



# Stanford Iran 2040 Project

An Academic Platform for Research on Iran's Long-Term Sustainable Development

## Governance and Development in Iran

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## **About the Stanford Iran 2040 Project**

The Stanford Iran 2040 Project is an academic initiative that serves as a hub for researchers all around the world—particularly scholars of the Iranian diaspora—to conduct research on economic and technical matters related to the long-term development of Iran and to evaluate their possible implications in a global context.

The project encourages quantitative and forward-looking research on a broad array of areas relating to Iran's economic development. It seeks to envision the future of the country under plausible scenarios. The project has been co-sponsored by the Hamid and Christina Moghadam Program in Iranian Studies and the Freeman Spogli Institute for International Studies at Stanford.

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## About the Author



**Pooya Azadi** is the manager of the Stanford Iran 2040 Project. He has written widely on issues relating to various aspects of development in Iran including demographics, economic policy, oil and gas, renewable energy, land and water resources, food security, and scientific research policy. The overarching goal of his research is to shed light on the fundamental forces and trends pertinent to development and economic growth in Iran. He has also led the *Iran in Charts* project which is a comprehensive public data portal for curation and presentation of Iran's statistical data on a wide array of topics. Before his current position at Stanford University, he worked as a researcher at the universities of Oxford, Cambridge, and MIT for several years where his research was focused on energy and the environment. He studied chemical engineering at the University of Tehran (B.Eng) and the University of Toronto (M.A.Sc. and PhD).

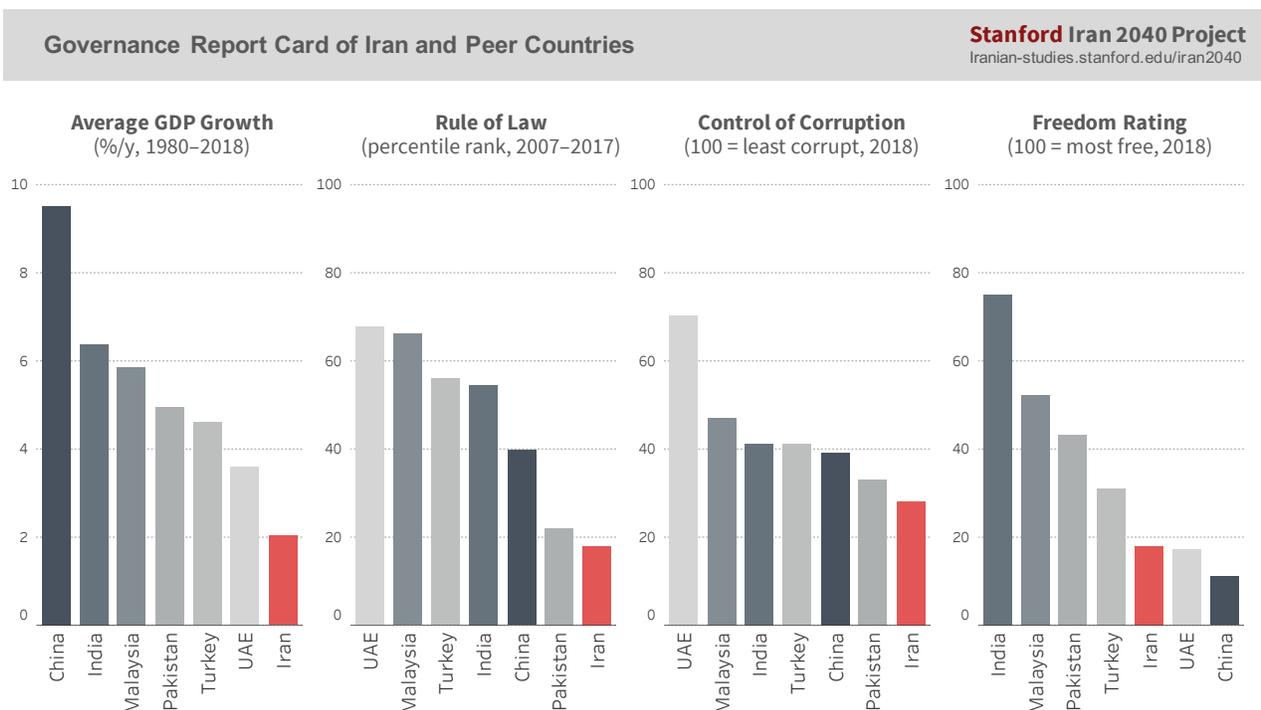
## Executive Summary

Systematic analysis of governance and interactions among its constituent elements is key to understanding a nation's development trends. This paper attempts to provide such an analysis by evaluating the quality of governance in Iran over the past half-century. To this end, a multidimensional framework is employed to describe the evolution of the state (the power-deploying institution within the system of governance), the rule of law and accountability (the checking institutions within the system of governance), and their relations with economic growth, the state's legitimacy, and social mobilization in contemporary Iran. Four distinctive time periods have been considered in this analysis: the prerevolution period (1970–79), early stage of the revolutionary state (1979–89), the period known as reconstruction and reforms (1989–2005), and the period of governance deadlock and economic stagnation (2005–present). The main dynamics of governance in each period are discussed by focusing on the evolution of the above institutions and the interactions among them. The paper argues that Iran's major challenges are rooted in its poor governance. Today, as a result of the low and non-inclusive growth of the past four decades, the signs of stress in the Iranian economy and society are multiplying. Widespread poverty and growing inequality, low labor force participation and high unemployment, human capital flight, declining productivity, banking and pension crises, high and rising public debt, loss of social capital, and serious environmental issues are among the challenges currently facing the country. In the meantime, corruption has become systemic and turned into a downward spiral that reinforces itself over time. Considering the poor outcomes of Iran's state-dominated development strategy—which to some extent had hoped to copy the China model—the paper highlights the urgency of implementing a transformational approach to governance to reduce the discretionary actions of the political institutions, improve transparency and accountability, and allow for the establishment of a strong civil society. Without these changes, development in Iran is unlikely to proceed much further regardless of the prevailing political system in the future. Furthermore, given the extensive range and depth of Iran's internal challenges—which will likely be exacerbated in the long term by exogenous factors (e.g., physical impacts of climate change, global efforts to move away from fossil fuels, and the diminishing potential of cheap labor as a driver of growth due to automation)—the window of opportunity for Iran to overcome its development logjam and avoid a dire future in the coming decades is closing rapidly.

## 1. Introduction

Since the inception of the Islamic Republic in 1979, Iran has collected \$1.3 trillion in oil export proceeds [1]. In the meantime, the country has entered—and already passed a third of—its one-time demographic window of opportunity in which the favorable age structure of the population is conducive to rapid economic growth [2]. Yet the growth of average real per capita income during this period has been at a very low annual rate of 1% [1] while the country also suffered from a loss of social capital, human capital flight, endemic corruption, and environmental deterioration over the entire land. As the state struggles to reform itself, the intensification of these economic and social crises is now leading Iran to an important turning point in its history.

As will be discussed throughout this paper, Iran’s major challenges and shortcomings are deeply rooted in a lack of effective governance. To put this claim into a broader context, I first briefly compare Iran’s key governance indicators with selected peer countries (China, India, Malaysia, Turkey, Pakistan, and the United Arab Emirates). While half a century ago Iran was perceived to be on a comparable or better trajectory of development than these countries, it is today behind its peers in virtually all major aspects of governance and development (as shown in **Figure 1**). Since 1980, annual GDP growth in Iran has averaged 2% which is fairly low compared to the performance of the peer countries whose gross domestic products have expanded at an average rate of 4–10% per year. Compounded over forty years, these seemingly small differences in annual output growth have given rise to an enormous gap between the extent of improvements in the economic well-being of Iranians and the citizens of these countries.



**Figure 1.** Comparison of Iran and select peer countries along key governance indicators [3, 4, 5,6].

Based on the quantitative measures provided by international institutions, Iran's comparative performance with regard to the political aspects of development such as rule of law, freedom (political rights and civil liberties), and control of corruption is also extremely poor (**Figure 1**). In the following sections, I first discuss the theoretical background for measuring the quality of governance in general and then apply the described framework to evaluate the quality of governance in contemporary Iran.

