but it continues, mainly because it reflects the judge's true position under the traditional Islamic legal system. Moreover, the judiciary, rather than an independent Bar Association, has become responsible for the authorization of lawyers – what the International Committee of Jurists states is a conflict of interest and outside accepted rules of law. In recent years as well, evidence reveals that the judiciary is taking on security functions independent of the police or other security bodies. This was clearly the case with the murdered Canadian photojournalist, Nadia Kazami, who was killed within the custody of the judiciary in 2003.

Prosecution of
office abuse

Religious prestige and power guarantees protection. The hegemony of the mullahs over the political process is, in effect, paramount, with the result that access to clerical support is far more important than independent rule of law. Since governors, mayors and prison wardens are appointed posts, they have no democratic accountability, and since they liaise with the local security organs, there is virtually no possibility to control corruption within the political and administrative process or to interfere with their activities. There is thus virtually no redress against authorities' abuse of power despite the supposed democratic safeguards, which allows them to be as repressive as they wish.

Civil rights

4 | Stability of Democratic Institutions

In 1906, Iran was the first Middle Eastern state to have a constitution. It established an elected parliament (*majles*) outside control of the Shah and institutionalized a system of electoral politics. Even prior to 1906, a tradition of "societies" or *anjoman* that combined political and community or professional activity characterized Persian social organization. This tradition has continued, despite the vicissitudes of Iranian politics in the course of the past century, which

Performance of
democratic
institutions

have seen alternating waves of democracy and authoritarianism. For example, most of the Islamic Republic's original founding fathers were members of several important underground anjoman during the Shah's reign, which became critical centers of political activity once the Shah fell. Democratic institutions therefore constitute an ongoing and stable part of the Persian political fabric, even as authoritarian practice often excludes them from direct political intervention. In fact, the anjoman tradition accounts for Iran's ongoing ability to re-invent itself, infuse existing institutions with new democratic ideas and undercut authoritarianism from the grassroots level.

Both the representative institution of the majles and the presidency have remained unchanged in design since their inception and continue to wield effective power in their respective positions (unlike the largely nominal majles under the Shah). The president selects a roster of ministerial candidates who must be approved by the majles. There is no guarantee of approval, as was illustrated by Ahmadinejad's experience when several of his selections were rejected (including two different proposals for Minister of Oil). There is likewise vigorous competition between the majles and the Council of Guardians, even if it often means that one will not pass legislation favored by the other. Finally, the majles has a strong relationship with the regions its members represent. The views of the local populations on the conduct of the majles and the executive frequently find voice in the provincial media, which act as fora of comment and criticism on government actions.

Commitment to
democratic
institutions

5 | Political and Social Integration

Popular support for the Iranian state as an Islamic Republic remains high even though many factions within the country would prefer aspects thereof to be differently interpreted. The Muslim norms that the government embodies and its utopian ideology of leading the struggle to develop an Islamic ummah (community) as an alternative to the Western model resonate widely and retain a legitimacy that cannot be underestimated. The revolution was widely recognized to be an experiment in marrying modernization, Islamic law, constitutionalism and Iranian tradition. The evolution of this marriage in the course of the 29 years since the revolution reveals the commitment of both the political elite and the population at large to the spirit of experimentation. The acceptance of the radically different approaches of the contrasting (but both extremely popular) presidents Khatami and Ahmadinejad as well as the many adjustments made to the constitution, political doctrine and institutions of government attest to this relative flexibility. For the vast majority of the population, who remain within the parameters set by the dominant Shi'i faith and see the social order as legitimate, political and social integration is high.

Party system

During the Khatami years freedom of movement within the parameters of the Shi'i social order was at its greatest. His rule encouraged active participation not only by student groups but also by artists, writers, and ethnic and religious minorities in refining the rules to favor greater human rights and freedoms of expression. Khomeini however, had stipulated for the experiment in modern Islamic society to take place within extremely strict religious and social guidelines, allowing for little real criticism of either the theocratic nature of the leadership nor of the religious interpretations of order. The clampdown by the security forces on a group of student demonstrators who had expected Khatami's protection proved that resisting the system without sufficient support at the top can be extremely dangerous.

Interest groups

The E'tala'at – or more correctly, the Vezarat-e E'tala'at va Amniyat-e Keshvar (VEVAK) – is the core of the Ministry of Intelligence and Security (MOIS), also known as the Ministry of Information. It was created after the revolution from the remnants of the Shah's notorious SAVAK and is now linked to the IRGC. Reformed by Hashemi Rafsanjani, it is now a full-blown ministry that is, in effect, controlled by the Supreme Leader and not by the president, despite the fact that the latter appoints a minister who holds formal control. The VEVAK is effectively above the law and thus can use any techniques it wishes to achieve its objectives, including torture, sexual abuse and ill-treatment as well as extra-judicial execution. It also operates the Herasat, a system of monitoring and control of public morality and political orthodoxy in public and educational institutions.

