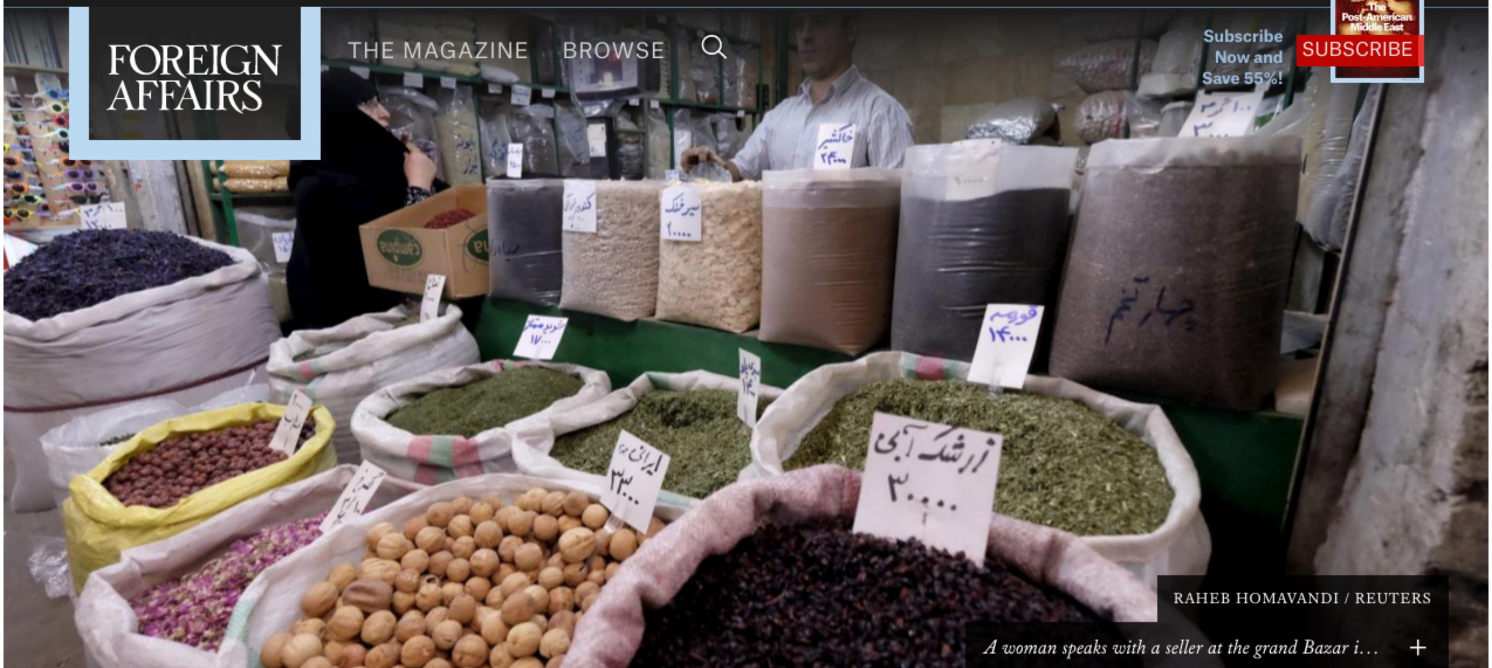

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*A woman speaks with a seller at the grand Bazar i…*

SNAPSHOT November 22, 2015 Iran Economic Development

# Rebooting Iran's Economy

## What Tehran Needs to Do to Fix its Finances

*By Masoud Movahed*



The deal between Iran and the P5+1 powers could not have come sooner for the Iranian economy, which has been crippled by some of the twenty-first century's strictest economic sanctions. The United Nations Security Council's trade embargoes against Tehran caused the state's oil revenues to shrink daily, and made Iran's national currency devalue by almost 80 percent. Unemployment and inflation simultaneously soared to unprecedented levels, and the Iranian economy plummeted to pre-sanctions levels.