## 2. Theoretical Framework

Effective governance plays a decisive role in the social and economic development of nations. In fact, it is differences in the scope, capacity, and legitimacy of different states that bring about massive disparities in their policy outcomes. Governance can be defined as “*a government's ability to make and enforce rules, and to deliver services, regardless of whether that government is democratic or not*” [7]. According to this definition, the quality of a nation's governance should be evaluated based on the performance of its political agents in fulfilling their given tasks, without a priori value-based judgments about the democratic nature of its institutions (norms of good governance vs. norms of good democracy [8]). In other words, institutions should be evaluated in this view based on how their nature, dynamics, and interactions enable governments to achieve their goals. For instance, in order to describe the quality of governance in an authoritarian regime, one needs to assess the quality of decisions made by its leaders rather than conveniently recognizing the authoritarianism per se as the cause for certain outcomes [7,8].

The institutions that constitute modern political systems can be grouped into those that concentrate and use power (i.e., the *state*) and those that act as constraints on power, namely the institutions of *rule of law* and *accountability* (**Figure 2**) [7,9,10,11]. Nations' development paths depend on their extent of institutionalization with regard to these three pillars of governance as well as on the sequence in which their different institutions have been built and have evolved. Therefore, disaggregating the realm of political development into these three sets of institutions as the first step of the analysis allows for a more precise and dynamic assessment of the interaction between different dimensions of development by avoiding the limitations caused by the standard static and dichotomic views of economic versus political developments.

One of the key determinants of the quality of governance is the *capacity* of the state (i.e., the executive branch of the political system and its associated bureaucracies). In general, the chief aims of benevolent modern states can be described as addressing market failures and protecting the poor and vulnerable [12]. Market failure occurs when the market economy, due to a variety of reasons, fails to allocate optimal amounts of resources to provide particular goods or services. Among the main forms of market failure in which state intervention finds a rational economic basis are providing public goods (e.g., defense), curbing negative externalities (e.g., pollution),

promoting positive externalities (e.g., education), and addressing monopolies in the economy and asymmetric information (e.g., moral hazard and adverse selection issues in health insurance) [12]. States should prioritize among these functions by taking into account their potential impacts on the well-being of citizens as well as their own capacity and resources required to fulfill them successfully. Based on their perceived suitability for different levels of state capacity, The World Bank classifies state functions into three groups: *minimal*, *intermediate*, and *activist*, although in reality some degree of overlap exists among these functions [12]. **Figure 2** provides some examples for these three broad groups of state functions.

The higher the capacity of the state, the wider the range of functions it can successfully perform. In fact, many states in the developing world, including Iran, are expected to do too much with their limited capacity and, as such, end up playing a negative rather than a positive role. It is therefore suggested that states with low capacity focus on the provision of pure public goods in the early stages of the prolonged period of state-building as the pursuit of *activist* functions (**Figure 2**) by low-capacity and incompetent states often proves to be counterproductive. The industrial policy implemented by the state in Iran—which for decades has overridden market price signals through subsidized credit and import control measures—is a prime example of such policy mistakes as it failed to take into account Iran’s low state capacity. In the subsequent sections, I will discuss how such ill-fated state interventions, in conjunction with the nontransparent and poorly managed process of privatization of state-owned enterprises, have become a major source for creation and extraction of rent and an important factor for the establishment of patronage relationships in Iran.

## Governance Institutions: State, Rule of Law, and Accountability

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**Figure 2.** A conceptual framework for the analysis of governance based on three sets of institutions: state, rule of law, and accountability [10,12,13,14].

Another essential component for a functional governing system is the rule of law, which can be defined as “*the impersonal and systematic application of known rules to government actors and citizens alike*” [11]. Central to the principles of *good governance* is a set of defined and fair rules and regulations that control the actors in the state, the market, and society in general. The main function of such a system thus comprises political actions (restricting the power of government) and economic actions (protecting property rights and enforcement of contracts). Moreover, and more fundamentally, the rule of law has an important societal impact by providing a basic form of “social contract” which organizes the expectations and behaviors of different parts of the society. Achieving a fully developed legal system spanning all those aspects is a complex and long-term process. Empirical data suggest that the rule of law may not be a necessary precondition for economic growth at early stages of development but becomes more important at later stages when the economy gradually becomes more complex. Development of the rule of law is a slow process which happens as a result of the interactions between political and economic institutions over long periods of time [11,15]. In fact, there are different stages of legality, whereby “*rule by law*”—that is, using laws as an instrument of domination by the rulers—typically precedes “*rule of law*” which emerges at a later stage when those rules apply not only to citizens but also to rulers and political elites [11,15].

How exactly such a transition to the rule of law happens, including how the rulers stop using their power to violate those rules and respect an independent judiciary system, is not completely clear and there seem to be different paths in each country’s case [15]. Different types of transitions have been identified historically, ranging from transition from an informal and highly pluralistic system of law to a successful adaptation of foreign legal systems [11]. In Iran’s case, different components seem to be involved in the making of the current legal system. Sharia<sup>1</sup> and tradition have historically been the main sources and origins of the legal system but modern democratic components were also added to the law at different stages, including the constitutional revolution, the Pahlavi era, and even in the current constitution of the country written after the Islamic revolution. However, Iranian society currently appears to be undergoing a transitional period, whereby the legitimacy of the traditional sources of laws and order is declining due to the society’s rapidly changing values and the shortcomings of the religious-based rules to address the complex needs of the new society. As a result, a state of legal anarchy is emerging where the previous sources of traditional order and rules are not as legitimate and overarching as before, while a new, modern system of regulations has not yet developed. As will be discussed later, this decline in legitimacy of the law can be an important factor contributing to a drastic increase in crime and corruption of the past decade.

Accountability constitutes another important element of modern governance. One of the main channels through which accountability contributes to the quality of governance is by making

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<sup>1</sup> The terms Islam and Islamic are mentioned more frequently in Iran’s current constitution than in the constitutions of all other Middle Eastern countries combined.

recruitments and promotions in the bureaucracy more meritocratic, thus enhancing the quality of decisions and their outcomes. Through periodic multiparty elections, procedural democratic accountability can potentially improve governance by providing the principals (the people) with a way to purge corrupt and incompetent agents (the officials), although in reality procedural accountability does not always lead to substantive accountability. In the modern era, authoritarian and even totalitarian regimes often feel the need to stage elections to legitimize their power. However, in the absence of real multiparty competition, such elections can never really challenge the monolithic power structure. In such regimes, existing and emerging cleavages are deactivated before reaching the stage of crystallization to form issue-oriented parties [16]. In any case, lack of substantive accountability can jeopardize the government's ability to embark on serious reforms, especially when those entail austerity measures such as reducing subsidies or increasing tax.

Accountability has commonly been ascribed to the democratic elements of governance such as multiparty elections and free media. For instance, the relevant index in World Governance Indicators combines “Voice and Accountability” and defined it as the perception of “the extent to which a country's citizens are able to participate in selecting their government, as well as freedom of expression, freedom of association, and a free media” [17]. It can be argued, however, that accountability might not be formally present in the form of procedures and institutions but may instead function in other forms, like moral accountability, in other political cultures [10]. Although democracy is an end in itself, it cannot be assumed a priori that procedural democratic accountability would necessarily give rise to improvement in substantive accountability and its subsequent effect on state capacity [10,18].

Accountability can be divided into *de jure* (procedural) and *de facto* (substantive) forms in terms of the structure of institutionalization, and can be divided into vertical, horizontal, and diagonal in terms of the type of interactions between citizens and officials that it affects [18]. While vertical accountability is related to the mechanisms outside the state institutions and concerns the relationship between the citizens and the elected bodies (e.g., multiparty elections), horizontal accountability highlights the separation of power in the state and manifests in terms of the oversight exercised between different institutions (e.g., questioning government officials by legislative committees) [18]. Diagonal accountability, which is also called social accountability, highlights the role of citizens, civil society, and independent media in holding the power accountable beyond participation in elections [18]. All three mechanisms can be present to various degrees, in either *de jure* (procedural) or *de facto* (substantive) forms. *De jure* accountability is related to the presence of formal institutions that make accountability possible (e.g., constitutional provisions for multiparty elections; legal provisions for extensive suffrage; statutes providing for formal independence of the judiciary). *De facto* accountability refers to the extent to which accountability mechanisms are realized in practice (e.g., free and fair elections without vote buying or systematic fraud; effective oversight by the judiciary).