Consent to democratic norms

Widespread volatility does not threaten the Iranian social fabric. Save for the student demonstrations under Khatami, there have not been significant uprisings or other mass political expressions of discontent (although sporadic popular outbursts occur and are usually suppressed harshly). The population as a whole seems satisfied to exercise its voice through the ballot box. Iran has had over 20 national and local elections in the last two decades and the electoral cycle – for the presidency, the parliament or the other elected councils of the republic – take place with regularity. There is a transparent transfer of power at the executive and legislative levels, since established rules and regulations govern elections and the electoral process. Election results are rarely violently contested (nor have international observers suggested that there is significant fraud) and the elite seems content to accept the will of the people, even in the face of surprise triumphs such as Khatami's, and perhaps even Ahmadinejad's. Although the state machinery has controlled electoral menu has to some extent, the candidates that have surfaced have spoken to the people's concerns.

Associational activities

II. Market Economy

Iran's economy is constitutionally mandated as centralized and managed, with the vast majority (80%) of industry, banking, transportation, communication and energy functioning as nationalized entities. Defying critics, Iran's economy has grown at a steady 4.5% year after year. In addition, in July 2006, the Supreme Leader called for a sweeping privatization program that if implemented would fundamentally alter the structure of Iran's current economy. In early February 2007, Ahmadinejad presented a budget that emphasized a reduction in the vast government subsidies on imported petrol, a reduction in oil-export revenue dependence and announced that "justice credits," that is, privatized company shares for Iran's poor, had already begun to be dispersed. Nonetheless, although the figures for Iran's performance appear superficially healthy, structural constraints on fiscal policy, lack of sufficient foreign investment in the oil sector and increasing rates of domestic consumption of subsidized petrol suggest that harder times lie ahead. Increased U.S. pressure to widen the sanctions against Iran will exacerbate the situation, as these sanctions could cut into needed foreign investment and reduce oil export income. To prepare for this eventuality, Iran has taken steps recently to shift from dollar to euro-based transactions. It has also softened its bargaining position concerning oil-partnering to accept both buy-back options and possibly joint-exploration deals.

6 | Level of Socioeconomic Development

Iran is in the process of moving from a rural- to an urban-based economy. Government investment in population infrastructure has been high, and the Human Development Index has gradually been rising, although it remains classified in the "Lower-Middle" range. Despite the enormous surge in population in the first decade following the revolution, literacy rates are the highest in the Middle East, with UNICEF's figures putting it at 80.4% for all over six years old (85.1% for men, 76.5% for women). Additionally, the school enrollment ratio stands at 97%, with girls and boys about equal. The Iranian population's enormous gains in educational status owe to massive government investment in public education, which constitutes 45% on average of its social affairs budget since 1989. More girls than boys are graduating from university, with parents stating that they are now more comfortable sending their daughters to university in a society protected by Muslim norms and rules. Health care has also seen notable improvement, particularly since the Iran-Iraq war. Life expectancy rates at birth in 2005 stood at 77%, 90% of births are attended by professional caretakers, and over 90% of the population is immunized.

Socioeconomic
barriers

Nonetheless, disparities in income distribution are severe, and are more marked in rural than urban areas. Drug usage is among the highest in the region, and malnutrition continues to pose an intractable challenge. Exact figures for the portion of the population that lies under the poverty line remains elusive; UNICEF places it at 18% with the caveat that over 16.5 million people can be viewed as poor (the World Bank claims a much lower figure of 8 million). Unemployment is high, and has been growing at 4% a year, partly due to large numbers of women joining the work force, and partly due to the demographic explosion which took place after the revolution and is now coming of age. It is estimated that 700,000 jobs need to be created annually to keep pace until the bubble subsides. Interestingly, World Bank statistics show that the unemployment rate has fallen since 2004 from 14% to 11.2% due to private investment, strong output growth, and employment initiative schemes. Population growth has meanwhile dropped dramatically: from 3.7% in the 1980s to 1.4% today. The Fourth Five Year Plan has endorsed a qualitative restructuring to move towards a knowledge economy, that is, greater emphasis on ICT exposure and investment in technology. The most recent HDI places Iran's ICT skill levels below the median, though it has for several years rated its innovation ability at well above the median.

Economic indicators		2002	2003	2004	2005
GDP	\$ mn.	116,421	135,410	163,227	189,784
Growth of GDP	%	7.5	7.1	5.1	4.4
Inflation (CPI)	%	14.3	16.5	14.8	13.4
Unemployment	%	12.8	11.6	-	-
Foreign direct investment	% of GDP	0.5	0.4	0.1	0.0
Export growth	%	8.3	11.2	-0.8	-13.2
Import growth	%	23.3	23.9	13.9	-13.2
Current account balance	\$ mn.	-	-	-	-
Public debt	\$ mn.	6,604.0	8,933.4	9,984.9	10,492.5
External debt	\$ mn.	8,900.0	13,912.1	20,356.1	21,259.5
External debt service	% of GNI	1.3	1.3	1.3	1.3
Cash surplus or deficit	% of GDP	0.7	1.6	4.1	7.4

