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Prosperity in Depth: Iran The Iranian Economy The Glass Half Empty

Looney, Robert

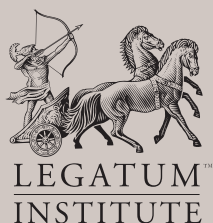
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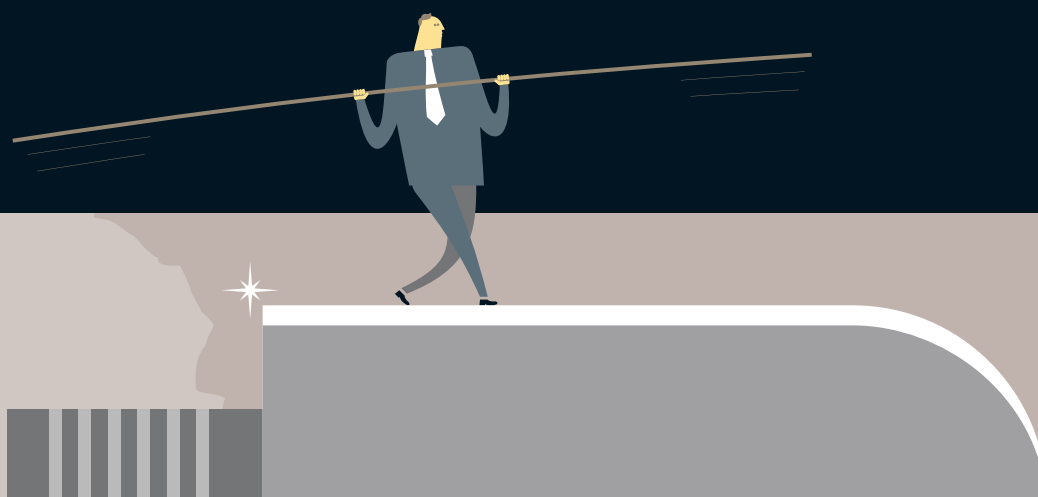
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PROSPERITY IN DEPTH: IRAN THE IRANIAN ECONOMY The Glass Half Empty



By Robert Looney

THE 2012 LEGATUM PROSPERITY
INDEX™ RANKING: IRAN

102/142

■ GLOBAL TRANSITIONS ■ PROSPERITY STUDIES

THE LEGATUM INSTITUTE

Based in London, the Legatum Institute (LI) is an independent non-partisan public policy organisation whose research, publications, and programmes advance ideas and policies in support of free and prosperous societies around the world.

LI's signature annual publication is the *Legatum Prosperity Index*[™], a unique global assessment of national prosperity based on both wealth and wellbeing. LI is the co-publisher of *Democracy Lab*, a journalistic joint-venture with *Foreign Policy Magazine* dedicated to covering political and economic transitions around the world.

PROSPERITY IN DEPTH

To complement the Prosperity Index, we commissioned 12 specialists—economists, political scientists, journalists—to provide additional analysis of selected countries. Their studies vary from essays putting contemporary challenges into historical context (Iran, China, Mongolia) to up-to-the-minute surveys of the barriers to economic growth (Egypt, Japan, India) to controversial alternatives to the conventional policy interpretations (Iceland, Colombia, Vietnam). In each case they represent highly original work by distinguished experts that adds depth and insight to the statistical analysis of the Prosperity Index.

FOREWORD

Iran haunts our nightmares these days because its anti-Western government covets nuclear weapons. But Iran and its economy are worth understanding in some detail for a host of other reasons.

The country is both blessed and cursed by oil wealth that makes it easy to sustain a decent living standard, but difficult to build a balanced industrial economy. It is an Islamic theocracy, and thus a natural experiment in whether Islamic fundamentalism is compatible with economic development. And it is an authoritarian state that can be seen as both as a model for the Islamists who have been empowered by the Arab Spring and a cautionary example of the consequences of turning back in the clock in a rapidly changing global economy.

Iran is troubled society, to say the least—a reality that explains its 102nd ranking out of 142 countries (down by 5 places since 2011) on the Legatum Institute Prosperity Index in spite of its relative prosperity. Indeed, while it ranks in the middle (70th) of the globe by purely economic criteria, it is near the bottom on sub-indices for Social Capital (121st), Personal Freedom (125th) and Safety & Security (125th).

Robert Looney is exceptionally well qualified to analyse Iran's quest to build an economy on its own terms. He's a University of California-trained economist who has written extensively on the Middle East and South Asia. But he is also a professor in the Department of National Security Affairs at the US Government's Naval Postgraduate School in California. His primary focus, though, is that of a development specialist who links Iran's current woes to its elites' financial stake in inhibiting change.

Peter Passell, Editor

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THE IRANIAN ECONOMY

The Glass Half Empty



Iran has struggled almost continuously with high inflation, unemployment (especially youth unemployment) and a brain drain that has created a diaspora of well-educated emigrants.

To understand where the Iranian economy is going, it's important to remember where it's been. Like so many other oil-rich countries lacking the legal and political institutions of a modern market-based economy, pre-revolutionary Iran suffered from what has been dubbed the resource curse—a dependence on natural wealth that inhibited balanced economic development and sustained a culture of corruption. Indeed, discontent fed by the resource curse was an important factor leading to the overthrow of the Shah in 1979. After the consolidation of power as an Islamic republic under the Ayatollah Khomeini, the government proposed to run the economy on a model aimed at avoiding that trap.