In terms of the actual governance structure, the state in Iran has revolved around a single person—the king or the supreme leader—who has been beyond the rule of law, accountable only to the divine rather than the public or other parts of the government. The main tenet of this structure has persisted in contemporary Iran, both during the Pahlavi dynasty and after the Islamic Revolution (although in different forms and by alluding to different grounds for legitimacies). Iran’s current constitution gives an almost unconstrained power to the Supreme Leader as the head of the state. His supervision and control span over all major aspects of governance institutions, including direct control over the judiciary, armed forces, state media, and foundations, plus indirect control over the central government and parliament (primarily through the role of the Guardian Council in elections and decrees). However, even in a system with such a high level of concentration of power in a single person, the quality of governance is influenced by complex and dynamic interactions between the institutions and more fundamental trends in the society.

The rest of this paper thus discusses the quality of governance in Iran based on the broad conceptual framework that explains the three sets of governance institutions with minimal reference to the details of the political structure or politicians. This approach allows for a better understanding of the role of institutions and fundamental forces which underpin governance in Iran rather than being trapped in daily politics and historical contingencies. In other words, detailed historical information is distilled to elucidate the major patterns and underlying forces driving a complex phenomenon such as a social movement or a chronic economic issue. In contrast with the historical accounts that focus mainly on specific events that unfolded in the past, this analysis seeks to shed light on fundamental forces and deeper trends. These forces are behind the evolution of society and governance while the actual historical events, which may appear to be haphazard, ride on top of these more fundamental trends and are modulated by them. Hence, the characteristics of the institutions play a subliminal role in driving the events, although the exact time and appearance of events depend on individuals and micro-factors. Overall, this paper should be seen as an attempt to discuss the gap between what constitutes “good governance” (normative view) and the general patterns of governance in contemporary Iran (empirical account).

Finally, I note that this paper primarily presents a qualitative account of governance although it frequently refers to empirical data to advance its arguments. Readers interested in direct quantitative measures of governance are referred to **Appendix A**, which provides a discussion of the merits and limitations of quantitative approaches for evaluating the quality of governance, particularly those related to Iran.

### 3. Assessment of Governance in Iran

In this section, I attempt to evaluate the quality of governance in Iran through the conceptual framework described in the previous section. To this end, I look at how the three sets of political institutions (state, rule of law, and accountability) evolved and interacted with each other, with dominant ideas and demands of the nation, and with economic factors. As mentioned earlier, the advantage of this framework is that it does not reduce development to a single dimension (e.g., economic or political), nor does it reduce the evolution of governance to isolated factors in a static manner. Instead, it takes into account the dynamic interactions among multiple dimensions.

The analysis presented here divides Iran's past half-century into four distinctive time periods: the prerevolution period (1970–79); the early years of the establishment of the Islamic Republic up to the end of the Iran-Iraq War and appointment of the new supreme leader (1979–89); the postwar period commonly referred to as *reconstruction* and *reforms* (1989–2005); and, finally, the post-reform period of governance deadlock and economic stagnation (2005–present) (**Figure 3**). Major developments within each period are explained by specific dynamics of interaction between the components mentioned earlier, as I briefly outline in the following.

**Prerevolution (1970–79):** The dominant process in this period was acceleration of the previous top-down efforts by the state for modernization and industrialization, which was enabled to a large extent by the massive oil revenues of the '70s. Perceptions of injustice and exclusion in the fast-growing economy, combined with the natural resistance of a traditional society against a top-down modernization agenda, gradually gave rise to massive social mobilization which, through multiple complex channels, brought about a huge increase in demands for fundamental changes and eventually toppled the Pahlavi dynasty. The dynamics and sequence of interactions between institutions in this stage are in fact very similar to the classical scenario of political decay in fast modernizing countries as described originally by Samuel Huntington [19].

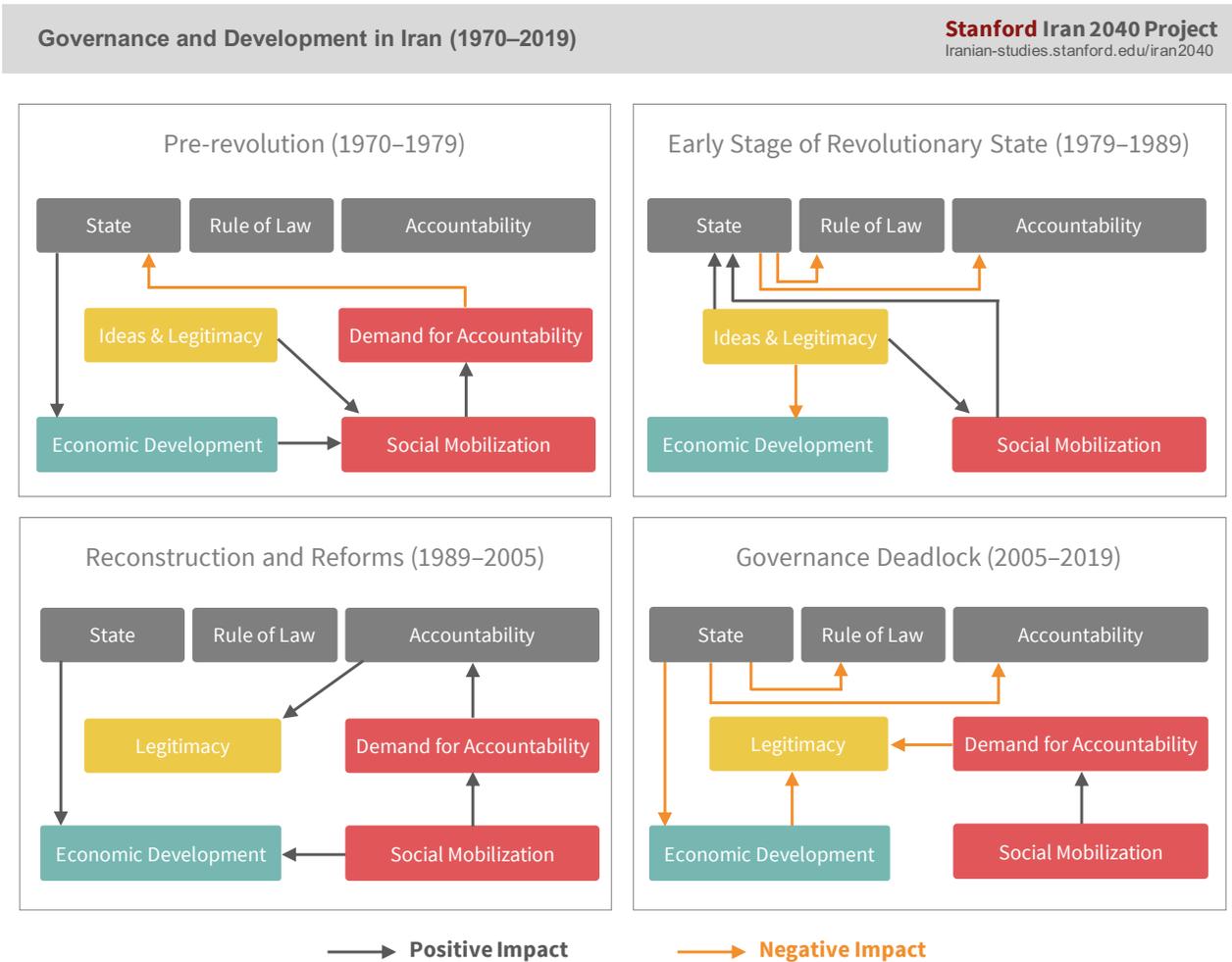
**Early Stage of Revolutionary State (1979–89):** This period encompasses the transition from a state with modernization and westernization agenda to a revolutionary state with Islamic ideology and cadre organizations. The new state was based on completely different grounds for legitimacy: independence and a return to Islamic values as opposed to westernization and modernization; and redistribution of resources and egalitarian rhetoric as opposed to industrialization and growth. Spearheaded by a charismatic leader whose personality initially overshadowed all formal institutions, the revolutionary state increased the political participation of the public, especially the poor and underrepresented class, but at the same time undermined the very institutions of rule of law and never improved substantive accountability. Economic conditions started to deteriorate soon after the revolution due to political turmoil and the dire consequences of the eight-year Iran-Iraq War. Despite its negative impact on the economy, the war paradoxically helped the establishment of the revolutionary state by creating

an environment where any form of suppression of the opposing political groups and civil society could be justified. The contraction of the economy, at least for some years, did not significantly delegitimize the state since economic growth was never the primary goal of the revolution's ideology.