		2002	2003	2004	2005
Tax Revenue	% of GDP	5.5	5.9	6	7.9
Government consumption	% of GDP	12.8	12.1	11.4	12.2
Public expnd. on edu.	% of GDP	5.0	4.8	4.7	4.7
Public expnd. on health	% of GDP	2.4	3.3	3.2	-
R&D expenditure	% of GDP	-	-	0.7	-
Military expenditure	% of GDP	3.8	4.4	3.8	5.8

Sources: The World Bank, World Development Indicators 2007 | UNESCO Institute for Statistics | Stockholm International Peace Research Institute (SIPRI), Yearbook: Armaments, Disarmament and International Security

7 | Organization of the Market and Competition

7.1 The constitution places all “strategic” sectors of the economy in the hands of the state, thus removing large chunks of the Iranian economy from the market. Additionally, large religious endowments called bonyads act as virtual monopolies, managing vast financial and business holdings in both the private and public sectors, employing large numbers of people and acting as an important revenue stream for the government and its leading cadre. Finally, there is the informal economy, which infiltrates society from the bottom to the very top. Informal or no, such quasi-governmental structures as the Revolutionary Guard Corp., the senior clerical class (such as the Rafsanjani family network) and the intelligence services dominate its operations.

Market-based competition

Privatization and trade liberalization were begun in 1988 during the Hashemi-Rafsanjani presidency, and have continued with varying degrees of success. Originally conceived as an effort to shrink the size of the government by outsourcing contracts to private enterprises, the result was in fact to create a class of oligarchs that bridges business and politics and runs enormous conglomerates, often in association with the bonyads. Commonly referred to as the aqazadeh, literally, “offspring of notables,” they are active in retail, construction and telecommunications to name a few, often in collaboration with foreign corporations as well as through the more shadowy informal economy. They have played a key role in subverting sanction regimes, as they illegally import goods using what have been dubbed “invisible piers” along the Persian Gulf Coast, and have thereby turned the import of sanctioned goods into a revenue stream for the ruling elite.

Anti-monopoly policy

The oligarchal elite is engaged in joint ventures with international corporations; however, few of these corporations are integrating production in Iran into their global market networks but are instead investing to ensure their presence in Iran at the moment when its market opens up. The close association of the clerical conservatives with these joint ventures has strengthened their appreciation not only for the private sector but also for its linkage to global corporate interests. This accounts for the increasingly “pragmatist” focus on economic rather than political reform. Nonetheless, the result has been that trade liberalization, although a priority, has only truly benefited large institutions and corporations, although the Bazaar (the age-old association of businessmen and religious officials) – if to a lesser degree – is also a beneficiary. Furthermore, as conditions for international economic interaction toughen, the financing of trade deals becomes more expensive, particularly in light of Iran’s dispute with the United Nations Security Council and particularly the United States over its nuclear program. Meanwhile, movement has begun toward a serious privatization program, with plans to privatize 80% of all industry and manufacturing with the exception of the oil and gas industries, key banks, the Civil Aviation Organization and the Ports and Shipping Organization. It is expected, however, that only 35% of all private shares will actually be available for flotation, as 40% will likely be distributed to cooperatives and as “justice shares” to the poor, while another 5% is expected to be offered directly to company employees. As a result, the program may not deliver the level of private investment and control that would make the buy-up of shares sufficiently attractive for the general public. To ease the legal framework for privatization, Article 44 of the constitution has been amended to allow the privatization of some of the so-called “strategic sectors.” This has been more effective in the financial sector than in the commercial sector. Four private banks have been established over the past two years. Confidence in their performance was boosted by the flexibility they were given to set lending and deposit rates and credit allocation, which set the stage for further private sector activity. Meanwhile, in 2003, four private insurance companies were licensed, and two more are in the pipeline.

Liberalization of
foreign trade

The banking and the financial sector underwent both internal and external deregulation under the administration of President Khatami. His government amended the law to allow for the establishment of private banks and insurance houses as well as a general deregulation of the financial sector. A handful of private banks were thus established in the early 2000s, and activity on the Tehran Bourse increased as a direct response to the liberalization of the financial sector, which is constitutionally required to be in the hands of the state. However, under President Ahmadinejad private banking has fallen out of favor and as a consequence the number of operating private banks is likely to fall to as few as two or three in the next two years.

