

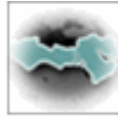


Earthquake Emergency Recovery Project

With the aim of restoring people's livelihoods as soon as possible, in June 2003 the World Bank approved a \$180 million loan to support the Islamic Republic of Iran in relieving social and economic hardships caused by two devastating earthquakes last year. The loan will also help reduce the impact of future earthquakes through an effective system of monitoring and management. The Earthquake Emergency Recovery Project will finance the reconstruction of housing, schools and health clinics as well as public infrastructure such as water and drainage networks, telephone, power, road and electric systems in four northwestern provinces hit by the earthquake. The project will use a newly developed earthquake-resistant housing model that was developed and tested in Iran.

In June 2002, Iran — one of the most earthquake-prone countries in the world — was struck by an earthquake registering 6.2 on the Richter scale. About 230 people died and nearly 1500 were injured. A total of 373 villages and four cities were affected by the earthquake, with more than 33,000 houses destroyed. The Government of Iran estimated damages to be around \$257 million. The people most affected were those from low-income communities who live in mud-brick houses with limited means and expertise to build earthquake resistant structures.

C O U N T R Y B R I E F



Middle East & North Africa Region (MENA) - Iran

Development Progress

Iran has the second largest population, after Egypt, in the Middle East and North Africa region. Most of its 65.5 million people are young, with increasing hopes and expectations of a better future. Larger numbers of increasingly well-educated women seek opportunities to participate at all levels of Iran's labor market and civil society. The country's health and education indicators are among the best in the region.

Education: Fifteen years ago, the Government of Iran embarked on a comprehensive program to develop its human-resources capabilities. These efforts have enabled Iran to increase enrollment ratios, extend educational opportunities to the poorest regions of the country, and reduce gender gaps in all levels of education. Consequently, Iran is well placed to achieve the MDG target with regard to eliminating gender disparities. Similarly, youth literacy rates increased from 86 percent to 94 percent over the same period, rising significantly for girls.

Health: Health outcomes in Iran have improved greatly over the past twenty years and now generally exceed regional averages. Key to this success has been the Government of Iran's strong commitment to and effective delivery of primary health care. Iran's "Master Health Plan", adopted in the 1980s for the period of 1983-2000 accorded priority to basic curative and preventive services as opposed to sophisticated hospital based tertiary care, and focused strictly on the population groups at highest risk, particularly in deprived areas. Moreover, as a result of the prioritization and effective delivery of quality primary health care, health outcomes in rural areas are almost equal to those in urban areas, with outcomes in terms of infant and maternal mortality nearly identical between urban and rural areas.

Social Protection: Iran has a comprehensive social protection system with some 28 social insurance, social assistance, and disaster relief programs benefiting large segments of the population. These programs include training and job-search assistance, health and unemployment insurance, disability, old-age and survivorship pensions, and in-kind or in-kind transfers including subsidies (e.g., housing, food, energy), rehabilitation and other social services (e.g., long-term care services for the elderly), and even marriage and burial assistance.

Despite significant achievements in human development and poverty reduction, serious challenges to growth call for reform. While labor-market pressures continue to increase because of demographic dynamics and increased participation of women in the labor force, Iran's economy is still unable to generate enough needed jobs to absorb the new flows into the labor market and at the same time reduce unemployment extensively.

To overcome the unemployment problem, fueled by a labor supply growth of about 4 percent, the challenge is to ensure high and sustainable economic growth with strong employment creation, driven by a broader participation of the private sector in the economy, particularly in non-oil and export sectors. Furthermore, the current shift of structure of the supply of labor toward higher female participation and higher skill composition requires a shift in the demand side, implying a qualitative change in the growth structure toward the knowledge economy, a direction endorsed by the Fourth Five-Year Development Plan. This envisages upgrading the quality of the educational system at all levels, and improving its effectiveness in terms of a better alignment with the needs of the economy and the labor market. It also envisages reforming education curricula, and developing appropriate programs of vocational training, a continuation of the trend towards labor market oriented education and training.

A major challenge is how to channel the network of untargeted energy subsidies amounting to more than 10 percent of gross domestic product (GDP) -- into productive, job-creating, private-sector investment, the only viable vehicle for sustained growth. Another challenge is to reverse continued environmental degradation and inefficient use of Iran's considerable natural resources. Another growth constraint is limited access to knowledge and information technology and related infrastructure. Moreover, improved governance, public-sector inclusion, accountability, and transparency are needed. Finally, addressing these issues during transition requires a social safety net and programs to preserve stability and prevent the more vulnerable groups from descending into poverty. Iranian authorities have reached broad internal consensus even as political differences sharpen on the urgent need to advance the reforms necessary to meet these challenges.