That model, which shifted priorities from economic growth powered by oil wealth to social and economic justice, has worked better in its own terms than many would like to admit. Income per person has increased by half (in terms of purchasing power) since 1980, and a lot more of it ends up in the pockets of the poor. Health, as measured by factors such as infant mortality and life expectancy, has improved considerably. Average years of education have increased dramatically for women as well as men. But the formula has hardly proved a panacea.

Iran has struggled almost continuously with high inflation, unemployment (especially youth unemployment) and a brain drain that has created a diaspora of well-educated emigrants. In the last 15 years, most of the growth (and job creation) has taken place in urban areas, leading to massive internal migration from the countryside. A raft of subsidies and price controls has badly distorted market prices—a problem that stubbornly resists solution. Meanwhile, economic sanctions have made it difficult to import critical industrial parts as well as depressing the exchange rate—further adding to inflationary pressures.

Looking ahead, that raises a host of questions. Can Iran make the changes needed for the rapid growth required to manage unemployment? More generally, is ongoing authoritarian rule, complicated by the strictures of fundamentalist Islam and an aggressive foreign policy, compatible with further development?



THE PEACOCK ECONOMY

In the early 1960s, Iran's living standard was roughly equivalent to that of Malaysia, South Korea and Turkey. And the monarchy's fanatical drive for regional power, built around rising oil revenues and alliance with the west in the Cold War, gave it quite a bump. Between 1965 and 1979 the economy grew at an average real rate of 7.4%, among the fastest rates in the world.

The aggregate figures, however, concealed a host of weaknesses. Per capita GDP expanded at an average annual rate of 4.4%—again a comparatively high rate, but one that reflected Iran's population explosion and the looming necessity of creating a lot of jobs for its exceptionally young population. Moreover, much of the increase in national income came from increases in the production of oil—and after the Arab oil embargo of 1973, from increases in the price of oil.

Then, too, there was the issue of legitimacy for a monarch installed by former colonial powers and not given to hand wringing over inequality. While there's not much hard evidence about the impact of Peacock Throne on the quality of life at the bottom, the

oil-based boom certainly increased the perception of injustice. The Shah and his cronies flaunted great wealth, and the division in living standards between rural and urban areas almost certainly widened.

AFTER THE FALL

In part, Iran's post-revolutionary economic struggles can be traced to the attitude of the Islamic Republic's founding father, the Ayatollah Khomeini. Khomeini believed economic growth was an unworthy pursuit, a sentiment that was incorporated into the 1979 Constitution, which notes that the economy is "not an end in itself, but a means intended only to contribute to the attainment of the ultimate goal," namely "a movement toward God." When asked what he was doing about rising rates of inflation in the new Islamic Republic of Iran, the Ayatollah replied, "This revolution is not about the price of watermelons."

From this starting point, the Islamic republic's economy has gone through several phases. The one constant affecting policymaking during all these phases has been the tension between the two main factions within the regime: the conservative 'Islamists' and the more pragmatic 'modernists.'

EARLY POST-REVOLUTION AND THE WAR YEARS

Initially, the conservative leaders of the Islamic Republic sought to create new economic structures compatible with both revolutionary ideology and Islamic precepts of social justice. The country's new constitution committed the government to eradicating poverty, banning usury and 'extravagance,' aiming at self-sufficiency in food production, and preventing foreign economic domination—especially in the oil industry.

Economic policy had a decidedly anti-market, anti-capitalist and anti-globalist slant. The country's major industries, private banks and insurance companies were all nationalized. Thousands of businesses belonging to the Shah's associates and supporters were confiscated, and turned over to Islamic charitable foundations—the Persian term is *bonyads*—providing safety-net services that are generally the province of government in the West. While *bonyads* pre-dated the revolution, their real power was built on newly confiscated wealth—and the patronage that came with dispensing it.

The Islamic Revolutionary Guard Corps (IRGC) also took on added importance. Initially, Ayatollah Khomeini tasked the IRGC with the defence of the new regime. During the titanic 1980–88 war with Iraq, however, the Guard also took on the job of providing welfare and small loans to veterans and their families.



When asked what he was doing about rising rates of inflation in the new Islamic Republic of Iran, the Ayatollah replied, "This revolution is not about the price of watermelons."

Wholesale nationalization, together with the exodus of middle-class Iranians, the decline in international oil prices and the destruction caused by the war of attrition with Iraq, had devastating economic consequences. Between 1980 and 1988, per capita GDP and capital formation each declined by one-third. Inflation accelerated to nearly 20%.

Compounding these problems, the Islamic government encouraged rapid population growth (which had hardly been slow under the Shah); accordingly, the country's population expanded at an almost unprecedented average annual rate of 3.8% between 1980 and 1988. While the government later had second thoughts about procreation to the max and did succeed in curbing births, the demographic momentum built up in the early 1980s was difficult to overcome. The country's population nearly doubled between 1979 and 2001, putting enormous demands on Iran's education system and shovelling millions of young, relatively unskilled Iranians into the workforce.

RAFSANJANI AND THE NEW ECONOMIC ELITE

Following the death of Ayatollah Khomeini in 1989, the authoritarian (but also pragmatic) Akbar Hashemi Rafsanjani became Iran's president and began an economic liberalization phase. His first priority was to rebuild after the devastating war with Iraq. To his credit, Rafsanjani understood that the economy's problems stemmed not just from the ravages of war; their roots lay in the excesses of the immediate post-revolutionary years that were reflected in overbearing regulation, a narrow tax base, scattershot subsidies, an overvalued currency reflecting dependence on oil, and a dysfunctional banking system.