Banking system

8 | Currency and Price Stability

The central bank, Bank Markazi, put the inflation rate at 11.5% at the end of 2006. A freeze on prices of staple goods and services was instituted in 2004 and remains in force, which keeps the inflation rate lower than might otherwise be the case. Nonetheless, prices appear to be rising at a greater rate than the central bank has admitted. This is a more likely scenario now than in previous years, as President Ahmadinejad recently brought the central bank under executive control in what has been described as a “bank coup.” This was motivated in part by his desire to set a lower lending rate at 14%, which bank officials had rejected for the more realistic 16%. Heavy government expenditure, which has poured oil money into the economy for the political expediency of fulfilling election promises, has been largely responsible for the rise in inflation, and has drawn strong condemnation of Ahmadinejad’s economic performance from both the media and members of the majles. As inflationary pressures are expected to remain high in the near future, interest rates are unlikely to drop. The currency has remained markedly steady against the dollar, moving down only slightly since 2005, from 9.026 to the dollar, to 9.2 to the dollar in 2006. Movement against the euro was slightly more significant: from 10.7 to 13.5 in the same period. The gradual shift in currency reserves from the dollar to the euro was made official this year by the Bank Markazi, which stated that Iran was reducing the conduct of business in dollars to a minimum, not least to offset the U.S. sanctions effects. As a result, euro holdings rose as foreign currency investments reached an estimated equivalent of \$30 billion in 2006. Net foreign assets in April 2006 stood at the equivalent of \$35 billion. Iran claims that 57% of its income from 2.4 mb/d was received in euros in 2006.

Anti-inflation /
forex policy

In an effort to boost economic activity and drag Iran out of the war economy structures of the 1980s the administration of President Hashemi-Rafsanjani had little choice but to compensate for domestic capital shortfall through foreign borrowing. Thus during his administration Iran’s foreign debt grew from under \$1.0 billion to more than \$24 billion. But the Khatami administration made the repayment of this debt one of its priorities, a strategy that also enjoyed the support of the IMF. By 2005, therefore, Iran’s foreign debt had fallen to below \$5 billion. Today, as Iran is enjoying unprecedented oil income of over \$40 billion per year its government is keen to wipe the slate clean and reduced Iran’s foreign debt to near zero.

Macrostability

9 | Private Property

Private property is legally protected in Iran. Except for a brief period after the revolution when businesses and properties belonging to the old monarchical elite

Property rights

were transferred to the bonyads, the government has respected the right of private ownership. The Bazaar, small business and family-run businesses constitute 90% of the industry and service sectors in Iran, with the majority funded from private savings rather than government mandated small-business loans or programs. Although there is significant liquidity in the economy, loans to private businesses are not well managed, and investment tends to be directed toward import and distribution rather than local production, plant modernization and internal innovation. This has left the mid-level business sector suffering from a low productivity rate. In 2006, over 250 industrial townships were established with government funding to improve the cooperation between mid-size and large industrial enterprises.

The private real-estate market has been booming, with prices soaring in a seller's market. Because of the price freeze on staple goods, money has gone elsewhere and frequently into property. This has also owed to the monetary growth spurt, estimated by the Bank Markazi to be in the vicinity of \$35 million, as well as to a new government housing loan program making \$12,000 available to every family. In any event, prices on property have increased by 40% over 2005, and may rise to 50% by the end of fiscal 2007. Additionally, Iran offers several destination travel sites, particularly along the tropical Caspian Coast, which have become hot vacation spots for Gulf Arabs seeking to avoid the prejudice and unsettling anti-terrorist security measures at European locations. There has been an increase in prices because Iran is easy to reach by air, conforms to similar social and religious mores (particularly as regards the conduct of women on the beach) and offers appealing properties for sale.

Private
enterprise

10 | Welfare Regime

The revolution's economic ideal, designed by the Republic's first president Bani-Sadr, was to enable Iran to operate as a vast charitable organization, thus justifying the seizure of elitist properties, the nationalization of all industries and the development of the large charitable bonyads. This approach fed into the Khomeini ideology of the state as an integrated and supportive community, the product of a temporal and divine partnership that rules and protects its people. This is a common Islamic view; one sees such social and charitable services offered by political and often militant Islamic groups throughout the Middle East, particularly in "societies of suffering" – which Khomeini viewed Iran to be under the Shah. However, it took on added resonance after the Iran-Iraq war, when war veterans and families of "martyrs" flooded Iran. The government is spending 10% of its budget on subsidies, most of which are geared to the poor, save for the significant subsidy on petrol. In a speech in January, Ahmadinejad revealed the total had reached \$15 billion in 2006.

Social safety nets

Young graduates will argue that equality of opportunity is a myth in Iran and that securing employment is as hard a task as getting a degree. But in principle equality of opportunity does exist and individuals and communities do have access to employment. One of the interesting areas of change is women's rights. Women are fighting a rearguard action to win back rights taken away in the 1980s and are also constantly fighting for new rights. The Ahmadinejad administration has promised to address the problem of uneven income distribution by dispersing some of the excess oil income to the needy social groups and classes. With around 800,000 youth joining the job market every year it is hard to see how such populist measures can address the root causes of the lack of opportunity, or indeed address the vast wealth gap in the country.

