Iran Country Brief

Iran is ranked as the second largest economy in the Middle East and North Africa in terms of GDP – after Saudi Arabia – at about US$330 billion in 2009 and in terms of population – after Egypt – at about 73 million people. Iran's economy is centrally planned, relying heavily on five-year plans. It is characterized by a large hydrocarbon sector; small scale private agriculture and services, and a noticeable state presence in large manufacturing and finance sectors. In 2007 the service sector (including government) contributed the largest percentage to GDP at about 56 percent, followed by the hydrocarbon sector at about 25 percent, and by agriculture at about 10 percent. Iran ranks second in the world in natural gas reserves and third in oil reserves. It is the second largest OPEC oil producer with output that averaged 4 million barrels per day in recent years. Iran's chief source of foreign exchange comes from oil and gas. As a result, the health of its economy depends upon international prices for these commodities and its exports which are affected by domestic consumption and production limits.

The country’s social indicators are fairly high by regional standards. The poverty headcount rate (based on a US$2 per day poverty line) was more than halved between 1998 and 2005, to 3.1 percent. Inequality has been reduced, though only marginally. Health and education conditions have improved markedly over the years, and the gender gap has narrowed. Iranian women are playing an increasingly important role in the economy, though their market participation and employment rates remain limited. Some 10 percent of all central government expenditures are allocated to social welfare programs. Iran’s new development plan continues to place emphasis on improving social policies. However, overall social policy lacks a coherent framework, and its efficiency and effectiveness are reduced by fragmentation, duplication of benefits schemes and poor targeting mechanisms.

In education, efforts to develop human resources capabilities over the last fifteen years were marked by increased enrollment ratios, improved access among the poor, and greater female participation. 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. Currently, women outnumber men at the university (undergraduate) level by a factor of 2. Efforts are under way to reform the Technical and Vocational Training System. Quantitative improvements however outpaced improvements in quality of education which is currently the main focus of the sector’s reform agenda.

Iran’s health outcomes have also improved greatly over the past twenty years, standing currently above regional averages. Key to this success is effective delivery of primary health care. Iran’s First Master Health Plan, 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.

Iran has a large 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 transfers including subsidies (e.g., housing, food, energy), rehabilitation and other social services (e.g., long-term care services for the elderly and marriage and burial assistance). Various social insurance, social assistance, and active labor market programs operate with little coordination, and there are problems with their financial sustainability, efficiency and equity.

Notwithstanding improvements in social indicators, the economy continues to confront mounting labor market pressures. Growing unemployment, officially estimated at 12 percent, underlines rapid growth in the labor supply (especially with women entering the labor force) and the sluggish performance of the economy. Macroeconomic imbalances and inefficient public administration has stifled growth, particularly private led. The current shift in the structure of the labor supply toward increased female participation and higher skills requires a shift in the growth structure towards a knowledge economy, a direction endorsed by the Fourth Five-Year Development Plan. Labor market regulations are also hampering progress. Since 2002, Iran has ratified 2 ILO conventions including the Child Labor Convention. This adds to 11 conventions ratified during 1920s – 1950s. The convention regarding freedom of association has not been ratified. Meanwhile, limited progress has been made in terms of the reform to the labor code, which continues to be restrictive in terms of the generous severance pay amidst high unemployment insurance rates. The current regulations are said to be very costly to firms and discourage the creation of jobs.

Iran’s macroeconomic problems also include high inflation. Despite major efforts of the Central Bank, inflation has consistently remained at double-digit levels, and the balance of the Oil Stabilization Fund was reduced, not increased, during the period of exceptionally high oil prices. The result has been boom and bust cycles in economic performance which increase the uncertainty faced by private firms, thus further impeding private investment and job creation. A sharp fall in inflation occurred in 2009/10 as a result of lower international commodity prices, with the rate falling from 25 percent in 2008 to about 10 percent- the lowest in 3 years. However, inflationary pressures are expected to build up again in 2010 as a result of tighter sanctions and the implementation of fuel and food subsidy cuts.

The Iranian state plays a key role in the economy with large public and quasi-public enterprises, which have a large presence in the manufacturing and commercial sectors. Over 60 percent of the manufacturing sector’s output is produced by the state-owned enterprises; the financial sector is also dominated by public banks despite the creation of four private banks in the early 2000s. Progress in privatization has moved very slowly in the past years. In July 2006, the Government announced a major privatization program whereby large, strategic industries mandated to be state-owned by Article 44 of the Constitution could be privatized. These include, among others, the downstream oil sector, the utilities sector, a large proportion of the financial sector, and the large industrial and commercial sectors. The implementation of the program is continuing as planned, though with limited real outcomes. In the latest privatization developments, the government reduced its stake in the country’s two biggest automotive manufacturers from 49 to 31 percent. Unofficial sources in Iran estimate that only 14 percent of past privatization transactions went actually to private hands.