**Reconstruction and Reforms (1989–2005):** This period starts with the appointment of Khamenei as the supreme leader and Rafsanjani as the president. The main feature of this period was attempts to introduce development-oriented features to the revolutionary state in order to reconstruct a shattered economy while being cautious about not destabilizing the political structure. This period marks the beginning of the pursuit of industrial policy by the Islamic Republic and renewed public investments made according to the country's first five-year development plan after the revolution. These state-dominated economic activities along with the lack of transparency and strong institutions of rule of law gradually created large rent-seeking opportunities, which can be seen as the beginning of a new era in terms of the public perception of corruption. Later in this period, demand for accountability and formation of a more-structured civil society increased, which then manifested itself in the election of Khatami and the emergence and partial bureaucratization of the Iranian reform movement. Lack of a viable path for the implementation of meaningful reforms within the current constitution framework and lack of incentives for the reformists to push for a more serious reform agenda were among the main causes of the failure of the reform movement. Before reformist attempts were fully blocked and eventually dismantled by the unelected part of the state, this period arguably represented the peak of the state's legitimacy and, in hindsight, the best window of opportunity for meaningful reforms in governance institutions.

**Governance Deadlock and Economic Stagnation (2005–present):** The start of this period is coincidental with the election of Ahmadinejad at the time when the progress toward reforms had already come to a halt since a few years earlier. The reversal in the development of political institutions was amplified by Ahmadinejad's anti-institution and populist policies, which intentionally undermined or bypassed bureaucracy to achieve his goals. By the end of Ahmadinejad's first term, a combination of failures in different arenas (political, economic, and social) had already created a significant demand for change in the way that the country was governed. This pressure culminated in the controversial presidential election of 2009 which ultimately caused a major blow to the legitimacy and political stability of the state. Since then, Iran has consistently struggled with serious internal issues (including economic stagnation, escalation of crime and violence, and entrenchment of corruption) and external challenges (most notably, surrounding its nuclear program and regional behavior). Since his election in 2013, Rouhani has attempted to depict a more rational, internationally cooperative, and even—in some cases—socially liberal picture of the state. In reality, however, Rouhani's only major achievement to date was the nuclear deal which temporarily restored Iran's oil exports to their full capacity before America's unilateral withdrawal from the agreement in 2018. Today, after

decades of the state's resistance to political and economic reforms, Iran is facing the most severe and extensive economic, social, and environmental crises in the history of the Islamic Revolution. The sheer size of the cumulative impacts of the past irresponsible policies and economic mismanagement along with the entrenchment of corruption at all levels have eroded the state's ability to address the crises that are gradually causing the country to fall into a path of political instability and decay.



**Figure 3.** Interactions among various components of economic, social, and political development in Iran during four time periods spanning the past half-century. Arrows and their colors show, respectively, the transmission channel and *sign* of impact (positive vs. negative) between different elements in the model. The framework was adapted from reference [14].

Note that, in the conceptual model depicted in **Figure 3**, I mainly focus on major drivers and their interrelations to highlight the principal patterns in governance, without delving too much into the second-order details. As such, different periods and the distinctions between them should be considered as ideal types (in the Weberian sense) to facilitate understanding and analysis. In reality, it is more likely that the idealized dynamics of each period exist to various degrees in other periods as well. For example, the period of governance deadlock and economic

stagnation comprises two distinct periods of Ahmadinejad's and Rouhani's presidency. During each, the government tried to revive certain dynamics of the previous periods, namely the egalitarian rhetoric of the early stages of the revolutionary state period and the postwar pragmatism in the use of technocratic tools for public management, respectively. In the remainder of this section, a more detailed account of the evolution of the abovementioned components (legitimacy, state, rule of law, accountability, economic development, and social mobilization) is provided to illustrate the patterns of governance and development in Iran over the past half-century.

### 3.1. Legitimacy

Authoritarian regimes can often stay in power insofar as they preserve a minimum level of legitimacy, particularly among the elites tied to them and when a robust civil society does not exist. In such regimes, erosion of one source of legitimacy, if not replaced by a new source, would lead to loss of capability for effective action. Throughout the decade leading to the revolution and amid a period of unprecedented economic growth, paradoxically, the underpinning legitimacy of the Pahlavi regime declined to an extent that ultimately led to its collapse in 1979. In addition to motivations that were purely ideological, the causes that contributed to such a counterintuitive phenomenon can be grouped into three broad categories. First was the perception held by members of the low- and middle-income classes that they were being deprived of their fair share of the massive economic windfalls amid the oil boom of the '70s. Second was social mobilization stemming from an improvement in literacy and increased urbanization—both catalyzed by the shift from an agrarian to a modern economy—which failed to be properly accommodated by the existing institutions. Third was the coalescence of forces of the traditional institutions of clergy and *bazaar* (the traditional merchant class) whose socioeconomic status was at risk due to the emergence of the modern institutions of education, judiciary, and industrial manufacturing. This can be seen as a classic example of what Huntington labeled as the political decay that happens at the early stages of the state-building process when the political system fails to accommodate its consequential social mobilization (**Figure 3**) [19]. During the ensuing decade of the revolution (1979–1989), the relationship between the prevailing collective ideas of the people and changes in political and economic institutions was sharply different from what occurred in the last decade of the Pahlavi dynasty. During this period, the newly established regime consolidated power by purging previous top managers, cracking down on political opponents and civil society, and providing funds and human resources for a prolonged and devastating war with Iraq. As a result of these developments, the (revolutionary) state consolidated its power while the economy gradually contracted to about half the size it had been at the onset of the revolution.

The constitution of the Islamic Republic is composed of democratic, theocratic, and autocratic elements, where the democratic and theocratic elements serve as the *de jure* sources of

legitimacy. The Islamic Republic's de facto sources of legitimacy in early stages, however, revolved around the twin principles of *equality* and *independence*—contrary to the Pahlavi dynasty that was seeking to legitimize its authority on the basis of *modernization* and *nationalism* (e.g., by referring to the idea of a Great Civilization and alluding to the golden era of the Persian empire). The two regimes also relied on different sources of traditional legitimacy, namely kingship and religion. Despite their tremendously different ideas and economic interests, different classes of society rallied behind the promises of equality and independence to address the historical quest of the nation for recognition: equality as being recognized by their own state to have the same value and rights, and independence as being recognized by other states to have the same value and rights. The evolution of governance in the postrevolution era can be analyzed in light of the ramifications and culmination of these new pillars of legitimacy.

The interpretation of the concepts of equality and independence that ultimately prevailed in the new regime was not only inefficient from an economic standpoint but also contained various forms of important internal contradictions. Reducing poverty to a mere issue of economic inequality paved the way for the implementation of various forms of redistributive measures such as heavy subsidies on energy carriers with far-reaching implications for the economic growth and patterns of institutional development throughout the history of the Islamic Republic. This naive interpretation of the concept of equality was to some extent attributable to the lack of a clear understanding of economic principles among the elites of the Islamic Republic and their unrealistic view of Iran's overall economic standing in the globe. This exaggerated view of Iran's economic importance in the world was also shared by the Shah, with the difference that in the Islamic ideology of the revolution, the economy was secondary from the beginning. Regardless of their original intentions, the seemingly pro-poor policies of the revolution formed a lasting ground for a new form of clientelism at the national and subnational levels with implications clearly reflected in the country's chronic fiscal deficit and low productivity. As will be discussed later in this paper, high inflation throughout the life of the Islamic Republic has consistently imposed a hidden tax on those with fixed income throughout the year (e.g., rank-and-file employees) and those who do not know how to invest their money. High and volatile inflation has also significantly damaged the Iranian economy by making long-term planning impossible.