Equal opportunity

11 | Economic Performance

In 2002/03 real output grew by 7.4 %, the highest growth in the region, and the non-oil sector grew at 7.8 %, with increasing momentum in investment, which reached 40% of GDP, and private-sector activities, particularly in constructions and manufacturing. This high growth performance can be attributed partly to the private sector's growing confidence following the progress made in structural reforms. Higher than expected oil prices and expansionary fiscal and monetary policies have likewise contributed to this growth. The government's fiscal policy stance improved in fiscal 2003/4 (the most recent year for which the World Bank has figures), going from a deficit of 2.4% of GDP in 2002/03 to 0.2% of GDP. This came as the result of expenditure cuts, particularly capital expenditures. On the other hand, the government continues to use trade blacklists and import restrictions on certain countries. This technique of mixing economics with politics was inherited from the Khatami years when trade with Britain, South Korea, Argentina and the Czech Republic (among others) was interrupted because of a human rights stance those countries took in the United Nations in 2004.

Output strength

12 | Sustainability

Iran has been classified as 117th of 133 nations in environmental degradation by the U.N. Environmental Program. Its rapid population growth in the 1980s and 1990s (from around 32 million inhabitants to around 70 million in two decades) has put a severe strain on the infrastructure of the country, particularly as rapid population growth has been accompanied by rapid urbanization. It suffers severe traffic congestion in its major cities and, because of its continued use of leaded petrol and its very high proportion of old cars, the level of air pollution is significant. This is compounded by vast urban sprawl, particularly in the capital of Tehran, which, according to the most recent census data from 2002 has a

Environmental policy

population of 12 million living in its metropolitan area and suburbs. Lack of adequate wastewater and disposal systems contribute to ground and surface water pollution. However, the municipal government has been accusing buses and other public transport for excessive natural gas usage. Likewise, a pollution control plan has been put into effect with the help of the UNEP not only for Tehran but also for six other municipal centers. Deforestation has altered the landscape in the drier reaches of the country, where floods have become an increasingly serious problem. Pollution in the Caspian Sea, primarily generated by industrial waste and runoff by the ex-Soviet states around its northern perimeters, have contributed to a drop in sturgeon production and thus the famous Persian caviar. A similar problem has developed on the Gulf Coast, directly related to the vast oil and petrochemical industries and the burgeoning nuclear industry, which are putting severe strain on the water quality and marine life there. Additionally, the rush to create hydropower stations on the major rivers of the country has resulted in grave environmental impact and has been associated with creeping desertification.

Iran has a healthy reservoir of scientists and research organizations to explore in particular the environmental problems of the country and some of these bodies have been at the forefront in producing scientifically derived reports on development and the environment. Sadly, the vast government machinery seems to have been unable to respond to the country's recognized challenges in a coherent and systematic fashion. Education and training opportunities are also plentiful with a growing army of youth interested to make environmental management their chosen career, but the field is still a new one and not yet embedded.

Education policy
/ R&D

Transformation Management

I. Level of Difficulty

The factional domination of the institutional framework of the state means that the political leadership will continue to use institutions as vehicles for promotion of their narrow interests. The Supreme Leader has a key role to play in mediating rivalries and containing the fallout from the factional battles that characterize the system. However, his open association with the traditional conservative factions in the power elite has diluted his ability to successfully chart a neutral path between the factions. The direct result of this system is that the executive branch is never able to pursue its agenda free of interference. It cannot, in short, govern unhindered. So far, not a single president has managed to present a balanced budget to the majles. Ahmadinejad's record in this regard has been particularly dire: he has elicited protests from the majles, which takes its budget review responsibilities very seriously. In an unparalleled move, the president was sent a letter in early 2007 signed by 150 members condemning his choices and demanding significant revision. Finally, there is the constant tension of reconciling modernization with religious and traditional practices.

Structural constraints

Civil society, though not advanced, remains rooted in the traditional structures of Iranian social and religious organization with its focus primarily on family and tribal ties, religious pilgrimage and schools. Iranian society is differently structured than that in Western countries. For example, many religiously motivated organizations in Iran have similar social roles and civic purposes as "civic" ones do in the West. Furthermore, Iran has vibrant arts and sports fields; its film industry in particular is innovative and internationally recognized despite morality restrictions at home. Developing a stronger civil society will come slowly, since it faces the dual obstacles of social tradition and the government's ineffective social management. Finally, the media, though a large portion is state-controlled, maintains a lively ability to comment on and criticize the government and other aspects of society. Although it has regularly been purged and reduced for political reasons, it has rebounded each time.

Civil society traditions

Iran is a truly multi-ethnic country with a number of recognized religious communities (Christians, Jews, Sunni Muslims and Zoroastrians) and ethnic

Conflict intensity

groups. Typically, its ethnic minorities inhabit many of its borderlands, thus giving their presence a strategic dimension. Tensions between the ethnic minorities and the center have at time reached a boiling point, particularly in the south among the Khuzestan Arabs and in the west among the Kurds and the Azeris. Over the past three years, bombs have gone off in centers near the oil fields, which the government has accused the British presence across the border in Basra of instigating. The Kurds and Azeris, meanwhile, have both been exposed to significant influences across their borders due to U.S. presence. The growing autonomy of the Iraqi Kurds has inspired the leader of the Iranian Kurdish Democratic Party to speak out after many years of reticence and call for regime change in Tehran. Demonstrations have taken place in both regions demanding better human rights treatment, though not independence. Perhaps the most difficult area to manage is the eastern border with Afghanistan and Pakistan, where the Baluchi tribe is involved in high levels of narcotics trading and smuggling and where the U.S. government supports low level anti-regime terrorism. The Iranian government takes the drug situation sufficiently seriously that it has begun to build a wall to make patrolling and apprehension more effective and less dangerous for its border guards.