Currently, Iran’s business climate is considered to be poor. In 2010, Iran’s Doing Business score was the lowest by regional standards. Weaknesses are noticeable in areas such as registering property, trading across borders and employing workers. In order to improve the operational environment for private firms and to enhance returns to investment, the Government launched in 2008 a program of investment climate reforms. These efforts produced positive results leading to
improvement in the overall DB ranking in 2010 (based on 2009 data) by 5 positions to 137th (out of 183 countries). The Action Plan includes various administrative, legal and sectoral reforms that are linked to the cost of doing business and the investment climate. These include the simplification of administrative processes for starting and closing businesses, obtaining construction permits, and paying taxes. They also include legal reforms aimed to protect investors and enforce contracts and property rights. Sectoral reforms have targeted the financial market and trade and transport infrastructure. Additional regulatory reforms have also been made in the areas of ease of paying taxes and trading across borders. In the past, it would have taken a small-to-medium-sized company nearly six weeks to establish itself as a legal operator; it now takes on average nine days. Moreover, the time required to obtain a construction license has been cut nearly in half, from 670 days to 322 days. Nonetheless, the timeframe for both starting a business and dealing with permits is still nearly twice as long as the average in the Middle East and North Africa Region. The authorities announced a new incentives package for foreign investors in July 2010 that includes tax exemptions and import duties waiver on inputs.

In recent years, Iran has made some progress in implementing its trade reform agenda by streamlining tariff and non-tariff barriers. Nonetheless, customs duty applies on nearly all goods imported into Iran. Imports of consumer goods generally incur tariffs of 30–50 percent; capital and intermediate goods have slightly lower tariff rates; and tariffs on medicines, wheat and —strategic goods are at zero. Other reforms that helped to enhance foreign trade are the elimination of the multiple exchange rate system six years ago. In 2005 Iran was invited by the WTO to launch accession negotiations and has been working on its trade regime report to be presented to the organization. Non-tariff barriers remain significant as a result of large scale implicit energy subsidies that protect domestic producers (domestic energy prices are fixed well below international prices). The most notable areas needing improvement relate to the reduction of burdensome bureaucratic procedures and lengthy documentation needed to conduct trade transactions.

Subsidy reforms are gaining momentum. In the face of a mounting fiscal deficit, Iran plans to phase-out most of its subsidies on fuel and a number of food commodities and services over the next 5 years. A reform bill was approved in early 2010, and is planned to be implemented from September 2010 through March 2015. With the cost of subsidies as high as $100 billion, the government aims to achieve savings in the annual budget and reduce domestic fuel demand and vulnerability to international sanctions. A significant portion of the resources saved under the reform program (about 70-80 percent) will be transferred to low-income families, and businesses as cash or non-cash payments. However, the phasing out of food and fuel subsidies is also expected to push up the inflation rate. Currently, energy subsidies account for more than 10 percent of gross domestic product (GDP).

Targeting the poor more accurately by with public transfers would help to 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. While this support is partly effective, it is not specifically targeted to the poor, and remains expensive. Subsidies, including energy subsidies, and credit subsidies are excessively large, and their distribution is 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 from gasoline subsidies than the poorest decile.

In terms of health policy, current priority areas include: (i) designing and implementing new incentives and regulations for health service providers to ensure more equitable and effective access
to health care; (ii) expanding the family physician care model to serve as the first point of contact and gatekeeper; (iii) redesigning provider payment mechanisms and harmonizing the existing fragmented social health insurance system for better cost containment; and (iv) mobilizing additional resources for health.

Iran has had a successful population policy, but there are signs that it might be changing course. Iran’s family planning program in the past two decades has been considered international best practice: Iran managed to decrease the fertility rate from 4.8 to 1.8 births/woman during 1990-2008. Recently, plans were unveiled for a new subsidy scheme of a $950 one-time lump sum grant and $95 annual bank deposits for each child born to a family until the child reaches the age of 18. This new policy, if implemented, could cause significant challenges to Iran’s development prospects, worsening unemployment, inflation, and public resources shortages.

In the education system large challenges remain with regard to aligning education, enrollment and training with the needs of the economy and industry. The Fourth Five-Year Development Plan envisages upgrading the quality of the educational system at all levels, as well as reforming education curricula, and developing appropriate programs of vocational training, a continuation of the trend towards labor market oriented education and training.

Iran faces major environmental challenges, especially given its rapidly growing population and declining infrastructure quality. Air pollution poses a major urban environmental concern, especially that caused 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 overflowing— the effects of which pose serious health risks. In an effort to overcome these challenges, the Government has taken a number of actions, including the installation of an air quality monitoring network with stations in a number of provinces (Mashad, Esfahan, and Arak) and has initiated the revision of water and soil standards. In addition, the Government has allocated a budget to conduct economic valuations of the Iranian Ecosystem.

All dollar figures are in US dollar equivalents. Updated September 2010.

For more information, please contact:
In Washington:Najat Yamouri at (202) 458-1340 or nyamouri@worldbank.org.