An Evaluation of Iran's First Development Plan

by Hooshang Amirahmadi

With the end of the Iran-Iraq war, as Iran entered the second decade of the revolution, the country had a chance to focus again on political and economic development. Crucial items on the government's agenda included reconstruction and a general improvement of the quality of life of the Iranian people. Iran sought to concentrate on medium-term development programs, to balance the short-term needs of its people against the nation's long-term interests. It was against this background that planners developed the first five-year plan for political, economic, social and cultural development, covering 1989 to 1993.[1]

An evaluation of the first plan in terms of both its positive and negative results can help pinpoint the strengths and weaknesses of the plan and shed light upon policy errors made by the Republic's leaders.

The First Plan

Iran's first development plan involved assumptions concerning the country's economic and political situation. Among the assumed economic ailments were:

- the economy's heavy dependency on fluctuating (and falling) oil revenues;
- sharp decreases in domestic production and per-capita income;
- inefficient use of the country's production capabilities, especially in the industrial sector;
- a rise in government spending, due to the war effort, economic subsidies, and a bloated bureaucracy;
- huge budget deficits coupled with high rates of liquidity in the private sector;
- negligible government revenue from taxation;
- sharp inequalities in income distribution and wealth;
- galloping inflation;
- low levels of investment and low rates of return;
- high population growth rates and high levels of unemployment;
- acute shortages in infrastructure, education, health and housing; and,
- inappropriate geographic distribution of facilities and development activities.[2]

The first plan essentially was conceived to create structural improvements in the nation's economic condition. It was intended to reverse then-current economic trends and achieve balanced growth in various sectors. The

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First Development Plan

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planners hoped to realize these goals through a package of oil revenues, foreign aid, mobilization of domestic economic resources, removal of infrastructural obstacles, and support of the private sector. In this vein, they adopted supply-side economics, striving to increase production (the Iran-Iraq war had fostered commerce and speculation in real estate, foreign currency, and goods).

Alongside the main objective of accelerating economic growth, the first plan also pursued other objectives: upgrading defense capabilities; reconstructing war-devastated areas; diversifying the economy; expanding infrastructure; developing the industrial, mining, petroleum, natural

gas, agricultural, energy and telecommunications sectors; supporting higher education and research and improving medical care; pursuing an equitable distribution of resources and legal due process; reforming the administrative structure; and, finally, reorganizing the distribution of population and economic activity nationwide.

The plan's preoccupation with economic growth, however, led to neglect of other aspects of national development, even some originally within the plan's scope. Issues of social justice and legal due process, in particular, were relegated to the margins. Ultimately, the following areas got the emphasis:

- Fostering economic growth—As noted, economic growth was singled out as the most crucial objective of the first plan. Population growth and weak economic performance had resulted in sharp declines in per-capita income and a fall in living standards for the average Iranian household. To accomplish its main task, the plan sought to exploit the petroleum sector and underutilized resources, alleviate structural deficiencies, and introduce rational management. It therefore had to increase the ratio of total investment to gross domestic production, which had experienced sharp declines in the pre-plan period, and to control domestic consumption. The plan also sought to mobilize the private sector, whose financial resources were controlled by relatively few people and concentrated in nonproductive activities. It was also intended to attract foreign investment and aid in the industrial, petroleum, natural gas, and infrastructure sectors.
- Controlling population growth—It was considered vital to control population growth since rapid growth led to increased consumer demand and an unmanageable expansion of the labor force. By controlling population growth, the gap between supply and demand in goods and resources could be reduced, with a direct bearing on living standards and expanding investments in productive activities.
- Managing the budget deficit and inflation—The plan sought to strengthen the private sector's confidence in the government's economic policies and macrobudgetary structure by containing costs and expanding taxation as a source of government revenue. Controlling prices, restricting the money supply, and gathering idle liquidity, especially by rejuvenating the banking system, were thought to be ways to control inflation and alleviate hardships on the expanding indigent section of the population.
- Adopting import substitution and export promotion policies—Import substitution and export promotion were pursued simultaneously, both to diversify the economy and to reduce its dependence on foreign exchange earnings. Import substitution would reduce demand for imported consumer goods, thus curtailing demand for foreign exchange and reducing the economy's dependence on volatile oil revenue. The lack of such policies in the past, coupled with falling oil revenues, had pushed a considerable portion of the nation's economic capabilities into nonproductive sectors; its capital resources were employed in nonproductive activities with quick returns such as commerce and distribution, with a subsequent proliferation of middlemen.
- Optimizing resource exploitation and completion of unfinished projects—The plan's emphasis on utilizing present economic resources to their fullest capacity was triggered by low rates of return on public sector investments, as well as a realization that decreases in national revenue and variegated economic problems beset capital formation in productive sectors. Sheer numbers dictated the need for placing unfinished projects high on the agenda: stranded projects not only obviated a quick return on investment, but also meant added costs when they were eventually completed. Thus it was decided that new investments would be prohibited in the first plan period, and that resources would instead be diverted to completion of projects that would either help reduce dependency on foreign exchange or generate foreign currency income through export promotion. In this regard, steel and petrochemical projects were singled out.