Parallel to the idea of equality, the Islamic Republic's leaders pursued the image of an ideal independent state as another cornerstone of their legitimacy. This concept proved effective in buying popular support in the early stage of the republic, but it has had enduring consequences on the quality of governance and development in the entire postrevolution era. Anti-imperialist rhetoric increased the isolation that Iran faced after the Islamic Revolution, and this isolation in turn fueled the rhetoric (in reality, Iran has increasingly tilted toward the east in later stages due to various strategic reasons). This vicious cycle has severely affected Iran in multiple ways, for example:

- ❖ Declining productivity due to lack of access to international financial markets and new technologies;
- ❖ Missing the opportunities created by globalization;
- ❖ Unsustainable population expansion due in part to pronatalist policies (from the early days of the revolution to the mid-'80s and yet again from 2014 until the present) as a large population has been perceived as strengthening and stabilizing the revolution;
- ❖ Unsustainable exploitation of the country's water and land endowments to achieve food self-sufficiency and hence reduce vulnerability against potential international embargoes rather than focusing on the long-term food security of the nation;
- ❖ Poor quality higher education and research, due in part to an intentional disconnect between Iran and the modern world aiming to curb what is frequently labeled as cultural diffusion.

Noticing the practical shortcomings of the original grounds for legitimacy in the ideology of the revolution, the Islamic Republic inclined to somewhat more developmental and modern behavior in the postwar period commonly referred to as reconstruction and reforms (1989–2005). The period started with the presidency of Rafsanjani, who, through the following decades, tried to depict himself as a pragmatic and technocratic state builder (by alluding to the image of Amir Kabir as one of the first state builders in Iran). In the real world, however, it seems that Rafsanjani was more influenced by Deng Xiaoping, who had just successfully led China out of the massive inefficiencies of its centrally planned economy without mass privatization or structural reforms in the political realm. Rafsanjani's economic liberalization reforms per se, unlike their counterparts in China, failed to buy much new popular support. Nevertheless, some elements in these reforms, such as the improvements of technocratic capacity at high managerial positions, persuaded a significant portion of the middle class that development and modernization could still be achieved through gradual reforms of the current regime. It was, in fact, such hopes working in tandem with demographic factors that led to a landslide victory for Khatami, then a relatively unknown politician. He galvanized people's demand for better governance in general and for more social and political freedom in particular. The social mobilization that resulted in Khatami's election soon resulted in the victory of his close supporters and allies in parliamentary and city council elections. These in turn created the impression that the Islamic Republic could be made more accountable through available constitutional mechanisms. These developments temporarily boosted the legitimacy of the regime before disappointment in reforms became dominant yet again.

The failure of Khatami's political reforms despite their wide popular support can be attributed to two distinct factors. First was the inherent limitation of elected officials' power due to the coercion of legal and quasi-legal power by the non-elected body of the state (e.g., the Guardian Council). Second was the occurrence of a classic principal-agent problem where the elected reformist politicians (i.e., the agents) did not act in the interest of their constituencies (i.e., the

people who wanted change) simply because these politicians knew their future success in politics would depend primarily on satisfying the non-elected institutions of the state. These politicians viewed competition for people's votes as an easy win due to the lack of strong alternative opponents. After a few rounds of trial and error, the non-elected part of the state also realized the rules of the game and started to disqualify any politicians who had the political will to pursue genuine reformist agendas, based on an underlying assumption that people always participate in elections regardless of the candidacy of a particular group or individual.

The next period in the evolution of governance during the Islamic Republic started with the presidency of Ahmadinejad, who possessed all the main characteristics of a populist politician: implementing unsustainable but popular economic policies for short-term political gain, trying to weaken formal institutions and fill the void with a direct connection with the people, and narrowing the definition of *the people* to only those who are supportive of him. The widespread belief that the state rigged both presidential elections of 2005 and 2009 in favor of Ahmadinejad was arguably the first major blow to the legitimacy of the state in the eyes of the educated middle class which, until then, was seeking change primarily through the ballot box. Ahmadinejad's policies (or, more accurately, the policies of the state during the period in which he was the president of the country) had lasting and multifaceted impacts on the regime's legitimacy. First, like many other populist politicians, he leveraged the resentment that existed among the poor and marginalized classes to justify his anti-elite and anti-institutional actions. He in fact tried to present his plans as the resurgence of the revolution's original ideals and ideas (especially equality and independence). For some years, close ties to religious leaders and the deep state helped him push many controversial policies whose implementations were otherwise impossible. On the economic front, Ahmadinejad embarked on a number of major populist programs, similar to Venezuela's former president Hugo Chavez, whose costs even exceeded the country's enormous oil revenue of the time. Despite their inefficiencies, these policies for some years strengthened the position of the state among the targeted classes. Furthermore, as will be discussed later, a significant part of privatization and associated misconduct occurred when Ahmadinejad was in office. During his second term, the economic pressures of some of the state's poorly designed mega-projects, such as affordable housing (*Maskan-e-Mehr*), intensified by the effects of oil sanctions, resulted in another bout of very high inflation and a wide dissatisfaction among the very constituencies who were the beneficiaries of Ahmadinejad's populist policies in the first place. Besides the economic direction of the country, the aftermath of the highly controversial presidential election of 2009 and wide and intensive attacks on civil society can be viewed as a turning point in the perception of a large part of the middle class with regard to the workability of reforms advocated by the former president, Khatami, and his political allies.

Similar to the Soviet regime, the Islamic Republic has made sporadic attempts to make up for its troubled economy and justify sociopolitical repression by claiming technological achievements

perceived by the public as associated with superpower status. The most notable example of these legitimacy-boosting strategies has been the country's highly controversial and expensive nuclear program. Besides its obvious strategic regional purposes, the program has been presented to the public as a technological leapfrog whose economic, environmental, and medical benefits would change the course of history for the nation. In fact, for more than a decade, the rhetoric of irreversible progress toward the edge of nuclear technology was the state's most glorious message sent to its core supporters. However, just within a year after the start of the 2012 oil sanctions, Iran's fragile economy underwent such a significant contraction that continuation of the nuclear program could have imposed existential risks to the regime. It was under these circumstances that the presidential election of 2013 was held, leading to Rouhani's election. His main promise was to solve the complicated nuclear deadlock (eventually leading to the Joint Comprehensive Plan of Action, JCPOA, in 2015). But contrary to his previous views and track record, Rouhani also augmented his message with promises for more social and political freedom to appeal to members of the educated middle class who were disappointed by the regime's crackdown after the 2009 presidential election.

In addition to the effects of sanctions that reduced the amount of Iran's oil exports to half their pre-sanction level, the sudden drop in the price of oil between July 2014 and July 2015 (when Iran signed the JCPOA) resulted in Iran's oil revenue being cut by another half. Following the implementation of the JCPOA in January 2016, and thanks to the increase in oil exports, economic growth started to improve from deep negative rates. However, being aware of the existential threat to his position from both top-down and bottom-up pressures, Rouhani avoided reforms as they would have provoked the people, the regime's elites, or both. Besides lacking political will for embarking on economic reforms, Rouhani's administration has been mostly comprised of the top managers of the previous governments who did not have many new ideas for policy improvement anyway. He instead almost entirely relied on the impacts of the nuclear deal for fostering economic growth and encouraging investments. Since mid-2018, the unilateral US withdrawal from the JCPOA, which immediately eliminated all the economic benefits for Iran from the deal, severely undermined hopes to salvage the economy. All in all, the fate of the nuclear program and its economic consequences resulted in a major blow to the regime's legitimacy. The former undermined its legitimacy among the regime's core supporters and elites and the latter created a wide sense of dissatisfaction and even agony among all economic classes.

One of the most important impediments to economic reforms in Iran is the role of the Islamic Revolutionary Guard Corps (IRGC) in the economy. Soon after the end of the war and during Rafsanjani's presidency, IRGC embraced for-profit economic activities as a contractor in infrastructural projects (e.g., building highways and dams). Over time, however, IRGC expanded to all other possible sectors of the economy, including oil and gas, banking, agriculture, telecommunication, and car manufacturing. Today, the nature of IRGC's economic activities has

somewhat changed from the original contributions, which were based on engineering capacities, to a middle-man position, taking public contracts and distributing different parts of the project among domestic (including IRGC's own subsidiaries) and even foreign companies. Given the sheer amount of profit IRGC makes in this process, and its essentially unsupervised military power, it comes as no surprise that IRGC resists any structural changes, especially with regards to increasing the role of the *real* private sector in the economy.