Rafsanjani's initiatives to address these impediments to growth were embodied in a structural adjustment programme—the so-called Rafsanjani perestroika. One of its key elements was the proposed privatisation of many of the increasingly inefficient state enterprises. This proposal met with vigorous opposition from state employees and other beneficiaries, and led to heated clashes between liberal and conservative factions. The initiative was stillborn.

Unable to make significant gains in through privatisation, Rafsanjani tried a different tack, stimulating competition between state entities—especially in the areas of construction and restoration of facilities damaged in the war. The IRGC was a key participant, transforming itself into a conglomerate that opened enterprises and bid on government contracts. The IRGC's financial activities also expanded during postwar reconstruction, as it extended its wartime micro-lending operations into



Once he died, Ayatollah Khomeini's edict that social justice should be the primary goal of the revolution faded in importance. In its place burgeoned a crony capitalist system reminiscent of the Shah's time—though with a distinctly Islamic flavour.

SHOE MENDER IN SHIRAZ



Aleksandar Todorovic / Shutterstock.com

money laundering and the creation of vast smuggling networks. In a pattern presaged in revolutionary China, it would eventually build an industrial arm that serves as patronage and income supplement to IRGC leaders—and as a potent opponent of inclusive reform.

Once he died, Ayatollah Khomeini's edict that social justice should be the primary goal of the revolution faded in importance. In its place burgeoned a crony capitalist system reminiscent of the Shah's time—though with a distinctly Islamic flavour. Corruption rose as the bonyads and the Guards, along with the traditional military, the Rafsanjani family and their clients, were freed to do business without the discipline of either even-handed regulation or a competitive marketplace. At one point, Rafsanjani was reputed to be Iran's wealthiest individual. Insider mullahs also benefited through interest-free loans from the state banks and access to foreign exchange at official rates that could be resold at a market rate that was five times higher.

Though designated as religious charities serving the poor, the bonyads became some of Iran's wealthiest entities. With executives appointed by the Supreme Leader, they own much of Iran's industry as well as vast tracts of real estate. While there is little financial

NASIR AL-MULK MOSQUE, SHIRAZ



data on these organizations, the indirect evidence suggests the bonyads control about 20% of Iran's GDP. The bonyads are exempt from taxation, and their capacity to dole out patronage has become a key element in the regime's ability to maintain political control.

Thus rather than opening the economy by freeing enterprise from the strictures of government ownership and/or regulation, Rafsanjani ended up strengthening only the IRGC, the bonyads—and, of course, the insiders who ran them. Companies associated with the bonyads and the IRGC won a disproportionate share of government reconstruction contracts and used their preferential access to licenses, foreign exchange and bank credit to become leading traders. Well-connected conservative merchants (bazaaris) with established trading networks also used some of their accrued wealth to enter industry, which had been the preserve of the state since the revolution.

The protection from competition granted to the bonyads and IRGC took a toll on productivity that was reflected in lagging economic growth. The economy recovered somewhat during the post-war period, with per capita GDP growing by 26% between 1989 and 1996. However, that gain only brought per capita income back to the level at the time of the revolution. Ominously, high inflation became chronic, averaging 25% across the period.

KHATAMI TO THE RESCUE?

In 1997, the ascension of Mohammed Khatami, an Islamic scholar who was a veteran of the revolution, to the presidency ushered in a social reform phase that was vigorously opposed by the conservatives. Although Khatami did not directly threaten the legitimacy of rule by clerics, he did encourage political dialogue and edged Iran toward détente with the West.

On matters economic, he sought a normalization of trade and investment with the outside world, and talked about re-privatising industry that had been confiscated in the wake of the Shah's departure. However, there is little evidence that he had the will to challenge the economic interests of what might be called Iran's military-theocratic complex. Nor, for that matter, did he have a way: world oil prices fell sharply on his watch, leaving his administration with little surplus with which to win friends or buy allegiance to market reforms.

Declining oil revenues after the Asian financial meltdown (and subsequent fiscal retrenchment) in 1997 did put pressure on Khatami to attack the country's vast array of household subsidies. These subsidies, a legacy of the Iran Iraq War, had been left in place both to mask the regime's economic failures and insure the support of the poor. But the political dam held; subsidy reform was postponed for a decade during which their cost grew to nearly one-fifth of the GDP.

During Khatami's second term (beginning in 2001), rising oil revenues made it possible to pursue some adjustment policies—in particular a move to ease controls on capital movements and to adopt a floating exchange rate that offered hope for a gain in non-oil exports. Inflation eased to around 15%, and investment grew by about 8% annually, faster than any time since the revolution.

Nonetheless, Iran never came close to creating enough jobs to accommodate the hordes leaving school. Even before the full effect of a 1980s baby boom began to be felt in labour markets, unemployment rose to the double digits. Between 1996 and 2000, some 700,000 workers entered the labour market, while only 300,000 jobs were created. By 2000, unemployment was estimated at between 15 and 25%, with much higher rates among urban youth. According to the World Bank, to create the 700,000 to 800,000 new jobs each year needed to reduce unemployment to acceptable levels and keep it there would have required 6% growth. Post-revolution Iran has not come close.

Explanations abound for Iran's mediocre economic performance. While the 1980s war with Iraq, international sanctions and volatile oil prices have all played a part, the more fundamental



Between 1996 and 2000, some 700,000 workers entered the labour market, while only 300,000 jobs were created. By 2000, unemployment was estimated at between 15 and 25%, with much higher rates among urban youth.

cause was a structural trap in which the power of incumbent interests stymie the reallocation of capital from inefficient firms to more productive ones.