Revisions to First Plan

While most economic plans are revised in their actual execution, in the case of Iran's first plan, the modifications were substantive and structural. The government adopted the various revisions discussed below while the plan was being implemented.[3]

• Although full utilization of current resources was one of the plan's main objectives, new investment projects were undertaken during the process of executing the plan. Mas'ud Rowghani-Zanjani, head of the Plan and Budget Organization, recently alluded to the number of hospital beds that had been added in the course of the first plan but had remained unutilized.[4] According to recent surveys, 11,000 new hospital beds were added from 1989 to 1992 (a 4.5-percent annual rate of increase); conversely, occupancy rates decreased in the same period. In addition, private hospitals are currently creating 25,000 new hospital beds. Not only did the utilization of current hospital beds remain unchanged, but also, in effect, additional unutilized hospital space was created. The point is that the old policy of quantitative, as opposed to qualitative, improvement remained in effect.

It is important to note that the number of projects envisaged during the course of the first plan far exceeded the government's financial capabilities,[5] illustrating the administrators' lack of conviction about maximizing exploitation of present resources. One of the prerequisites for optimal utilization of resources is a hierarchical ranking of unfinished projects, so that investments toward their completion would follow the government's priorities and financial capabilities. In this way, top priority projects would be the first completed. As a result, project completion times have been protracted and unnecessary costs incurred. Some projects never saw the light of day during the plan period and thus did not contribute to realization of the plan's objectives.

• Another revision occurred in the area of export promotion. The plan primarily emphasized import substitution, with export promotion deemed desirable only as an accompaniment. In fact, the plan sought first to contain

demand for foreign exchange and realize the nation's economic potential. Such strategies entail protection of domestic markets and government provision of foreign exchange for industries to enhance production of consumer goods and heavy machinery. In executing the plan, however, the government opted for export promotion over import substitution, and industries were expected to become self-sufficient regarding foreign exchange, mainly through exports. In addition, controls on imports were lifted, so the domestic market was flooded with foreign cars, household supplies, and other imported consumer goods. The government should instead have encouraged substitution by imposing stricter controls on imports, restricting them to products and heavy machinery that would be instrumental in boosting domestic production.[6]

- Yet another modification to the original plan involved the setting of a single exchange rate for foreign currencies and allowing their prices to float. Creating a single exchange rate has long been an important issue debated among government policymakers, and its creation is regarded as one of the major accomplishments of the first plan.[7] But the original plan did not call for a single exchange rate for foreign currencies, and so far as economic growth was concerned, it sought to utilize present industrial capacities while maintaining several rates of exchange. Fixing a single rate of exchange by no means reduces the importance of having a precise foreign currency budget, including rational expenditure of such currency. The first plan did not argue that the rates of exchange should be determined by supply and demand; instead, it required that the government adhere to a fixed currency budget.

- Rapid privatization was still another modification to the plan. The first plan sought to encourage private investment in the productive sectors and popular participation in decisionmaking regarding educational and cultural issues. The private sector was to assist with some of the hard economic tasks and thus alleviate the government's burdens. The cooperative sector was to grow considerably. In practice, however, conservative thinking in government circles was against expanding private participation in the economy. Industries and public services were arbitrarily offered for sale to the private sector, banks, and agencies affiliated with the government. While the private sector was not yet prepared for full-scale participation in the economic process, the government offered it factories to buy and manage. As an informed source said, pragmatist President Hashemi Rafsanjani's attempt to sell the nationalized industrial units to their ex-owners and other capitalists was criticized by Ayatollah Khamenei and the conservatives, so the government then decided to offer the industries to religious and loyal elements at better terms. Overall, privatization of government-owned services and industries did not follow a well-conceived plan, and rather than promoting development, it became an objective in itself. Consequently, privatization quickly strengthened the bazaar and those with strong government affiliations.

Evaluation of the First Plan

Three points should be made in any assessment of the first plan. First, the plan cannot be held responsible for all of Iran's economic ills. Devastation wrought by the war with Iraq, domestic power struggles, natural disasters, and political pressures by the international community are among the non-plan culprits in the country's economic and social malaise. On the other hand, there have also been positive developments that likewise cannot be attributed to the plan. An example is the significant success of efforts to control the population growth rate.

Second, any evaluation is necessarily limited to the plan's short-term effects, thus disregarding the time lag between the inception of policies and their final outcome. This delay is especially significant for structural projects. For instance, major investments in heavy industries, petrochemicals, steel and aluminum, telecommunications networks, and utilities will have effects in the long run. By the same token, several projects that bore fruit during the first plan period were in fact remnants of previous eras. The Mubarakeh steel plant is an example.

Third, it is necessary to consider microeconomic as well as macroeconomic developments in the period covered by the plan. Rather than dealing solely with the average growth rate of the economy in the period under discussion, annual rates should be emphasized. It then becomes clear that the initial phases of the plan were marked by significant growth, culminating in 1991. The downward spiral followed, as the plan was further diverted from its original premises.

The fluctuating performance, though, indicates the plan's failure in instituting stable, long-term trends in the economy. Moreover, the downward spiral is likely to plague the economy in the years to come. It can be argued that the economy's growth rate, however infinitesimal, was not caused by rational economic planning but by exogenous factors such as the increase in oil revenue as an aftermath of the Gulf War, and rapid injections of foreign aid into the economy. Indeed, the termination of the war, coupled with the first installments of loan repayments, completely reversed the growth cycle.

This article is based on figures released by the Plan and Budget Organization, which at times contradict those released by other government agencies. Statistics gathered by the Central Bank, traditionally a more reliable source, are backlogged for two years. Figures for 1993 come from various sources, including a major speech by the former Governor of the Central Bank.

Overall, the plan can claim a limited success in realizing its objectives, although its shortcomings hindered its effectiveness in providing social and economic change.