II. Management Performance

The study of political science deems incipient democracies as highly volatile, and Iran is no exception. The innovative character of each elected government has caused internal tension and jockeying, although the nature of each has varied. Not only have new political and economic ideologies been introduced at each stage, but also a shuffling of the power elite has introduced new management styles, changes in Iran's international image-making and shifts in economic emphasis – adjustments that government more mature than the relatively young Islamic Republic could make with greater ease. Mismanagement has generally characterized all the post-Iran-Iraq war administrations, primarily because the government still lacks a professional bureaucracy. Additionally, the parallel nature of the state structure, in which the Supreme Leader's Office is responsible for key institutions such as the military and the judiciary while at the same time taking over management of the intelligence service, foreign policy and domestic order, creates severe duplication and confusion. This produces a system that lacks transparency and defies analysis.

14 | Steering Capability

No single government since 1989 has been able to pursue its objectives. By extension, no government has been able to achieve the goals it has set itself at the time of taking office. Governments have consistently set policy goals and clear objectives for their term in office, which are not only presented in the public domain but are also scrupulously scrutinized by the elected parliament. These successive government failures could owe to the overambitious nature of the targets set. Successive administrations have at the very least managed to articulate their aspirations for the country and have set transparent short-term and long-term (that is to say strategic) targets. While reform was the main priority of the Hashemi-Rafsanjani and Khatami administrations, the political and institutional obstacles they faced in delivering their programs revealed the structural problems within the governance system. Both presidents had a clear mandate from the electorate to push through wide-ranging reforms – social, economic and political – at different cycles of their tenure, but were frustrated in doing so because of the blockages in the system and the control of crucial instruments of power by competing factions. Building consensus in this kind of environment is practically impossible.

Prioritization

The Khatami administration was committed both to democracy and to a market-based economy. But his inability to fully deliver on these commitments left the population skeptical and weary of any new promises of a better future by the political leadership. Discontent and disillusionment with his failures were such that in June 2005 the same electorate that had turned out in its many million to vote for him twice before almost completely abandoned the reformist candidates in the presidential race and threw their weight behind Ahmadinejad, an unknown neoconservative figure who not only did not promise reform or democracy, but actually stated that he would reverse the “liberal” policies introduced by his predecessor. Steering Iranian policy-making towards greater relaxation of state control is unlikely as long as pressure from the outside remains high and Khamenei retains power. Khamenei’s success in steering around the reformist agenda of Khatami implied an acute understanding of how to distribute power among the government organs (the Supreme Leader and legislative, executive and judicial branches), as well as a clear vision of what Khatami meant by “Islamic Civil Society.” Untarnished by the corruption that hangs about Rafsanjani, Ahmadinejad promised to work within the system for greater economic return and to steer the country back to the self-sufficiency and Islamic purity that had defined revolutionary values. In that spirit, he emphasized programs for the poor and a foreign policy that eschewed international in favor of regional strategies. Though his personal approach has caused consternation at the top levels, his strong ideological agenda has served to force the Rafsanjani

Implementation

and Khatami camps to focus and cooperate, thereby enabling them to find unprecedented common ground. This pragmatic synthesis, carrying both reformist and rational trends back into government and contingent on Islamic/theocratic adjustment rather than threatening secular democratic thinking looks to offer everyone a solution, even the more pragmatist hardliners. Such pragmatic convergence at the top also has significant implications for the international front, namely steering the country out of the nuclear stalemate. As Khatami and Rafsanjani, as well as the Supreme Leader, have already publicly mooted statements made by Ahmadinejad, it would appear that they anticipated the way the government would handle the issue.

The Iranian political class is very astute and fully aware of the system's constraints and opportunities. This astuteness has thus far resulted in policy decisions being derived through a pragmatic and need-based approach. Some compromises have been better than others, but compromise has been the essence of policy-making. Since 2005 however, the consensus-driven approach has been shelved in favor of a much more doctrinaire one. The removal of large groups of public servants in various ministries since 2005, purportedly for their liberal-leaning tendencies and affiliation to the Khatami camp, has resulted in the erosion of the basis of pragmatic problem-solving. This in turn has increased the pressure on the Supreme Leader to intervene more frequently than he might have wished in daily affairs of the state. The lesson learned by this administration is that talk of reform and democracy are destabilizing the republic and threatening the regime. Integration with the international community, détente and compromise with the West are seen today as impractical and unnecessary solutions to Iran's problems. Instead, the political leadership has concluded that Iran should engage with the rest of the world from a position of strength and compromise only if it is confident that none of its vital interests are likely to be forfeited in the process.