In the case of Japan (where the term was first applied) the government couldn't bring itself to withdraw support from failing businesses and the banks that propped them up during that economy's 'lost decade'. In the case of Iran, the mullahs, elements of the armed forces and those who enjoyed their patronage exercised veto power over reforms that would have privatised state-owned enterprises, rationalized the businesses controlled by the bonyads, and replaced consumer subsidies with less-distorting transfers to the poor. The result was (and still is) chronic economic underperformance, even during periods in which oil revenues are abundant.

Research from the IMF supports this interpretation. In the 1960–76 period, changes in total factor productivity—a key measure of the ongoing adaptability of enterprises to new technology and skills—rose sharply. But most of the gains were lost during the Iraq war, and productivity continued to slide through to 2000. Estimates by Farshid Mojaverhosseini of the International Centre for Economic Research in Italy suggest that nearly half of the difference in growth rates before and after the revolution can be attributed to lagging productivity, particularly in the government- and bonyad-dominated manufacturing sector. Khatami-era reforms did open a few opportunities for private enterprise, but limited access to credit, plus predatory competition from the bonyads, the IRGC and other protected entities, made success stories few and far between.

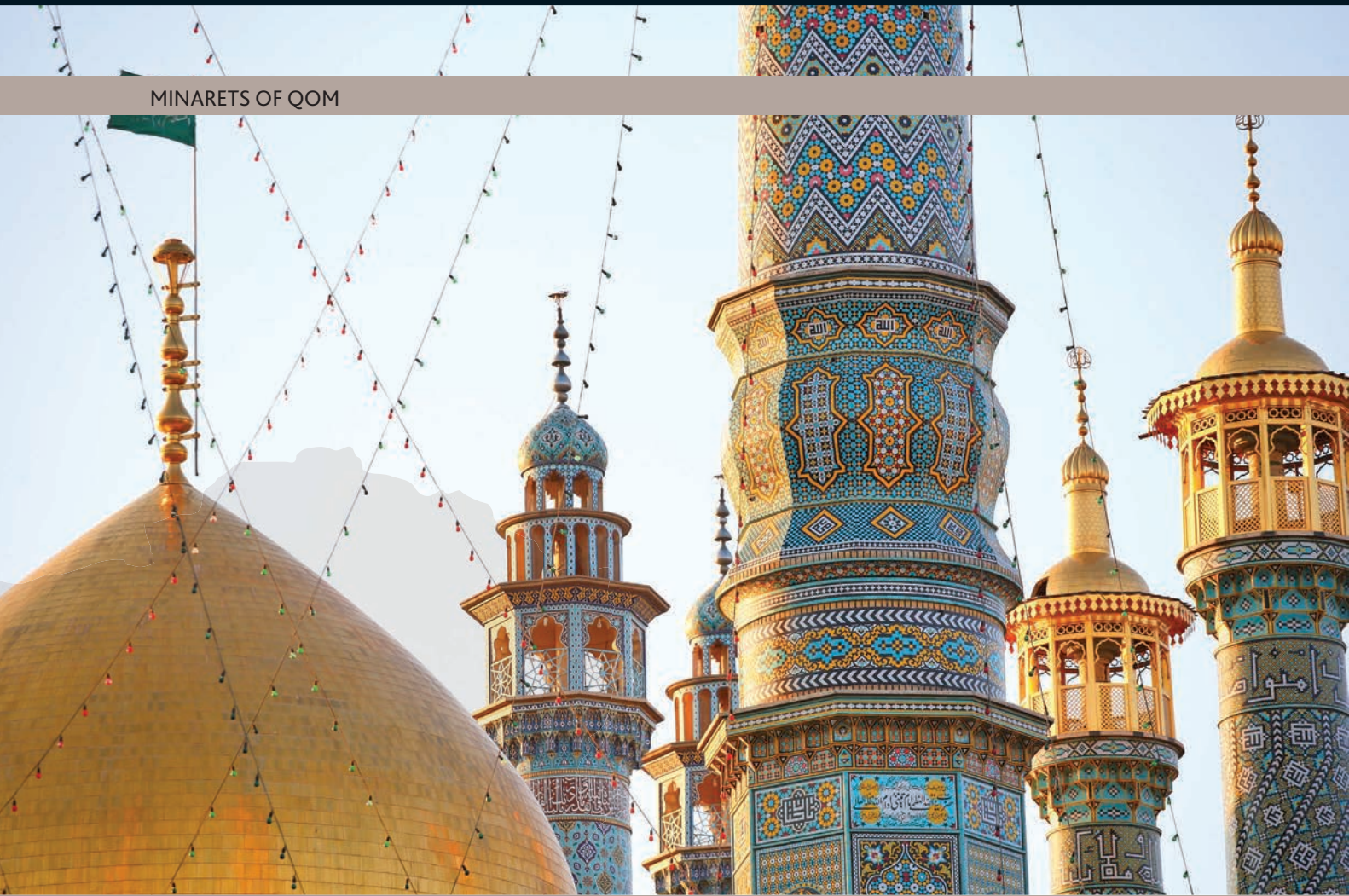
AHMADINEJAD AND THE NEW POPULISM

Hopes that reformers would dig Iran out of its structural trap faded with the election of Mahmoud Ahmadinejad in 2005. A former member of the Basij, the civilian auxiliary of the Revolutionary Guard, Ahmadinejad enjoyed active support from both the Guards and Ayatollah Khamenei, who had succeeded Khomeini as supreme leader. President Ahmadinejad helped extend the IRGC's control of Iran's security apparatus, consolidating his own influence by showering the Guards with favours in the form of government loans and contracts.