Population Growth Rate

Birth rates fell dramatically in the plan period. Prior to the plan, the population growth rate was 3.3 percent, which when compared with the rate of 3.9 percent (including emigration) for the decade from 1978 to 1988, indicates a decline in the 1980s. The plan aimed at continuing the downward trend, reducing the growth rate to 2.9 percent per year, to reach 2.3 percent by 2011. In the course of the plan, however, the rate fell to 2.2 percent. The Ministry of Health recently announced that the population growth rate had reached 1.8 percent per year.[8] The discrepancy of this figure and the previously announced rate of 2.4 percent for 1992 notwithstanding, the population is growing at a considerably slower rate.[9]

Contrary to the government's claims, however, falling

population growth rates are hardly attributable to successful family planning. The real explanations are dismal economic conditions and a general decline in living standards for the average Iranian household.[10]

Economic Growth

Economic growth, too, was positive in comparison to the pre-plan years. The first decade of the revolution saw a negative growth rate when measured in constant prices. Between 1977 and 1988, per capita income in real terms fell by almost 50 percent.[11] This trend was reversed by the implementation of the first plan (see table). According to government reports, GDP rose by an average rate of 7.2 percent per year in constant prices, slightly below the target rate of 8.1 percent.[12] With the fall in population growth rates, per capita production increased overall in this period. The increase did not lead to a rise in living standards, though, for it coincided with a sharp increase in the cost of living. In addition, the government, with its privatization campaign, passed on many of its socio-economic expenses to individual households. The government's policy of increasing revenue from taxes and tariffs pushed the cost of living even higher.

A sector-by-sector analysis of GDP shows positive growth as well, but not in line with the provisions of the first plan. For this period, average annual growth rates in constant values were significant in the utilities sector (electricity, water, natural gas): about 12.7 percent, compared to the plan's projections of 9.5 percent.

- ***Petroleum***. The petroleum sector grew at 8.7 percent, compared to the projected rate of 9.5 percent. The oil sector's positive performance was caused in part by the oil crisis following the Gulf War and cannot be primarily attributed to the plan. In addition, the oil sector grew only at the cost of nonconservationist extraction and a high waste ratio, both contrary to the plan's provisions.

- ***Agriculture***. The agricultural sector, too, experienced positive growth, although it was not evenly distributed among its subsectors. The sector's growth rate in this period approximated 90 percent of its projected targets. This partial success is particularly noteworthy considering that the agricultural sector employs about 22.5 percent of the country's labor force, contributes 22 percent of GDP, and 32 percent of non-oil exports, on a yearly basis.

- ***Industry and Mining***. The plan failed in the industrial and mining sectors, which were singled out for special performance with a targeted expansion rate of 15 percent per year, the highest of all sectors. Average annual growth of the two sectors, however, did not exceed 8.2 percent. The industrial sector is responsible for this dismal record: in fact, it grew at less than one percent per year in 1992 and 1993. In the first plan period, the industrial sector grew at an average rate of 7.6 percent a year, only 53 percent of its projected rate. Its growth fluctuated greatly until it stagnated in the plan's last two years. Its track record shows that not only did it suffer from intersectoral shortcomings, but also that a clear strategy for national industrial development was lacking. The sector's performance was adversely affected by policies such as economic liberalization, floating exchange rates, and unplanned facilitation of imports in the mid-plan period. Small and medium-size industries, which had previously enjoyed considerable growth under the government's protectionist policy, were especially hard hit.

In the mining sector, the average growth rate never exceeded 12.4 percent annually, although it was expected to reach 19.5 percent and be a major contributor to the nation's industrial development as well as to diversification of its export base. The main culprit here was inadequate planning. Privatization schemes failed as well. Considering that the sector accounted for 27 percent of jobs nationwide in 1992, its weak performance contributed considerable to the plan's overall failure to improve the social and economic situation in the country.

- ***Construction***. Construction was another ill-fated sector, failing to achieve even half its projected growth rate of 14.5 percent annually. With an estimated growth rate of 5.2 percent, construction fared the worst of the various sectors. This failure will inevitably create an acute housing shortage in the near future. Construction has the highest inter-sectoral linkage within the economy, and its stagnation reflects a poor overall economic performance. In addition, this sector provides the largest number of jobs for the lower classes, especially rural migrants, so its weakness also indicates high rates of unemployment, both seasonal and nonseasonal.

- ***Services***. The first plan was biased against the service sector, seeking to minimize its preponderant role in the economic life of the country. In actuality, however, the service sector outgrew its projected rate, except in 1989. It grew at an average annual rate of 7.4 percent for the plan period, exceeding the projected rate of 6.8 percent. Financial, monetary, and transportation subsectors grew the fastest. Their growth rates were not stable, however, declining in the plan's final years. Transportation, for instance, grew at a yearly rate of 22.4 percent in 1990, while it was down to 7.8 percent in 1993.