Despite the failure of economic and political reforms, strong loss aversion and status quo bias of Iranians—which presumably had roots in the events of the revolution and war—continued to inhibit demands for radical change until recently. Today, with unprecedented levels of socioeconomic dissatisfaction, the regime's remaining legitimacy is plummeting among a wide range of social and economic classes. The regime has tried to avoid the fate of Mikhail Gorbachev's Soviet Union by postponing any form of structural reforms, failing to realize that the window of opportunity for meaningful reform will not be open forever. In hindsight, during the forty-year history of the Islamic Republic, Khatami's first term in office (about twenty years ago) was arguably the best time to address institutional problems in governance, as the state's legitimacy and social capital were both at their peak.

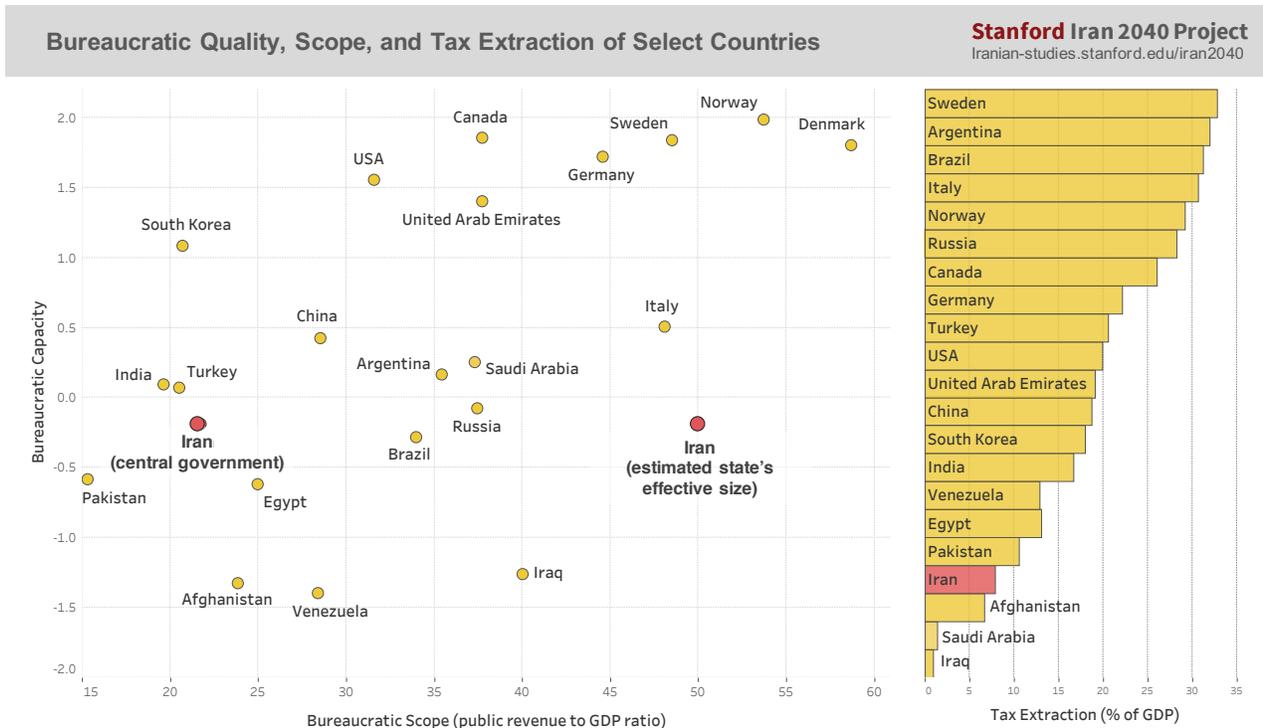
### 3.2. State

To provide an overview of the evolution of the state in Iran, I use a two-dimensional framework that considers *scope* and *capacity* as the principal components of statehood—the former to capture the extent of functions that the state seeks to fulfill and the latter to capture the extent to which the state properly performs these functions [9].

#### *Scope and Capacity*

While states with high capacity can be found across almost the entire range of government sizes, states with a wide scope and low capacity, such as Iran, represent the least desirable combination (**Figure 4**). As will be discussed shortly, there is a massive difference between the size of the central government in Iran and the actual size and interventions of the public sector (i.e., state's effective size, see **Figure 4**). The difficulty of reforms for the countries in this club arises from the need to simultaneously reduce the state's size and enhance its capacity.

Similar to global trends from the beginning of the twentieth century to the '80s, the relative size of the government in Iran, as measured by the ratio of government expenditure to GDP, increased gradually to reach about 50% in the years before the 1979 revolution. However, in drastic contrast with Western countries, the expansion of the government in Iran was driven by the windfalls from oil exports rather than an increase in the capacity of the state for tax extraction. In fact, the amount of tax collected in Iran (**Figure 5**) has never even reached 10% of the country's GDP until today.

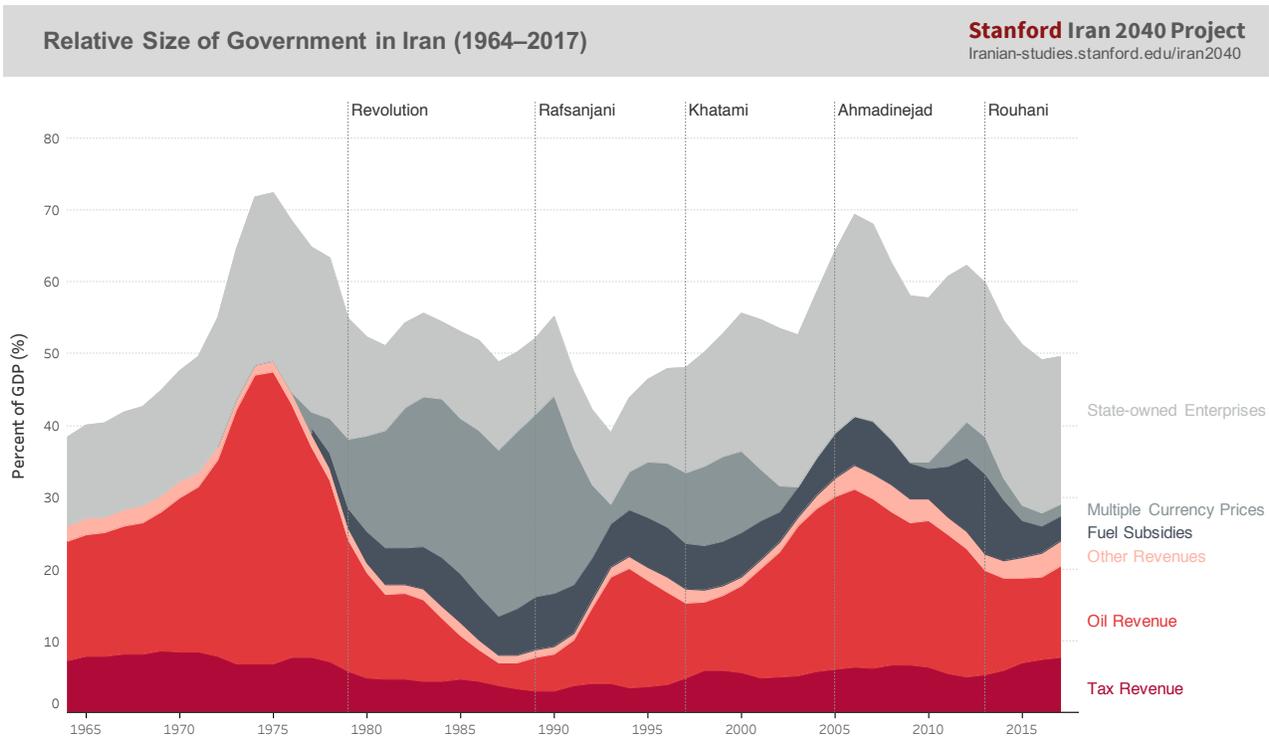


**Figure 4.** Bureaucratic quality vs. scope (left) and tax extraction (right) for select countries [4].

Given the radical promises made during the revolution for a complete change of the governance system to align it with Islamic principles and pro-poor policies, the Islamic Revolution started with a heavy footprint on the state institutions from its early days. The leaders began changes immediately by creating parallel institutions to some of the existing ones, nationalizing large private enterprises and banks, and purging the top and mid-level managers of the just-toppled regime, replacing them with young, inexperienced, idealistic, and ideologic revolutionary members who, before long, took the lead in most aspects of governance. As such, part of the institutional capacity of the country was lost while the new institutions struggled to deliver when faced with the realities of governance, especially in the chaotic conditions after the revolution, exacerbated by the emergence of the Iran-Iraq war.