Ahadinejad's economic strategy might best be characterized as petro-populism. Taken from the playbook of Hugo Chavez of Venezuela, the idea was to serve as champion of the common man in the struggle against ill-defined exploiters—to "put the oil money on everyone's dinner table" by redistribution to the masses.



MINARETS OF QOM



Long-time Iranian observer Nader Habibi of Brandeis University notes that while Ahmadinejad's economic policies seem erratic and capricious, they follow from simple principles. First, he believes in an active role for the government, and has little confidence in the ability of privatisation to improve the lot of the common citizen. Privatisation, in Ahmadinejad's world, is not out of the question. But to make sense to him, it would have to strengthen his political coalition.

Second, Ahmadinejad is a genuine populist in that he believes the government ought redistribute wealth and income to the poor. Third, he's sceptical of the need for fiscal conservatism, believing that the state should spend oil revenues aggressively to enhance its power. Finally, he views financial institutions, particularly the state-owned banks, purely as instruments of government policy and has little understanding of the role of financial intermediaries in the efficient allocation of capital.

But much of Ahmadinejad's strength lies in his inclination to pragmatism in designing policies that push his agenda and keep him in office. These can be seen in two big initiatives—privatisation and the removal of subsidies.

PRIVATISATION

In the 2009 election, both Ahmadinejad and his opponent, the centrist reformer Mir-Hossein Mousavi Khameneh, promised the wholesale privatisation of the gigantic public sector. But both had in mind transfers that would serve their own influential constituents—think of privatisation in Russia and Mexico in the 1990s.

The major difference between the two candidates lay in the groups that would benefit. Mousavi, who was backed by Rafsanjani, intended to enrich Rafsanjani's long-established network of businessmen, mullahs and their bazaari partners—essentially a continuation of Khatami's policy. Ahmadinejad, for his part, wanted the state enterprises to go to senior officers in Revolutionary Guard and their business partners. Under either candidate, the fortunate recipients could count on financing their acquisitions with loans on extremely favourable terms from state-owned banks.

Having won both reelection and the privatisation battle, Ahmadinejad issued a number of so-called 'Justice Shares', blocks of stocks reserved for employees of the privatised companies. While it is not clear how much stock has been given away in this manner, it is clear that high-ranking IRGC officers comprise the major shareholders of many of the privatised companies. Thousands of other active and retired IRGC personnel, along with their colleagues from the security agencies, also received shares. If these distributions continue on their current trajectory, a military-security elite of around 100,000 could emerge as the principal economic power bloc in the Islamic Republic.



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SUBSIDY REFORM

Khatami's attempts to overhaul the country's crazy-quilt subsidy programme came to naught; the Iranian government continued to spend the equivalent of \$100 billion a year on energy and basic commodities to the population at large. But the onset of the global financial crisis made oil revenues more volatile; meanwhile, international sanctions on Iran began to bite. Ahmadinejad was therefore pressed to embark on a parliament-approved plan under which subsidies would be phased out over five years.

To make the program politically palatable—subsidy withdrawal in Sadat's Egypt and, more recently, Yemen, had sparked riots—provision was made for cash payments on a graduated scale to buffer the anticipated price increases. Indeed, just 20% of the savings was earmarked for the government treasury; the

rest was to be returned to households in the form of cash or used to subsidize new, energy-saving equipment for businesses.

The approach made solid economic sense. On the one hand, it redistributed income from the rich (who have enjoyed more than their share of energy subsidies) to the poor. On the other, it reduced distortions in markets—cheap energy meant overuse, and a growing diversion of oil from export to domestic use. Initially, the reforms were backed by key political interests and supported by the IMF.

But the plan hit a brick wall when it became apparent that the survey data used to identify poor households for cash compensation was deeply flawed. Ahmadinejad bowed to pressure to drop means-tested compensation in favour of uniform payments of around \$40 a month to almost every man, woman and child in Iran. This preserved the progressivity of the plan—the flat per capita payment covers far more of the cost of purchases by the poor. And it still removed the price distortions. But the budgetary cost of the revised compensation was even higher than that of the old subsidies.

Overly optimistic revenue projections left the government unprepared for the added fiscal burden. Teheran has thus been unable to provide the promised support for companies, truckers and other organizations facing rapidly rising energy prices.

Moreover, since the prices that many of these energy users can charge for their own goods and services are controlled, some firms were caught in a price squeeze; this further dislocated an economy already reeling from high unemployment. And with more being spent on basic necessities, demand for a whole spectrum of other products is falling and worker lay-offs are on the rise. Adding to the economic misery, inflation has been accelerating, eroding the value of the monthly compensation payments.

HALF FULL OR HALF EMPTY?

By most criteria, the Ahmadinejad administration rates a failing grade for economic management. Its approach to privatisation has hardly been fair—the benefits are going to a select few. Nor has privatisation increased efficiency, since the newly privatised firms are no more subject to competitive pressures than they were as state-owned enterprises.