Iranian President Hassan Rouhani has managed to jump-start a modest economic recovery in Iran by dismantling some of his predecessor's ill-advised populist economic policies and adopting a slew of new economic strategies. As a result, the World Bank reports, Iran's GDP grew by 1.5 percent in 2014, following two years of economic recession. Iran's oil revenue is essential for the nation's recovery over the next few years, as its economy depends on this income for public investment and social services. But further economic growth in Iran will not hinge on oil revenue alone: the nation is home to a young, skilled labor force, 20 percent of which is college-educated. This stands in glaring contrast with the faster-growing economies of Brazil and India, in which laborers with a tertiary education account for less than 10 percent of the workforce. Iranian college graduates are trained in scientific fields, emerging technologies, and manufacturing—and the output they yield in a post-sanctions Iran may overshadow the economic gains expected from its soon-to-reopen oil sector.



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## A LOOK AT THE NUMBERS

Although Iran has been subjected to U.S. sanctions since the 1979 Islamic Revolution, its economy has managed to grow for most of the years since. That is, until the 2006 UN Security Council sanctions came into effect. These sanctions targeted key sectors of Iran's economy (banking, gas, insurance oil, petrochemicals, and shipping, to name a few) and resulted in a 15 percent shrinkage of the Iranian economy.

Things got worse in 2012, when sanctions began to target the nation's central bank. This move banned Iranian clients from engaging in international transactions and restricted the flow of capital into Iran, which dramatically impaired the nation's ability to generate the growth that could make up for losses in other sectors. The loss of oil revenue prompted a massive reduction of public investment (Tehran relies on oil exports to account for about 70 percent of its public revenue) and an almost 80 percent depreciation of the Iranian currency.

By 2013, inflation hit a record 40 percent. The price of basic commodities in Iran skyrocketed, Tehran's budget was stretched thinner and thinner, and personal savings accounts became worthless due to currency devaluation. Tehran's leadership soon realized that recession and stagnation would haunt the nation's economy so long as sanctions remained in place.

## AGAINST THE ODDS

In spite of economic and diplomatic challenges, Iran continues to perform well on human development indices such as education, health care, and social services. According to the United Nations Human Development Index, Iran has improved by 67 percent over the past decade. The nation's youth literacy rate is at 98 percent, and life expectancy has dramatically increased, from 54 years of age in 1980 to 74 years in 2012. Iran is ranked among the world's top 20 economies in GDP as well as purchasing power parity. Although sanctions hurt the nation's economy, they haven't damaged its labor pool. With the nation's leaders coming in from the diplomatic cold, Tehran is uniquely positioned to take advantage of its brainpower.

Iran's stock of human capital can be thought of as the most tangible representation of its wealth. Even during the current sanctions regime, Iran has remained one of the Middle East's largest investors in scientific research; it ranked 17th in global scientific knowledge production as recently as 2012. Some of its elite technical universities are ranked among the world's top academic institutions, with Sharif University of Technology—often referred to as Iran's MIT—hailed by the chairman of Department of Electrical Engineering at Stanford University as the "the finest university in the world preparing undergraduate electrical engineers." Many of Iran's graduates are employed in high-tech industries at home.

RAHEB HOMAVANDI / REUTERS

*People walk at the grand Bazar in central Tehran October 7, 2015.*

Although the Iranian economy continues to be largely resource dependent, it has been able to use its human capital to develop domestic industrial and manufacturing industries such as automotive, construction, aerospace, telecommunications, machine tools, and petrochemicals. In 2009, Iran became the world's 11th-largest automotive manufacturer, successfully producing more than 1.6 million vehicles. This ranking has placed Iran's automobile industry above some countries in the advanced world, such as the United Kingdom (13th) and Italy (24th). With thousands of engineers designing national vehicles, the auto industry is the second-largest sector in the economy, after oil, and offers a major employment opportunity to Iran's young population. The post-revolutionary government, since its early days in the late 1980s, has attempted to develop an Iran that is not only able to manufacture goods but also to become a major exporter in the global economy. So far, Iran's exports have largely remained confined to the energy sector. But Iran's competence in high-tech industries and cutting-edge sciences, such as stem-cell research and nanotechnology, represent the promise to generate economic growth, especially as sanctions continue to be eased.