Investments

An important indicator in assessing the plan is the ratio of investments to GDP. The plan envisaged an average annual growth rate of 19.7 percent for this indicator, but its actual rate in the first four years of the plan was 10.6 percent, only 54 percent of the expected rate.[13]

Thus, only a small portion of GDP was invested in the economy. This portion grew infinitesimally during the plan years, from 12.1 percent per year in 1988, to 13.2 percent in 1992. Yet just to replace depreciated capital stock, the government must invest 10 to 12 percent of GDP each year. Thus the net increase to the country's capital stock has been negligible. These results are even more disappointing when one considers the fact that the population is increasing by more than two percent a year. In contrast, in 1977, 27.4 percent of GDP was invested, while in countries with healthy, growing economies, the figure is above 30 percent.[14]

Budget Deficit

Controlling the budget deficit was another of the plan's main objectives. Superficially, the government succeeded in reducing it from 51 percent of the budget in 1988 to 6.7 percent in 1993. The ratio has been increasing again since 1993. As noted, the government passed on part of the burden of reducing the deficit to its banks and citizenry,

Iran: GDP and Its Sectoral Distribution During the First Plan, 1989-93—Planned and Actual
(in billions of rials, 1988 prices)*

	Agriculture	Oil	Industry	Mining	Water, Electricity and Gas	Construction	Services	GDP‡
1989†								
Planned	5,430	2,500	1,623	241	490	1,593	12,758	24,290
Actual	5,404	2,218	1,527	238	512	1,214	12,395	25,272
1990								
Planned	5,678	2,741	1,835	314	526	1,844	13,664	26,533
Actual	5,842	2,659	1,698	293	611	1,249	13,598	25,914
1991								
Planned	6,026	2,834	2,090	372	587	2,073	14,651	28,346
Actual	6,139	2,954	2,031	327	706	1,449	14,944	28,608
1992								
Planned	6,454	3,156	2,415	451	618	2,282	15,681	30,747
Actual	6,594	3,016	2,043	354	766	1,563	16,139	30,354
1993								
Planned	7,001	3,250	2,750	512	714	2,429	16,794	33,315
Actual	6,957	3,125	2,043	376	840	1,591	17,350	31,871
1989–1993 Growth %								
Planned	6.1	9.5	14.2	19.5	9.1	14.5	6.7	8.1
Actual	5.9	8.7	7.6	12.4	12.7	5.2	7.4	7.2

Sources:

First Economic, Social and Cultural Development Plan of the Islamic Republic of Iran (1989–93), Plan and Budget Organization, Tehran, 1990

Economic Reports, Plan and Budget Organization, Tehran, 1990, 1991, and 1992

"Economic Report of Mr. Mohammad Hossain Adeli [former director of the Central Bank] to the 34th annual meeting of the Central Bank," *Keyhan* daily, August 14, 1994, p. 2.

Various published interviews by government officials.

Notes:

*Whenever there was a difference in reported data, the latest figure was used. The 1993 data are mostly derived from the published interviews of Islamic Republic officials.

†Iranian year begins March 21.

‡Does not include the net factor earning (*Karmozd-e Ehtesabi*).

and traces of the resulting negative consequences are still felt in the Iranian economy. In order to reduce the deficit, the government entrusted the banking system with allocating funds to public enterprises. Thus, much of the needed funds were not reflected in the national budget, and instead were advanced as loans to those enterprises by the banks and, in effect, the populace. The net indebtedness of public enterprises just to the Central Bank, for example, was an estimated IR 1,056 billion in 1991; it reached IR 3,657 billion in 1993. In the future, the banking system will be pressed to finance these forwarded credits. Also, the money handed over to these agencies was injected into the economy, adding inflationary pressures.

Another option the government resorted to was concealing the real amount of the deficit by engaging in foreign exchange dealings on the black market. Selling dollars on the black market proved profitable: foreign exchange earnings accounted for an estimated 41 percent of government revenues in 1992.[15]

Taxes

In addition to balancing government expenditures with revenues, structural changes in the budget's composition were also to be effected under the plan, specifically by increasing the share of taxation. The plan aspired to raise 44.8 percent of total government revenues from taxes. Not only did the ratio of taxes to government revenue never reach the projection, it actually declined after 1992. On the average, the plan's performance was between 10 percent and 20 percent behind expectations. In 1992, only 6.2 percent of GDP returned to government coffers as taxes, while the projection was for 7.3 percent. In addition, the nation's tax structure is not progressive, and thus did

not provide for a more equitable distribution of income. The plan did succeed, however, in diverting budget allocations to development funds. Such funds accounted for 19.2 percent of the annual budget in 1988, while in 1992 they accounted for 34 percent.

Inflation, Employment

Galloping inflation, especially in the final years of the plan, was another indicator of failure. The plan intended to reduce inflation from an annual rate of 28.5 percent in 1988, to 8.9 percent in 1993. Thus certain monetary, financial and commercial guidelines were obligatory, paramount of which was reducing the economy's liquidity. Liquidity grew at an annual rate of 23.8 percent in 1988; the plan proposed to reduce this growth to a modest 3.5 percent per year by 1993, mainly by reducing the budget deficit and containing liquidity. The government would have to terminate cash injections into the economy.

In actuality, however, the economy's liquidity grew at an annual rate of 25 percent in the plan period. It was projected to reach IR 23,000 billion in 1993, but it was actually double that amount, at IR 47,000 billion. In fact, the inflationary trend of recent years can best be explained by comparing the 25-percent average annual rate of increase in liquidity with the 7.2-percent average annual rate of increase in GDP. This explains why the inflation rate, which was supposed to be tamed at 8.9 percent in 1993, reached 30.7 percent in 1992. The 1993 rate was about 20 percent, but instabilities in foreign exchange and monetary policies resulted in an inflation rate of 60 percent for 1994.[16]

Floating exchange rates and the elimination of subsidies were instrumental in driving inflationary pressures in the plan's final years. There is more to the story, however. In the pre-plan period, the budget deficit, that is, indebtedness to the country's banking system, was the chief reason for the high rates of liquidity. During the plan years, however, liquidity increased because of increases in private indebtedness. In 1993, IR 7,237.9 billion was added to the economy's liquidity, of which IR 5,292.5 billion, or 73.1 percent, was attributed to a net increase in private indebtedness over the course of that one year.