In addition to extensive and excessive scope, the Iranian state has also suffered from limited strength and capacity. For example, as described above, the state has historically had a limited capacity for tax collection. The modernization of the state which started early in the twentieth century could in principle have enhanced the state's capacity, but two factors hindered this process. First, oil revenue windfalls in the '70s undermined the importance of bureaucratic institutions and made them secondary in decision-making. This started the process of capacity destruction, which is notoriously happening in natural resource-driven booms [20], especially in countries with weak political institutions. This was then continued and intensified by the revolution in 1979, which reversed the process of modernization of the state, not only by purging the previous bureaucrats but, more fundamentally, by undermining the very structure of the

previous bureaucratic institutions. In fact, revolutionaries tried their best to replace—or, in cases where not possible, to supplement—any previous structure with a new revolutionary one, with the paramount example of IRGC as a parallel institution to the modern army.



**Figure 5.** Direct economic intervention of the state in Iran normalized by gross domestic product. A two-year moving average was applied. Underlying data obtained from [1].

Such parallel structures and institutions have persisted until today, adversely affecting the capacity of the state for making decisions and implementing its policies. This has contributed to the constant tension between the elected part of the governance system (e.g., the central government and the parliament) and the unelected parts (e.g., the judiciary or the Guardian Council, revolutionary foundations and IRGC). The presence of such factionalism has contributed to the short-sightedness of the elected governments and their inability to embark on serious reforms and long-term plans. They are only able—or willing—to address immediate issues with short-term results, postponing the confrontation with the challenges and their associated risks to the next administration. This short-sightedness is exacerbated by two more contributing factors: the weakness of political parties (or lack thereof) and the demise of social capital and accountability (for more discussion, see below under the section on Accountability).

### *Privatization*

During the '80s and '90s, Western countries reversed the trend of government expansion and reduced the size of their governments by implementing policies that are today commonly referred to as Reaganism and Thatcherism. In the meantime, the International Monetary Fund

and the World Bank were encouraging developing countries to rapidly liberalize their economies and privatize state enterprises by pushing a policy package known as the *Washington Consensus* [21]. During the '80s, in another unintended development caused by massive changes in oil revenue, the size of Iran's central government contracted substantially before stabilizing at nearly 20% of GDP in the following decades (**Figure 5**). A decade past the revolution and after the economic contraction of wartime, the Iranian state found itself with no choice but to make an economic U-turn and half-heartedly take some steps toward price liberalization and privatization. Since then, the Islamic Republic's economic policy has been a realm of trial and error at the fundamental level. There is no clear underlying strategy despite the official long-term economic plans that are frequently published by the state (but are of little value due to their unrealistic mandates). While a more detailed analysis of the macroeconomic policies of the state will be provided later in this section, I here focus on the state's path toward privatization as an effort to directly adjust the scope of its functions.

By the end of the '80s and after a decade of statism, the idea of privatizing state-owned enterprises emerged among the regime's elites. The end of war had created public anticipation for improvement in the disastrous economic situation.<sup>2</sup> Since 2001, approximately \$120 billion (in constant 2017 dollars) worth of state-owned enterprises have been sold off, with \$110 billion occurring during Ahmadinejad's presidency [22]. Also, given that only a small proportion of state assets and enterprises were actually sold off to the real private sector [22,23], the de facto outcome of privatization was the transfer of public enterprises from the central government to parastatal organizations such as pension funds, *bonyads*, IRGC-affiliated corporations, and banks. In terms of the ultimate beneficiaries of privatization, about 20% was given to the poor and lower-middle income class through the Justice Shares scheme (*Saham-e-Edalat*), 20% to the working middle class (through debt cancellation agreements between the government and major pension funds), 20% to business elites in the private sector with close ties to the state, and the remaining 40% to revolutionary foundations and IRGC-linked business entities. As such, the economy has not made a meaningful move toward liberal capitalism, nor can it be centrally controlled by the central government anymore [24].

In hindsight, while there was nothing wrong with the idea of privatization per se, lack of state capacity and the corruption and misconduct that occurred throughout the process resulted in its failure, evidenced by the country's stagnant, if not declining, capital productivity [1]. Today, after about three decades, privatization in Iran seems to be approaching an end as the majority of the remaining state-owned enterprises and assets to be sold are loss-making or small in value. As a result, selling off the remaining state-owned enterprises can no longer be used for paying the government's large and growing debt to government bondholders, pension funds, banks,

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<sup>2</sup> Three decades after the end of the war, state officials still sometimes refer to the war, along with sanctions, as underpinning the economic shortcomings of the present. But such arguments have almost completely lost the persuasive power they enjoyed in the past.

and contractors, which in total is estimated to be at least 40% of GDP. The transfer of ownership of state enterprises from the central government to the nongovernment public sector allowed the regime's elites to tap into a huge opportunity as the transferred companies have remained under various forms of governmental support such as directed credit and import licenses (which discourages them from making efforts to improve productivity) while now being able to generate lucrative salaries and bonuses for their managers. All in all, Iran has joined the club of countries where, due to low state capacity and lack of a proper rule of law, the outcome of the privatization process was disastrous for development.

### *Public Management Style*

Another important feature of public administration in Iran over the past four decades has been its revolutionary-style approach (colloquially called *jihadi*). This was best exemplified during the war period (especially highlighted in the different style and approach of the IRGC to war compared to the classic army, namely reliance on motivated volunteers rather than formal order and training). This approach was later institutionalized in the form of *Jihad of Construction* (involved in activities like road building, electrification, and irrigation canals in rural areas) and formation of an independent ministry which was subsequently merged with the ministry of agriculture to form the current *Ministry of Agriculture Jihad*. Revolutionary public management, which was the dominant operational tool during the first decade after the revolution, played a central role in mitigating the delegation problem and somewhat compensated for the state's low capacity amid the turmoil of the '80s. The revolutionary-style type of public management, which shares some similarities with the Chinese *cadre organization* model [8], is based on the ideological commitment of the personnel to the policy doctrine of the state. In this model of public management, in any specific situation, instead of making decisions based on a detailed set of rules, agents would do what the top managers would have done in that situation. This is why ideological training is of absolute importance in the revolutionary type of organizations. A comparison of the main characteristics of the Weberian type of bureaucracy and the revolutionary type of public management is provided in **Table 1**.

**Table 1.** A comparison between the characteristics of Weberian bureaucracy and revolutionary-style public management. Partially adapted from reference [8].

Characteristics	Bureaucracy	Revolutionary Public Management
Recruitment	Merit	Commitment
Basis of decisions	Detailed rules	Policy doctrine
Motivations	Incentives	Ideology
Group cohesiveness	Weak	Strong
Predictability	Strong	Weak
Tools	Routine	Ad hoc
Knowledge accumulation	Possible	Low
Position on transparency	Neutral	Uncooperative

### 3.3. Rule of Law

The institution of rule of law is an important cornerstone of good governance. This section discusses how different aspects of rule of law, including its roots and functions (political, economic, and societal), have evolved in Iran over the past decades. It is important to note that rather than being a binary characteristic of the governance that either exists or not, the rule of law is the result of a complex and long-term process, often entwined with other aspects of political and economic development.