## A WAY OUT OF RECESSION

In order to find a quick way out of Iran's recession, Rouhani would do well to focus on markets other than oil, since there are many perils and pitfalls associated with oil dependency, including price fluctuations and the enormous risks and uncertainties associated with development planning. Building an economy that focused on exporting non-oil commodities and non-oil revenue was difficult when the sanctions regime was in place. But now that sanctions are gradually being lifted, Iran's non-oil exports are sure to increase.

DARREN STAPLES / REUTERS

*Men look at newspapers at a road side stall in central Tehran, Iran August 24, 2015.*

All of this won't necessarily be easy for Rouhani. Oil, itself, is usually the main obstacle to the successful export manufacturing commodities. Since oil is capital-intensive and since it pumps immense revenue into an economy, it causes domestic inflation rates to increase compared to foreign inflation rates. As a result, profits for exporters reduce as wages increase faster than the price of national exports. This weakens incentives for manufacturers to produce export goods, since exchange rates no longer favor doing so. The very abundance of capital-intensive natural reserves, such as oil, make other sectors less lucrative just by comparison. Striking the right balance between industry and oil exports, however, can mitigate these effects. Although the Iranian sanctions regime (and the subsequent shortage of foreign currency that followed) wreaked havoc in the Iranian exchange rate market, it helped Iranian products to be more competitive as devaluation of the currency made them cheaper in the international market.

For Iran to take advantage of these trends, the Rouhani administration should do its best to diversify the Iranian economy and to bolster its manufacturing and industrial sectors. The administration should also promote exporting non-oil commodities, following the models of countries such as China, Malaysia, South Korea, and Taiwan. Energy industries are highly technology-intensive and do not provide ample employment opportunities within a young labor force. Labor-intensive industries, as well as service sectors like information technology, ought to be solidified. Rouhani should call upon state-directed industrial committees and agencies to provide Iranian entrepreneurs and manufacturers with fiscal resources and capital, and he should foster financial support and protection for firms that place emphasis on exporting goods abroad.



Rouhani's seeming commitment to lifting Iran out of recession through means other than its oil sector is a reassuring sign. To realize the country's development plans and ambitions, he has appointed the most competent, professional, and technocratic ministers in Iran's contemporary history. The nuclear negotiations and deal were, themselves, evidence that Iran's bureaucracy is capable of creating a business-and-investment-friendly climate for both domestic and foreign entrepreneurs. French and German companies are already on their way to do business in Iran, and others are soon to follow.

The work ahead will be hard. Tehran must find a way to reinvigorate the nation's economy after decades of sanctions. It must look beyond oil. And it must make the most use possible of the country's dynamic industrial base and its young skilled labor force. With the right economic policies, Tehran can capitalize on these other natural resources in order to become an economic power in the Middle East and Asia for decades to come.

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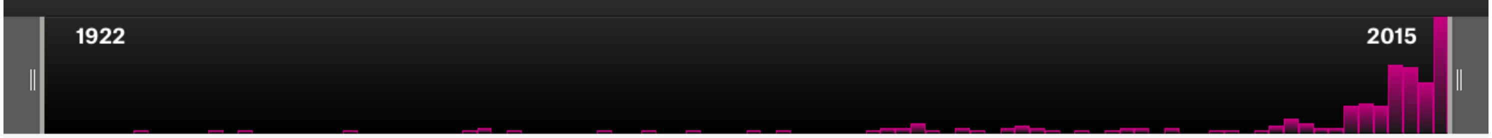


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