The plan gets a mixed review regarding employment. In its initial years, it exceeded its own projections on job creation, which was 394,000 new jobs per year. But in the final years, it fell short of its goal. Overall, the plan succeeded in decreasing the unemployment rate from 15.9 percent in 1988, to 11.4 percent in 1992. The target was to lower it to 13.4 percent. It should be noted that the unemployment figures include official as well as unofficial jobs, full-time and part-time jobs, and real as well as underemployment. In addition, most new jobs were created in the public sector, while the private sector showed little growth, and only in the low-paying service sector.

The plan was also unable to effect changes in the nation's employment structure. The planners wanted to reduce employment in the service sector from 47.2 percent in 1988 to 45.5 percent in 1993. The opposite happened. Employment in the service sector soared to 50.4 percent in 1993. Over the same period, employment in the agricultural sector fell from 28.4 percent to 22.2 percent. The share of industry and mining increased slightly, from 24.4 percent to 27.4 percent.[17]

Inflation, unemployment, the elimination of subsidies, and extremely inequitable distribution of income have taken their toll on lower and middle income families. An estimated 60 percent of the Iranian population currently live below the poverty line.[18]

This will undoubtedly have negative social ramifications. A widespread bribe culture and corruption are prevalent. Addiction, theft, and other types of social delinquency have proliferated.

Debts

Foreign debts accumulated at an unprecedented rate. Forecasts estimated total government revenues, from oil as well as non-oil exports, at $99.2 billion for the entire plan period. Parliament also approved $27 billion in foreign loans.[19] Actual government revenues amounted to only 86 percent of the forecasts. Under the government's policy, the domestic market was flooded with imports. The total value of goods imported was $9 billion in 1988, $27.8 billion in 1991, and $29 billion in 1992.[20] Additional foreign exchange was obtained from loans and "usance" credits. Foreign debt accumulated and at the end of the plan in 1993, surpassed $30 billion.[21]

The distribution of interest payments on these loans also showed a lack of foresight. A major part of the accumulated foreign debts were two-year usances, with short pay-back periods.[22] Thus, not only did the Central Bank, and ultimately Iran, lose face in the international community for missing interest payments, but foreign loan financing also put further strains on the economy. After successful renegotiation of payment plans, the government decided to allocate 15 percent to 20 percent of foreign exchange earnings over the course of the second plan to servicing its foreign debts.

Export Promotion

The government export promotion policy was also unsuccessful. Non-oil exports performed well in these years and more than doubled their share of total exports, although they never achieved targeted goals. From 1989 to 1992, non-oil exports rose from $1.1 billion, to $1.3 billion, $2.5 billion, $2.9 billion and $3.7 billion. The total of $11.7 billion over the plan period was, however, substantially below the $17.8 billion projected by the plan. In the first trimester of 1994, non-oil exports produced $1.1 billion in foreign currency earnings. Falling domestic purchasing power, coupled with high rates for the dollar, will inevitably make for a lucrative export sector, especially since the export levels still lag behind the country's productive capacities.

However, the non-oil sector is still not well integrated into domestic production resources and is dependent on imported goods for the production process. Much of the export earnings generated by this sector are therefore absorbed by its own production process, so that the positive balance at the end of the day is negligible. Also, the products in this sector were not what the planners had in mind, and domestic industries played a minor role in their production. Over the plan period, industrial exports were supposed to earn the highest amount of foreign exchange of all non-oil exports ($9,000 million, compared to $4,000 million for carpets). In reality, however, export

earnings from carpets were double those from industrial exports. From 1989 to 1992, carpets exported totaled $3,194 million, while industrial exports lagged behind at $1,416 million. This shows the vulnerabilities of the export sector and the need for government support for expanding the nation's industrial base.

Causes of the Plan's Weak Performance

Factors that led to the plan's weak performance can be divided into two categories: structural and institutional obstacles, and administrative shortcomings. The first category was discussed in the previous article (in the February 1995 issue); the second is covered below.

Erroneous Assessment of Opportunities

The Islamic Republic's miscalculation of the political opportunity caused by Iraq's invasion of Kuwait was instrumental in the failure of the first plan. The Islamic Republic believed that appropriate economic policies would inevitably result in a stronger political and economic standing in the global community. These higher expectations were crafted into the plan's targeted objectives. What was lacking was a concomitant policy of political normalization, both domestically and vis-à-vis the world. To begin with, the Islamic Republic's hostilities with the U.S. continued, and the U.S. continued to exert economic pressure on the Islamic Republic, more or less in concert with other Western states. The Islamic Republic's alleged continued support for Islamic movements throughout the region, and its opposition to the Arab-Israel peace plan, made enemies of Israel and several Arab countries, including Egypt.

Officials of the Islamic Republic point to defectors in the Western camp, countries that did not follow the U.S. in excluding Iran from the global economy. These countries, however, did not help Iran achieve its targeted objectives in the first plan. Japan and Germany, for example, traded extensively with Iran, but only to gain access to Iran's domestic markets; neither country invested in Iran, and both run positive trade balances with the country.[23] The IMF and World Bank were also lukewarm to Iran, and the Islamic Republic failed in attracting significant investment from abroad. Surely, these facts cannot be divorced from Iran's political image. Iran should have first adopted a reasonable political framework within which it could conduct its international relations, and then exploited that framework to its benefit.