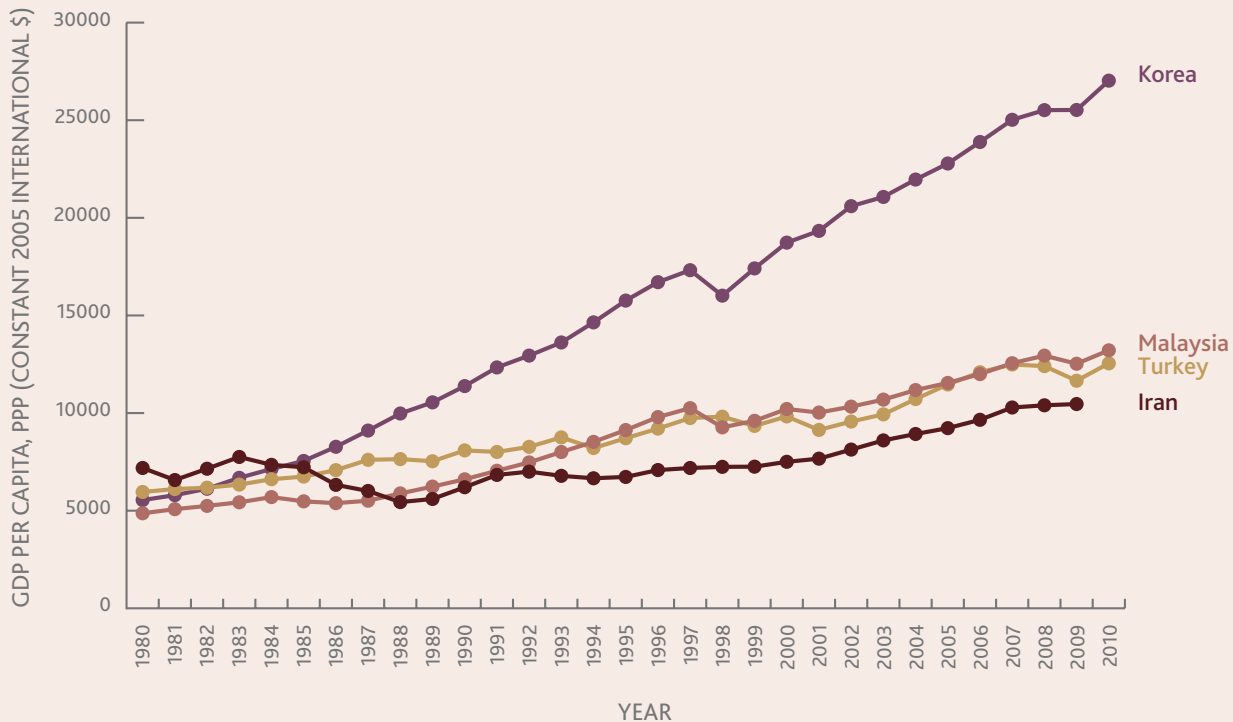
The subsidy reforms are a mixed bag. Conceptually, it looked like the best of possible approaches to untangling the Gordian knot. But the government wasn't prepared for the complexity of the task. And once it began to go wrong, Ahmadinejad responded by throwing money—money the government could ill afford—at the problem. Teheran has thus compounded its fiscal and monetary problems in the process of going in the right direction on price-distorting subsidies.

Ahmadinejad's record on growth is similarly mixed. Between 2005 and 2010, a period in which export revenues (that is, oil revenues) grew at a 7% clip in real terms, economic growth averaged only 3.3%. Inflation remains chronic and high, with some estimates projecting a 20% plus rate once the full effects of the subsidy reforms work their way through the economy.

By the same token, the long-run trend in investment adds no lustre to Ahmadinejad's record. Gross capital formation by the public sector reached a peak of nearly one-quarter of GDP in the last years of the Shah, falling almost continuously thereafter to an anaemic

PER CAPITA GDP: IRAN LAGS BEHIND

Source: World Bank, World Development Indicators



5% of GDP in 1989. It recovered a bit in the wake of the Iraq–Iran war, but remains comparatively low for a middle-income country with a high rate of savings and a big government sector. One reason is that much of the government budget goes to consumer subsidies. Another is the narrow tax base: half of the productive economy is tax-exempt because it is owned by government agencies or by the Islamic charities. The consequences are reflected in the backward state of agriculture, manufacturing and transportation.

Private investment has never picked up the slack. Reasons abound: a hostile business environment, price controls, crony capitalists unwilling to bear risk, uncertainty over government policy. And with Iran at loggerheads with the rest of the world, foreign direct investment (which has proved so important in bringing technology and management skills to other emerging-market economies) has slowed to a trickle.