Policy learning

15 | Resource Efficiency

Oil has masked massive inefficiencies in Iran and has failed to act as the driver of the economy, since its presence has allowed state support and subsidies to carry inefficient industries. The extra cash injected into the economy has encouraged speculative activities and diverted capital away from production to real estate speculation and the ballooning services industries. Besides hydrocarbons, Iran is rich in mineral resources, agriculture and fisheries. Apart from agriculture, which through subsidies has been a priority sector for the economy since the revolution, the natural resources of the country are not being efficiently exploited. And even in the realm of agriculture Iran has been a net importer of foodstuffs in recent years. Iran's vast and highly motivated human

Efficient use of assets

capital is not being fully exploited either. With high unemployment and the mass exodus of trained individuals abroad this precious asset of the country is going to waste. In 2006, for example, the parliament estimated that emigration has reached such a level that Iran now transfers overseas the equivalent of \$10 billion worth of workers a year, which is equivalent to all of Iran's annual non-oil exports. Under President Khatami the government was able to generate around 300,000 jobs a year of the 800,000 a year needed for a stable job market; in early 2007 that figure has dropped significantly as economic activity has slowed in response to the populist and controversial policies of the Ahmadinejad administration.

The current government has been unable to formulate and follow a clear set of policy objectives. Furthermore, in the wake of cabinet changes and disputes with Parliament in summer/autumn 2005 over the nomination of four key ministers, the new government took office with the very clear danger of policy drift. Resolution of this dispute has not removed the tensions between the legislature and the executive, even though the conservative factions of the republic now dominate both. The cabinet is largely inexperienced and this is the first time that an incoming government has sidestepped all existing and experienced ministers in favor of new faces. This clean sweep has come with a price: the inability to produce innovative policies and strategies.

Policy coordination

Iran has a poor record for tackling corruption, now rife at every level of the public sector, which results in massive waste and skews population income distribution. At the same time, Iran has a staggeringly large prison system, and a total prison population of some 600,000 or a ratio of around 850 prisoners per 100,000 population, against the international average of 10 to 15 per 100,000. The number of prisoners has increased rapidly in the past years, despite the apparent reformist trend under Khatami. U.N. statistics have marked a 40% rise since 1999. The prisons are now housing more than 100,000 inmates beyond capacity and as a consequence, pressure to use more Shari'ah punishments, which favor greater reliance on corporal punishment and the death penalty over imprisonment, has gained prevalence. This constitutes a serious loss of human resource capacity, and even the state's inadequate care costs it dearly.

Anti-corruption policy

16 | Consensus-Building

There is little agreement among the political elite about the desirability of a free market economy or democracy. While some members of the factions believe in a market economy others in the same faction may prefer a more controlled economic system. On democracy also, Khatami's remains one of the few voices that continue to call for the strengthening of his so-called "Islamic democracy." President Ahmadinejad of course believes that this is a contradiction in terms,

Consensus on goals

i.e. that Islam is in essence far superior to democracy and that the two must not be blended. Similar semantic and ideological ambiguities permeate the entire reform agenda.

The electoral process has affected the delicate balance of debate and power between the various factions in the country. At present, there is little room for compromise between the competing pro-reform and anti-reform camps, particularly as the latter now dominate the executive and the legislative wings of government. Prospects for reform are thus thin, given the political makeup of the current administration. The manner in which Khamenei has absorbed each successive leader into the fold of top government is becoming clearer today. He engages and encourages the ongoing political activity of reformist leader Khatami as much as that of economic pragmatist Rafsanjani and lay intellectuals as varied as the ideologically combatant Ahmadinejad, the urbane but still revolutionary previous Foreign Minister Velayati and the reformist speaker of the majles under the Khatami presidency, Mehdi Kerroubi. Not only has Khamenei incorporated these and other diverse voices into official positions, but they also act as a form of shadow cabinet (along with hardliner Ayatollah Mesbah-Yazdi) to the Supreme Leader. Although not much is known about Khamenei's exact methods, the Khomeini approach was to allow conflicting voices to be heard and in effect shake the controls of government from side to side until the competing voices themselves found common ground. He thus rarely intervened with a definitive pronouncement—which appears similar in the case of Khamenei.

Anti-democratic veto actors

Factional politics have the hallmark of the Islamic Republic and all the contenders tend to accept the red lines of the system, and therefore normally operate within them. Rarely do cleavages escalate into open conflict, but the supporters of the various factions have been known to indulge in occasional street fighting at times of high tension. Given the highly factionalized nature of the system it is quite remarkable that the cleavages are so well managed. However at the moment Iran appears to be at an important juncture. Three radically different presidents appealing to diverse but equally expressive constituencies are active in the government as well as in the process of building a consensus around significant issues, including the structure and internal political nature of the Islamic Republic, foreign policy (particularly in relation to the nuclear issue and Iraq) and economic liberalization. The provincial council elections at the end of 2006 illustrated the success of the opposition factions in working together. For the first time, Khatami, Kerroubi and Rafsanjani consolidated their candidate lists, a move that not only earned their respective supporters a larger share of seats, but also put the three men on the front page of the papers in a show of unity. What is more, the opposition's convergence played off rifts that had already developed in President Ahmadinejad's

Cleavage / conflict management

Abadgaran party, with members previously supporting his line prone to split off, while at the same time managed to reel in hardline conservatives disillusioned with the president's high spending, judicious contracts to sectional interests and risky foreign posturing.