Managerial Shortcomings

Managers in Iran are selected on the basis of their ideological affiliations, and this proved detrimental to the implementation of the first plan. The Islamic Republic has not invested in its human resources, and managers inevitably lack experience and expertise. The experience they have gathered in the post-revolutionary period has been at great cost. In addition, management is not solely an experiential science, and Iranian managers are not familiar with modern techniques and strategies in the field. In effect, managers are still chosen based on ideological affiliations. Thus organizational and managerial space is politicized, riddled with ideological and partisan confrontations. Managers promote political creeds rather than increasing efficiency and production. The first plan suffered a major setback as a result of its unqualified managerial staff.

Lack of Executive System for Implementation

The plan also lacked the necessary executive system to oversee its implementation. The plan was conceived in a sector-intensive framework, and a vertical power structure was crucial for its success. However, the Islamic Republic is characterized by plural and parallel power centers, similar to the distribution of power among various religious clusters in the country. Moreover, these centers are not just linked horizontally, but also have numerous vertical ties. The semifeudal structure of power has a debilitating effect on the country's administrative structure: it creates discord and strife in the upper echelons of government, reduces effectiveness, and works against efficient utilization of resources.

Hasty Revisions

The plan was handicapped by the many revisions and modifications made to it. The revisions disrupted the plan's internal cohesion, replacing it with a series of disjointed and at times incompatible policies. Thus, the plan also lost its long-term vision and was modified according to day-to-day economic considerations. Hasty revisions precluded appropriate scrutiny of prerequisites and consequences. Poor public relations also inhibited adequate utilization of economic wisdom. The government failed to attract Iranian expatriates with expertise in economics and management.

Unstable Policies

Perhaps the principle contributing factor to the first plan's failure was the government's inability to produce definitive, rational and cohesive policies in the financial, monetary, foreign exchange, and industrial sectors. The policy regarding a single exchange rate perhaps best illustrates this weakness.

Foreign exchange, like all other commodities, is bound to have a single price, determined by the laws of supply and demand. But economic precepts accommodate circumstantial differences and do not prescribe unified exchange rates in all cases. In Iran, the imposition of a single exchange rate was a problem not just because of its consequences, but also because of how it was implemented.

In a multi-tiered exchange rate system, especially when the official and market rates diverge widely, government subsidies to production and service units, provided at a rate lower than the market rate, are camouflaged and never accounted for. As a result, the managerial efficiency of these units cannot be assessed. Managers and directors whose firms enjoy favorable foreign exchange rates lack incentive to cut costs, increase production, or improve services.

Throughout the 1980s in Iran, firms with government affiliations tended to sell on the free market the raw products they had imported at the lower official exchange rate. They were therefore profitable and unproductive at the same time. This system clearly fails to encourage efficiency, discipline, productivity and innovation. Units of pro-

duction are transformed into commercial enterprises.

Multi-tiered exchange rate systems also play a negative role by fostering demand for imported goods. Imports, or any transactions involving foreign exchange, become more profitable. Lucrative dealings in foreign exchange give way to increasing corruption as eligible units seek to expand their access to the government agencies in charge of allocating foreign exchange at the official rate.

Creating a single exchange rate, however, does not necessarily put an end to such abuses. Once the single exchange rate mechanism was in place in Iran, it failed to prevent capital flight and to induce investment in productive sectors. Instead, it created a balance of payments crisis and led to an expansion of the black market in foreign exchange and of official corruption.

Imposition of a single exchange rate—or in other words, the devaluation of the country's official currency—should entail a decrease in imports and an increase in exports. What happened in Iran, though, was that it failed to increase the nation's foreign exchange earnings significantly, since most of this revenue is derived from the petroleum sector, which operates independently of domestic fluctuations in exchange rates. The single exchange rate produced mixed results even in the case of non-oil exports. While devaluation helped make these goods more competitive in the international market, it also increased their costs, in line with the increased costs of the imports that were used to manufacture them.

The fall in the price of the Iranian rial also failed to reduce domestic demand for foreign goods. The accumulation of wealth and income in a relatively small sector of society had increased the group's purchasing power to the extent that it was unresponsive to fluctuations in exchange rates.

Meanwhile, the productive sectors of the Iranian economy suffered negative effects from the imposition of a single exchange rate mechanism. In the short term, their liquidity was adversely affected, so many were forced to stop production or close shop. Since domestic production relied heavily on the availability of raw goods, semimanufactured goods, and foreign technology, the cost of production soared with an increase in foreign exchange rates. Some units were driven out of business, and some, upon the advice of the government, turned to the banks and accumulated huge debts. The single exchange rate also put upward pressure on inflation, another negative effect on production units. Increased costs reduced demand, and in some cases higher priced domestically produced goods were unable to compete with imports.

Another reason the single exchange rate mechanism failed in Iran was that the government concentrated on foreign currencies and neglected the Iranian rial. To be successful, a currency program must deal with both. To help the single rate mechanism succeed, the government should have implemented reforms in the country's financial, monetary and commercial sectors. For example, the inflationary pressures of a single exchange rate mechanism should be counterbalanced by appropriate management and measures to control private liquidity. In Iran, government injections of money into the economy increased by 25 percent in 1991 and in 1992. Also, since the government earned a large portion of its revenue by dealing in the foreign currency black market (41 percent in 1992), it did not respond adequately to foreign currency price increases. For Iran, economic policy should be based on industrialization, and measures, including a single exchange rate, should be adopted only if they contribute to that objective.