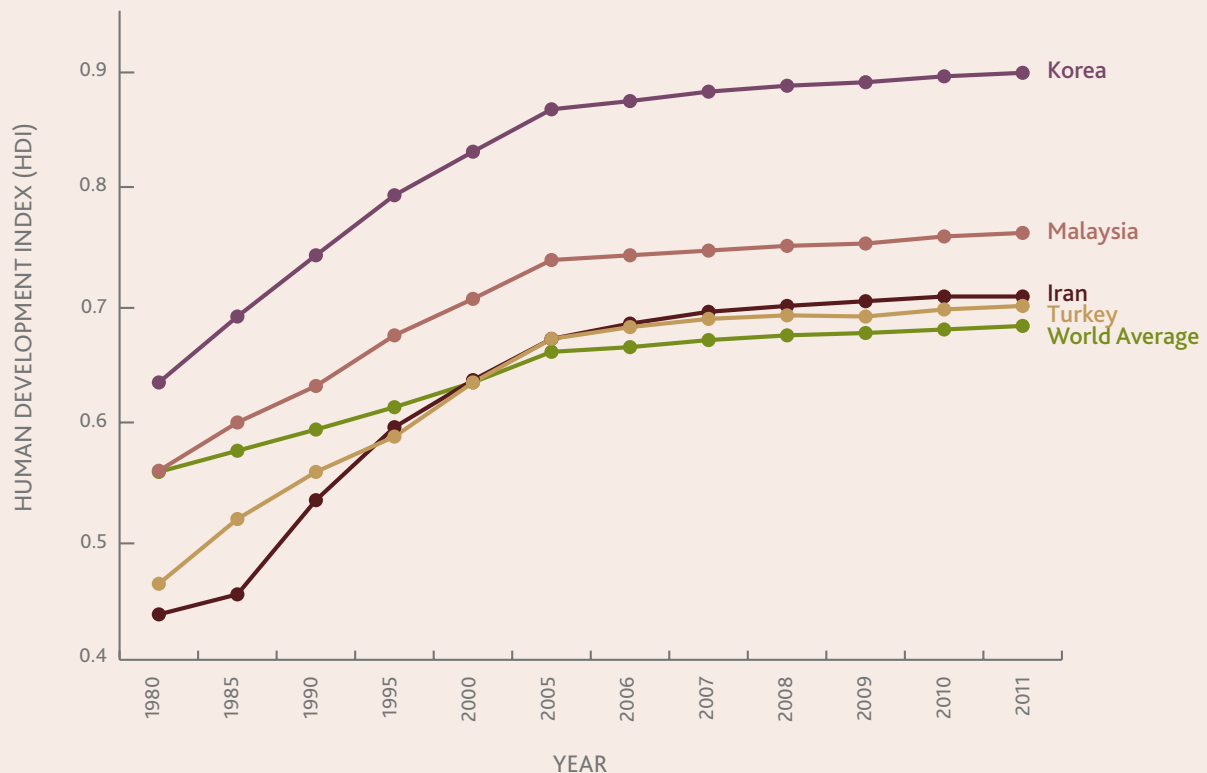
While the macroeconomic/growth trends make Ahmadinejad look bad, other policy areas tell a different story. Privatisation has hardly increased the efficiency of the Iranian economy, but it has served the Ahmadinejad’s administration’s parochial purpose of entrenching his allies. Moreover, while Iran’s distorted form of capitalism



Privatisation has hardly increased the efficiency of the Iranian economy, but it has served the Ahmadinejad’s administration’s parochial purpose of entrenching his allies.

HUMAN DEVELOPMENT: BETTER THAN YOU'D EXPECT

Source: United Nations Human Development Index Data Set



has limited growth to a rate that has left vast numbers unemployed (or working abroad), the Islamic Republic has succeeded on the mullah's own terms: Poverty is down sharply since the days of the Shah, while the benefits of basic medical care, public health and education have been spread to most of the population.

At the time of the revolution, Iran scored well below the average of all countries on the United Nation's Human Development Index, which heavily weights health, poverty eradication and socioeconomic mobility. But by 1995 the country had closed the gap with Turkey, and by 2000 it exceeded the average country's score. Moreover, progress didn't end with the rise of Ahmadinejad. Today, the country is actually ranked in the UN's High Human Development category—stark contrast to the Legatum Institute's ranking in terms of prosperity.

On the other hand, progress did stall quickly in another area of revolutionary priority: income distribution. Djavad Salehi-Isfahani found that, after the revolution, inequality as measured by the Gini index fell from 0.56 to 0.46, but has remained relatively constant since 1990. That latter figure implies less inequality than most of Latin America and sub-Saharan Africa, but more than other middle-income countries in the region including Egypt and Tunisia.

It's often easy—and sometimes misleading—to identify a handful of factors that determine the course of economic development. In the case of Iran, it doesn't make sense to attribute the mix of tepid growth, high unemployment and major gains in the living standards of the poor to Islamic fundamentalism's incompatibility

with competitive market capitalism. I think the causes are quirker—in part, an accident of history in which the new Islamic elite became the enemy of growth.

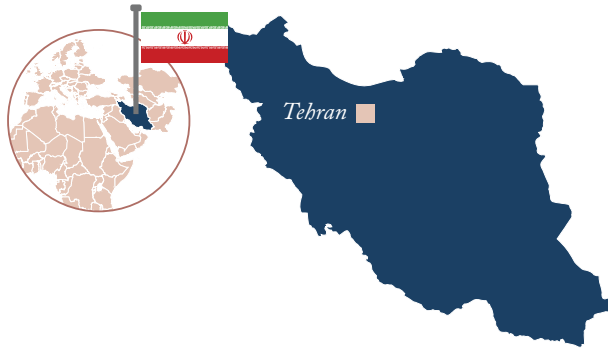
As the Islamic charities and the Revolutionary Guard gained power, they became increasingly effective in blocking reforms that would threaten their perquisites. Furthermore, since the political opposition to these groups was liquidated after the contested elections of 2009, the situation is unlikely to improve anytime soon.

Iran is thus a cautionary tale for other countries in the region that are remaking their societies and economies in the wake of the Arab Spring. Every post-revolutionary economy must cope with high levels of uncertainty as interests jockey to fill the vacuum of power left by the discredited elite. While there are better and worse ways to reorganize an economy—history confirms that macroeconomic stability, the rule of law and the perception of social justice matter a lot—a key lesson from Iran's experience is the importance of preventing those with a stake in inhibiting growth from coming to power.