CURRENT CHALLENGES

Notwithstanding some improvements in social indicators, the Iranian economy continues to confront major challenges: in addition to **employment** creation, **inflation is high and rising; price subsidies and controls hinder efficiency;** and **major structural impediments prevent private sector development.** **Targeting the poor more accurately** with existing programs should reduce poverty. Half of the poor in Iran about 4.5 million people, or 1.5 million households benefit from social coverage by government social safety net programs, charity institutions, and other nonprofit organizations. Whereas this support is partly effective, it is not specifically targeted to the poor, and remains expensive. Extensive subsidies, including energy subsidies, and credit subsidies are excessively large and their distribution is rather skewed toward the rich. Subsidies for bread and medicine, for example, are highly untargeted vis-à-vis the poor, and the richest decile of households benefits 12 times more of gasoline subsidies than the poorest decile.

Iran faces major **environmental challenges**, especially given its growing population and declining infrastructure. Air pollution poses a major urban environmental concern, especially the pollutants released into the atmosphere by motor vehicles, estimated at 5 million tons every year. Air pollution in Tehran and other major cities far exceeds the standards set by the World Health Organization, and is the cause of serious health problems for many Iranians. In Tehran, schools occasionally must close because of dangerously high levels of air pollution. In addition, the lack of adequate wastewater and disposal systems is contributing to ground and surface water pollution through infiltration and over-flowing—the effects of which pose serious health risks.

A **large public enterprise sector** dominates Iran's manufacturing sector (60 percent of sector output), in addition to the quasi-public *boniyads* which have a large presence in the manufacturing, and commercial sectors. The financial sector is also dominated by public banks, however, there is a continued trend to liberalize the banking sector as shown by the establishment of four private banks over the last few years. These private banks were given the flexibility to set the deposit and lending rate and the credit allocation which have helped boost confidence for business and lay the ground for more private sector activities. Privatization and the creation of a level playing field for private firms have moved very slowly in the past years. In July 2006, however, the Government announced a major privatization program whereby large, strategic industries mandated to be state-owned by Article 44 of the Constitution could now be privatized via issuance of up to 80% of their shares through the stock market. The Authorities estimate the total value of the approximately 100 concerned enterprises at \$130 billion. These include, among others, the downstream oil sector, the utilities sector, a large proportion of the financial sector, and the general large industrial and commercial sectors.

Housing is also a major challenge. The total effective demand for housing is estimated at about 570,000 units per year. To meet the Third Five-Year Development Plan household density objective, approximately 113,000 units need to be added per year for the next three years. An estimate for the low-income groups suggests that it needs slightly over 1 million housing units during the years 2000-04. The supply available, however, ranges from 66,000-133,000 housing units per year during the period of 1999-2003. This represents only 45% of the accommodation needed by these groups.

Recent Economic Developments

GDP growth is projected to reach 5.9 percent this year, compared to 4.8 percent in 2005/06, but still lower than during previous two years of high growth (6.7 percent in 2003/04 and 7.4 percent in 2002/03). Iran's non-oil exports reached \$8.1 billion in the first 10 months of 2005/06 (30% increase in nominal USD compared to the same period a year ago. Iran also remains the least indebted country of the MENA region. However, unemployment remains high at 11.5 percent overall and 23.2 percent among youth (up from 10.9 and 22.4 percent, respectively, six months ago). Inflation remains high at more than 12 percent despite having fallen by about 2 percentage points. Expansionary fiscal and accommodating monetary policy increase inflationary risks.

The budget bill for 2006/07 approved in March suggests that fiscal policy will remain expansionary this year as well. According to the document, overall public expenditures (including central government, sub-national governments, and SOEs) stand at 1,915 billion rials. This represents increase by about 7 percent in real terms compared to 2005/06. Budget of the central government will amount to about 26 percent of GDP. While current expenditure is projected to remain roughly constant in real terms, real capital expenditure is expected to increase by about 50 percent compared to its estimated actual level in 2005/06, reaching 8.6 percent of GDP. A large portion of additional public investment will be allocated to public transportation projects sector-wise, and to the lagging regions. While this targeting is generally reasonable, it is important to make sure that public investment is not larger than what current institutional capacity would absorb with reasonable efficiency.

World Bank Assistance

The overarching objective of the World Bank's partnership with Iran is to support

the country's economic transition and structural reform agenda towards a more open economy, sustainable growth with improved income distribution. Bank's analytical work focuses on sectoral reform strategies, public expenditure reform and on an integrated reform of Iran's oversized, inefficient and untargeted subsidies system to reach its objectives of growth and social justice.

The Iran lending portfolio consists of nine active operations - Tehran Sewerage Project, Second Primary Health Care and Nutrition Project, Environmental Management, Earthquake Emergency Project, the Ahwaz and Shiraz Water Supply and Sanitation Project, and the Urban Upgrading and Housing Reform Project, Bam Earthquake Recovery, Alborz Integrated Land and Water Management, and Northern Cities Water and sanitation, for a total commitment of US\$ 1,355 million.

All dollar figures are in US dollar equivalents.

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