As a rule, policymakers in Iran concentrate on the pros and cons of policies, rather than on assessing policies in terms of the government's ability, or inability, to implement them. An example is the performance of the country's banking system—in extending foreign exchange credits without proper guarantees, negotiating loans with simultaneous due dates, and adopting passive, short-term policies to regulate the chaotic foreign exchange markets. The banking system is plagued by multilayered connections with the government. Without an independent central bank, economic policies are bound to be undermined by political pressures.

Finally, policymakers in Iran concentrated on the supply side of the foreign exchange issue, neglecting the demand side. They were concerned with the volume of foreign exchange earnings and not with the expenditure of foreign exchange. In 1991, Iran earned $16 billion in foreign currency and spent $27.8 billion on imports; the figures for 1992 were respectively $18 billion earned, and $29 billion spent. Had demand for foreign exchange figured more prominently in policymaking, then its spending would have been prioritized and planned.

Another problem is that projections of foreign currency earnings tend to be inflated. The first plan assumed revenues of $81.5 billion from petroleum exports, and $17.8 billion from non-oil exports, for the entire plan period. Petroleum earnings were 90 percent, and non-oil export earnings 65 percent, of projected rates. A plan based on incorrect assumptions of the supply of foreign exchange is bound to run into problems.

Footnotes

[1]The 1979 revolution was a watershed in Iran's recent history. It was expected to inaugurate general political and economic betterment, to secure sovereignty in the domain of politics, and development in the economic area. The revolution, however, did not deliver what it had promised. In its first decade, the Islamic Republic faced the challenges of the Iran-Iraq War and a multitude of political and economic hardships, many of which were caused by exogenous factors. These challenges made for political ambivalence and ephemeral economic and social policies, thereby depriving Iran of the ability to focus on long-term planning and national development.

[2]For a comprehensive examination of the Iranian economy at the beginning of the first plan period, *see* Hooshang Amirahmadi, *Revolution and Economic Transition: the Iranian Experience*, Albany, New York: The State University of New York Press, 1990; Hooshang Amirahmadi, "Economic destruction and imbalances in post-revolutionary Iran," and "Iranian economic reconstruction plan and prospects for its success," both in Hooshang Amirahmadi and Nader Entessar, *Reconstruction and Regional Diplomacy in the Persian Gulf*, London: Routledge, 1992; and Jahangir Amuzegar, *Iran's Economy Under the Islamic Republic*, New York: I.B. Tauris & Co. Ltd. Publishers, 1993.

[3]Among the reasons for the revisions to the plan, the most important concerned the nation's economy and its political standing in the international community. Iran's foreign exchange earnings increased in 1991. Iraq's occupation of Kuwait and the ramifications for the international oil market led to $4 billion of added revenue for Iran. This sudden boost created an illusion of prosperity, and Iranian policymakers embarked on an ambitious plan for quick eco-

nomic growth. Middlemen and representatives of foreign firms in Iran took advantage of corruption and the absence of long-term planning to encourage the implementation of consumerism policies. Opening domestic markets to imported consumer goods was indicative of inappropriate utilization of new economic potentials in the first plan. Import substitution was neglected, and new investments were undertaken with inadequate financial backing. Economic free zones, too, were adversely affected: rather than promoting investment in non-oil export industries, they were flooded by imported consumer goods.

The revisions were also implemented because of the government's perception of Iran's position in the region and the world, and the Middle East's strategic considerations in the aftermath of the Gulf War. Iran's cooperation with the United Nations and the multinational forces fighting the Gulf War was a positive development, and led to better relations with the Gulf countries and with Saudi Arabia in particular. The government also believed that the breakup of the Soviet Union has resulted in a less ideological global order, more concentrated on economics and cooperation. With such considerations in mind, and in the aftermath of the tragic earthquake of May 1990, Iran embarked on bringing its economic policies in line with current trends in the international economy. Seeking loans and investments from abroad and approaching the IMF and the World Bank were moves made in this light. As a prerequisite for IMF assistance, the government was compelled to accept the IMF's guidelines for economic liberalization. Privatization, floating exchange rates, the elimination of price controls and subsidies were adopted to accommodate the international economic agencies and to integrate Iran into the world economy.

[4]"Gozaresh-e Rais-e Sazman-e Barnameh [va Boudgeh] az Etlaf-e Manabe'a Mali" [The Report of the Director of Plan [and Budget] Organization about the wasteful use of Financial Resources), *Hamshahri* daily, 1 Mordad, 1373 (1994), p. 4.

[5]As one of the deputies in the Iranian Parliament pointed out, "the government overstretched itself much beyond its capability." *See* the statements by Morteza Nabavi, Tehran's Representative to the Parliament, in *Kayhan* daily, 11 Mordad, 1373 (1994) p. 7.

[6]It is true that export promotion and government support for export-oriented industries are inherently positive developments. They encourage increased competition, qualitative improvements in domestic production, and increased foreign exchange earnings, all of which contribute to economic diversification. But export promotion is not an alternative to import substitution, and the former should have been pursued only alongside the latter and with long-term considerations in mind. Available studies concerning Iran show that generally, very little more foreign exchange is derived from export goods than is used in producing such goods, and that whatever small positive balance may remain in this regard (*i.e.*, the value added) is not returned to the domestic production process. *See* Sa'id Lailaz, "Saderat-e Ghair-e Nafti dar Negahi Digar" [Non-Oil Exports in a Different Perspective], *Ettela'at-e Siasi va Eqtesadi*, nos. 53-54, Bahman and Esfand 1370 (1991), pp. 80-82.