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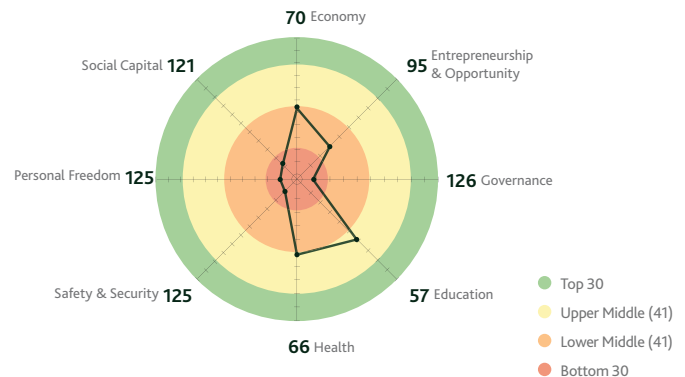
COUNTRY OVERVIEW

| | | Global Av. |
|---|-------------|-------------|
| Population (million) (2010) | 74.00 | N/A |
| Life expectancy (years) (2010) | 72.8 | 69.6 |
| Birth rate (per year per 1000 people) (2010) | 17 | 22 |
| Fertility rate (births per female) (2010) | 1.7 | 2.8 |
| Life satisfaction* (rated 0 > 10) (2011) | 4.8 | 5.5 |
| Female representation in the legislature (2011) | 2.8% | 19.5% |
| Internet access at home? (2011) | 22.0% | 34.2% |
| Satisfied with job/work?* (% yes) (2011) | 65.0% | 73.3% |
| People are treated with respect in your country* (% yes) (2011) | 83% | 85.1% |
| GDP per capita (ppp) (2009) | \$11,569.70 | \$14,774.73 |





INDEX COMPARISONS





| | Rank/ No. of countries |
|--|------------------------|
| Legatum Prosperity Index™ | 102/142 |
| Average Life Satisfaction Ranking* (2011) | 101/142 |
| Per Capita GDP Ranking (2009) | 60/142 |
| WEF Global Competitiveness Index (2011) | 62/142 |
| UN Human Development Index (2011) | 88/187 |
| Heritage/WSJ Economic Freedom Index (2011) | 171/179 |
| TI Corruption Perceptions Index (2011) | 120/182 |
| World Bank Doing Business Index (2012) | 144/183 |

SUB-INDEX RANKINGS



PROSPERITY INDEX: DATA IN FOCUS

| 70 | ECONOMY | Iran | Global Av. |
|---|---|-------|------------|
|  | 5 year growth rate (2009) | 3.2% | 2.7% |
| | Confidence in financial institutions?* (% yes) (2008) | 66.9% | 61.9% |
| | Satisfaction with living standards?* (% yes) (2011) | 64.9% | 59% |
| 95 | ENTREPRENEURSHIP & OPPORTUNITY | | |
|  | Business start-up costs (% of GNI) (2011) | 3.8% | 36.3% |
| | Mobile phones (per 100 ppl) (2011) | 74.9 | 98.7 |
| | Will working hard get you ahead?* (% yes) (2011) | 88.7% | 81.1% |
| 126 | GOVERNANCE | | |
|  | Confidence in the government?* (% yes) (2008) | 60.4% | 53.7% |
| | Confidence in the judiciary?* (% yes) (2008) | 58.1% | 52.5% |
| | Government effectiveness ¹ (2010) | -0.52 | 0.03 |
| 57 | EDUCATION | | |
|  | Pupil to teacher ratio (2009) | 20:1 | 25:1 |
| | Satisfaction with education quality?* (% yes) (2011) | 74.1% | 66.6% |
| | Perception children are learning?* (% yes) (2011) | 84.3% | 70.4% |

| 66 | HEALTH | Iran | Global Av. |
|---|--|-------|------------|
|  | Self-reported health problems?* (% yes) (2011) | 29.1% | 23.9% |
| | Hospital beds* (per 1000 people) (2009) | 1.7 | 3.2 |
| | Satisfaction with health?* (% yes) (2011) | 83.5% | 78.8% |
| 125 | SAFETY & SECURITY | | |
|  | Human flight ² (2011) | 6.7 | 5.4 |
| | Safe walking at night?* (% yes) (2008) | 56.5% | 61.9% |
| | Property stolen?* (% yes) (2011) | 21.5% | 16.8% |
| 125 | PERSONAL FREEDOM | | |
|  | Civil liberties ³ (2011) | 2 | 4.8 |
| | Tolerance for immigrants?* (% yes) (2011) | 55.1% | 65% |
| | Satisfaction with freedom of choice?* (% yes) (2008) | 60.1% | 73.4% |
| 121 | SOCIAL CAPITAL | | |
|  | Rely on others?* (% yes) (2011) | 58.2% | 80.6% |
| | Donations?* (% yes) (2011) | 51.0% | 28% |
| | Help strangers?* (% yes) (2011) | 70.2% | 45.7% |

NOTES: ¹ Gov. effectiveness: values range from -1.73 to 2.25, higher values indicate higher effectiveness. ² Human flight: values range from 1 to 10, higher values indicate higher levels of human flight. ³ Civil liberties: values range from 1 to 7, lower values indicate lack of civil liberties. *Survey data are taken from Gallup World Poll.



REGIONAL RANKING—MIDDLE EAST AND NORTH AFRICA (MENA)

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