The current political leadership is distinctly disinterested in civil society and its activities and has made it harder for such organizations to be set up and for existing ones to function without fear of closure and arrest.

Civil society participation

There exists no system for the government to address past injustices, or even to recognize past abuses as such.

Reconciliation

17 | International Cooperation

Unlike its predecessor, whose instinct was to work with the international community, the current administration is keen to distance Iran from cooperative structures. When it comes to reform issues and the country's development agenda, the government has little interest in seeking external ties. Although Iran remains a member of virtually every significant international body it is not at present engaging with them. It is locked in a major dispute with the UNSC and the IAEA over its nuclear program and uranium enrichment facilities, and seems to have no active links beyond this. It does however regard the Islamic Conference Organization to be an important multilateral forum and is keen to strengthen its links with this group of Muslim countries.

Effective use of support

At present the Iranian government's credibility is low and the president's repeated denial of the Holocaust and anti-Israel statements have placed a wide wedge between Iran (and also non-state Iranian institutions) and the West. On the other hand, Iran also wants to keep on good terms with as many of its Muslim and Asian neighbors as possible and seems committed to mutual dialogue with them.

Credibility

Iran's closest ally in the Arab world is Syria. This closeness owes more to the two countries' shared border with Iraq (a position of shared discomfort they occupied during the Saddam era as well as now) and censure by the West than to any inherent similarities of political outlook. In 2006, the war between Hezbollah and Israel spotlighted Iran as a significant player in the Levant, and one poised to shift winning hands, as the change in Saudi support for Hezbollah revealed. Iran's outspoken president in fact has been an important contributor to its rising reputation not only in the "Shi'i crescent," but among modern Sunnis dedicated to finding alternatives to the Western-supported dictatorships that surround Iran. Iran maintains close links with Turkey, with which it shares common concerns over the Kurdish areas. Its relationship with Afghanistan

Regional cooperation

meanwhile is tentative, primarily because the latter must take care not to antagonize its major benefactor, the United States. Iran, however, has made good on its promises to provide funding for roads and reconstruction, particularly in the vicinity of Kandahar. Iran remains watchful of events in Iraq, where significant portions of the Shi'i community leadership depended on Iran during the Saddam years and where close links continue – especially informally – with various factions within Iran's own Hydra-like government. Iran has often reiterated that it seeks the establishment of a stable government that promotes the Shi'i agenda without needing to dominate that agenda. It has also kept communication open with Iraq's Sunni leadership. The Iraqi situation poses a conundrum for Iran, namely in that civil strife on one's borders always carries costs. This is particularly true along a frontier that is volatile even in the best of times, especially the key waterway of the Shatt-al Arab. Moreover, Iran's nuclear program concerns virtually all of its neighbors. None want to see another U.S.-instigated war in the region, but nor do they cherish the prospects of a nuclear Iran on their doorsteps.

Strategic Outlook

The Ahmadinejad administration has increasingly needed to tone down its rhetoric or face pre-emptive moves by the Supreme Leader to soften Iran's stance on the nuclear issue. At the same time, opposition figures and the population at large are building toward a consensus concerning how to adjust the Islamic Republic from within and achieve its social democratic goals. New government reforms of its regulatory framework to build international confidence in investment security, for example, indicate Tehran's awareness that it must improve its image in the global financial community. This comes at a time when U.S. economic pressure on Iran is rising, not just because of the nuclear dispute, but because of American concerns over Iran's strategic clout both in Iraq and in other subversive groups such as Hezbollah. It is perhaps ironic that at a moment when Iran is making great strides to improve internal political clarity, foreign powers are ratcheting up external economic pressures. This will most unfortunately shackle Iran's economic ability to address the need for rapid employment expansion to accommodate the post-revolution baby boom. However, if Iran could open up to greater international corporate investment, its vast labor trove would make it a highly attractive and profitable site for joint ventures and foreign business activity. As a final note, it is worth observing that Iran's government is currently secure from domestic challenge and protected from outside shock. Today, it is enjoying a revival of missionary zeal that is resonating throughout the Muslim World. In fact, Iran has gained a greater level of national prestige than it had prior to the American adventures in the region from 2001 onward, and it is benefiting from an upsurge in the Muslim World against Westernism and Sunni extremism represented by the Salafi advocates within the al-Qaeda movement. This popularity is balanced by its negative reputation in the West and by the misgivings of its neighbors concerning not only its influence over Iraq but also its nuclear activity.