[7]*See* Alinaqi Mashaykhi, "Barnameh-e Avval-e Touse'ah: Dastavardha va Kastiha" [The First Development Plan: Achievements and Shortcomings], *Hamshahri* daily, 30 Shahrivar 1372 (1993), p. 10.

[8]*See* "Ta'mmoli dar Bare-he Seminar-e Jam'iyat va Touse'ah" [A Retrospective View of the Seminar on Population and Development], *Ettela'at* daily, 6 Mordad 1372 (1993), p. 2.

[9]*See Gozaresh-e Eqtesadi-ye Sal-e 1371* [The Economic Report of the Year 1992], Plan and Budget Organization, 1373 (1994).

[10]This is not to deny that government policies such as provision of clinical and health services, family planning clinics, encouraging literacy among women, campaigns for birth control, and repatriation of Afghan and Iraqi refugees have contributed considerably to declining population growth rates. Just as revolutionary euphoria and government espousal of larger families made for increasing growth rates in the early days of the revolution, gloomy economic forecasts, inflating, and falling government subsidies dissuaded population growth in the past decade. On the government's population policy in the years preceding the first plan, *see* Hooshang Amirahmadi and Fereydoun Nikpour, "Roshd-e Jam'iyat va Touse'ah-e Eqtesadi va Ejtema'i" [Population Growth and Economic and Social Development], *Ettela'at-e Siasi va Eqtesadi*, no. 40, Day 1369 (1990), pp. 47-57.

[11]Hooshang Amirahmadi, *Revolution and Economic Transition*, *supra* note 2.

[12]*See* Mohammad Hosain Adeli, former Director of the Central Bank, "Gozaresh-e Seey-o Chaharomin Ejlas-e Salaneh-e Bank-e Markazi-ye Jomhouri-ye Eslami-ye Iran" [The Report of the 34th Annual Meeting of the Central Bank of the Islamic Republic of Iran], *Kayhan* daily, 23 Mordad 1373 (1994), p. 2.

[13]*See* Alinaqi Mashaykhi, "Barnameh-e Avval-e Touse'ah," *supra* note 7.

[14]The adverse effects of this trend were exacerbated by the rapid increase in consumption. The first plan failed to contain consumption both in the private and the public sectors. In 1991 and 1992, for example, the public sector's rate of consumption grew twice as much as had been projected. Taken as a whole, these conditions are not conducive to investment.

[15]Mohammad Mehdi Rezaii, "Tahavoulat-e Arz az Didgah-e Kalan-e Eqtesadi" [Changes in Foreign Exchange from a Macroeconomic Perspective], *Rouznameh-e Ettela'at, Vizeh-e Kharej az Keshvar*, 6 Mordad 1373 (1994), p. 7.

[16]This figure for inflation is based on the author's research in Iran. Various sources give different figures for inflation. For example, in its June 1994 issue, p. 3, *Iran Business Monitor* (quoting an official of the Central Bank), put the average annual inflation rate for the first plan period at 40 percent to 60 percent; and *The Economist Intelligence Unit*, 1994-95, p. 21, reported the average annual inflation rate for the 1993-94 period at 30 percent to 70 percent depending on specific economic sectors.

[17]That the majority of new jobs were created in the service sector, characterized by lower wages and lower expectations on the job, demonstrates a decline in economic efficiency, production levels and wages. Each new job in the service sector requires an initial investment that runs three times higher than jobs in the agricultural, industrial, and mining sectors. New jobs in the service sector are therefore an inefficient use of national resources. A new job in the agricultural, petroleum, industry and mining, and construction and service sectors requires an initial investment respectively of (in 1982 prices): IR 1.66 million, IR 10.55 million, IR 2.00 million, IR 0.21 million, and IR 6.74 million. *Gozaresh-e Eqtesadi-ye Sal-e 1370* [Economic Report of the Year 1991], Tehran: Plan and Budget Organization, 1372 (1993), p. 81.

[18]Various sources have reported different figures on the number of Iranians living below the poverty line. In two sources in addition to the author's *Revolution and Economic Transition*, *supra* note 2, where the subject has received careful treatment, 60 percent has been confirmed. These sources are: Hosain Azimi, "Budgeh va Touse'ah-e Eqtesadi dar Iran [Budget and Economic Development in Iran], *Ettela'at-e Siasi va Eqtesadi*, no. 5, Bahman 1366 (1987), p. 32; and interview with Gholamhosain Naadi, a deputy of the Parliament, in *Resalat* daily, 14 Esfand 1366 (1987).

[19]The First Plan Bill did not outline a time schedule for the government to receive foreign loans.

[20]*Gozaresh-e Eqtesadi-ye Sal-e 1371*, *supra* note 17.

[21]*See Iran Business Monitor*, January 1994, p. 5.

[22]Ahmad Mir Motahari, "Barnameh-e Avval: Pendarha, Entezarat, Vaqeiytha" [The First Plan: Beliefs, Expectations, Realities], *Ettela'at-e Siasi va Eqtesadi*, nos. 83-84, p. 89.

[23]Oil exports to Germany in the third trimester of 1994 were 22 percent lower than in the same period of 1993. In fact, Iran supplies only two percent of Germany's demand for oil. *See* the article "German Oil imports from Iran Drop," *Rouznameh Ettla'at, Vizeh-e Kharej az Keshvar*, 26 Aban 1373 (1994).