#### *Rule of Law vs. Rule by Law*

One of the main functions of the rule of law is its political role in containing and controlling the concentration of power in the state. This aspect is best highlighted in the distinction between rule *of* law and rule *by* law. The transition to rule of law typically starts with institutionalization of rule *by* law, where laws are used by rulers to enforce their domination. Rule *of* law emerges at later stages when rulers and elites themselves are willing to, or are forced to, accept the constraints of law on their decisions and actions. In spite of top-down efforts to establish the rule by law and prolonged bottom-up pressures to make the rulers subject to the laws, the rule of law is still in primitive stages in Iran. Despite efforts toward (top-down) modernization of the state and the legal system during the Pahlavi era, in reality, whenever the king (be it Reza Shah or Mohammad Reza Shah) was in a strong position, he ignored the constraints of law on his absolute power and acted independently according to his personal desires. This was the case during the peak of Reza Shah's power but also resurfaced during the oil boom of the '70s as, for example, documented by the Shah's notorious rejection of advice from experts in the bureaucracy [25].

This tendency did not change for the better after the (bottom-up) revolution of 1979, despite its anti-dictatorship sentiments. Several factors contributed to this. First, the charismatic legitimacy of Khomeini as the revolutionary leader gave him a special position above and beyond rules. This charismatic legitimacy, which had the effect of legitimizing the rules rather than being bound by them, was further substantiated by the general tendency to return to religion (in effect, authority of the clerical establishment and the jurists) as the source of law. Apart from his revolutionary stance, Khomeini's legitimacy was rooted in his position as a religious and legal authority in Shia's clergy system, as the highest ranking authority of the Twelver Shia community (*Marja al-Taqlid*, the authority to be followed by the public in religious matters). As such, he was in essence representing the traditional source of rules and regulations (*Fiqh*, or Sharia) as opposed to modern (Western) laws, in a society which was increasingly feeling alienated through a rapid process of top-down modernization (Westernization) and hence demanding the "return" to the roots of itself.

This could have potentially led to the confinement of the (Islamic) ruler by the (religious) law,

and hence establishment of an indigenous route to a rule of law. However, Khomeini's theory for Islamic Governance, namely the theory of Governance of the Islamic Jurist (*Velayat-e Faqih*), or more precisely the *Absolute* Governance of the Islamic Jurist, effectively gave primacy to the jurist-ruler, and hence defined the ruler as the key religiopolitical figure above the rules. Although this has been seen as a solution to give the jurists the flexibility to interpret (*Ijtihad*) the traditional texts in a way which is compatible with the needs of modern times, in practice it has led to a situation where the religious ruler has the absolute, unchecked power to interpret the religious rules in the interest of survival and expediency of the (Islamic) state. This tendency to override the rule of law has been continued and further institutionalized during Khamenei's period as the supreme leader, as manifested in numerous decrees and unofficial orders that have been issued by him. As a result, the postrevolution system of governance reinforced the position of the ruler above the rules and thus hindered the realization of the political functions of the rule of law.

The most prominent manifestation of this can be observed in the judicial system, which notably lacks the necessary political independence from other parts of the state, especially the supreme leader who directly appoints its head. Since its inception, the postrevolutionary system of governance has used the judiciary as a political tool to suppress the opposition. This was, maybe not surprisingly, the case in the chaotic situation immediately after the revolution, when "revolutionary courts" formed to rapidly prosecute and execute former officials or confiscate properties without proper legal procedures. But, surprisingly, the essence of it has changed very little forty years after the revolution. It manifests itself more clearly whenever critical conditions like social turmoil or political unrest appear in the country (e.g., in the aftermath of the presidential election in 2009 and repression of the Green Movement) or when the unelected faction of the government wants to undermine the elected parts (as when it cracked down on the reform movement during Khatami's period or suppressed the free press). The function of the judiciary in contemporary Iran can thus be best described as a process of "judicialization" in autocratic regimes [26], whereby the judicial system is functioning as an instrumental tool to "resolve" the controversial issues arising from political tension between elected and unelected parts of the government (often in favor of the unelected parts and with the chief aim of suppressing any opposition), rather than representing an independent institution guaranteeing fair and impartial implementation of the laws across parties and citizens alike.

Such a structure has also seriously limited the economic function of the rule of law. The problem started with the original wave of confiscation and nationalization right after the revolution, which at the time had strong popular support due to the dominance of leftist rhetoric and the anti-aristocratic tones of the revolution. This initial trend was further consolidated and institutionalized in the next years by the formation of unelected, and mostly unmonitored, revolutionary foundations (*bonyads*). They took control of major industries and enterprises (public or private) as well as national resources in the name of the public and with the goal of

egalitarian redistribution. Tightly linked to one of the main pillars of the regime's legitimacy (equality), these "public" financial institutions acted as another wing, next to the judiciary, to enable the political aspirations of the state.

The judicial system became, therefore, politically subordinate and systematically incapable of preserving the property rights of individuals and private companies, especially when in conflict with those public institutions and the state. It also proved unable to enforce contracts and rules effectively and predictably, as legally vague and undefined terms like "spreading corruption on Earth" (*fesad fel'arz*) or "war against God and the state" (*moharebeh*) could be invoked whenever the state wished to suppress any individual or organization. This could happen even in purely financial scenarios, since the state might see certain financial activities as threatening its stability or general interest, making in turn the distinction between the political and financial sectors more obscure. Such unpredictable enforcement of the law, heavily reliant on the political conditions and interests of the state, has not only halted the transition to the rule of law but has undermined even the credibility of the system in ruling *by* law. This problem has been exacerbated by the presence of multiple sources of rules and regulations, where several bodies of law are present and often in conflict with each other. Despite negative implications for the establishment of the rule of law, the ambiguity and disarray in the legal system provide a means for the government to interpret the law as it sees fit depending on the situation.

The dominance of state political interests over legal and financial dimensions meant that even later changes in government policies toward economic liberalization were ineffective in bringing about any structural change. A case in point is the large-scale privatization effort which culminated during Ahmadinejad's period, with close to one-third of government assets and shares of firms covered by Article 44 being sold to the "private" sector from 2006 to 2009. However, even such large-scale privatization programs did not stimulate or protect the private sector. In fact, they strengthened the unofficial and unregulated part of the state and its oligarchs (e.g., elites tied to IRGC and *bonyads*), with inevitable deeper corruption and non-transparency in this process.

The combination of these deficiencies in the rule of law has seriously affected its legitimacy and hence its social function. As a result, the public has lost faith not only in the institutions of rule of law but also in the necessity or benefit of adhering to the law in general. This is specifically problematic as the Islamic Republic's system of governance has utilized the traditional sources of religious rules and regulations as the foundation of the legitimacy of its laws. Lack of proper function of these laws in practice has, therefore, left the public psyche in a state of legal anarchy, whereby the traditional foundations of laws have lost their ground for legitimacy, while a new, modern regime of the rule of law has not yet emerged. Thus, a system of governance which emerged as the result of a revolution opposing modern laws and advocating a return to traditional laws at its heart has through its own evolution ruined the legitimacy of those norms and regulations in the public mind.

### *Corruption and Crime*

Perhaps the most obvious point where the dysfunction of the rule of law and its different economic, political, and societal aspects manifest themselves is corruption. Corruption in its basic form is defined as misusing public resources for private gain and it is known to significantly reduce the capacity of state [11,14,27]. It damages both the economy and the political order by decreasing the capacity of the state to recruit the most competent people and to exploit the full potential of its human capital, while depriving the state of its legitimacy and public trust. As a result, corruption could also significantly affect social capital.

Although fighting corruption has been one of the main slogans of the Islamic Republic since its inception, four decades after the revolution corruption has reached a level that is widely accepted to be systemic. That is, corruption is present among high-ranking officials and fighting corruption has become increasingly more difficult. More fundamentally, the culture, the expectations, and the rules of the game have changed, as the state and its citizens are both accepting new norms of lawlessness and corruption as the common—if not the only—means to reach their goals and obtain short-term benefits. This has, in turn, severely limited the bureaucratic capacity and quality of governance. The most fundamental consequence of such endemic corruption has, however, been its adverse effect on social capital, as it has seriously damaged the trust between the public and the state. The chasm between the people and the government has especially widened, as such pervasive corruption at the level of officials is at odds with one of the major pillars of the legitimacy of the postrevolution government, namely equality.

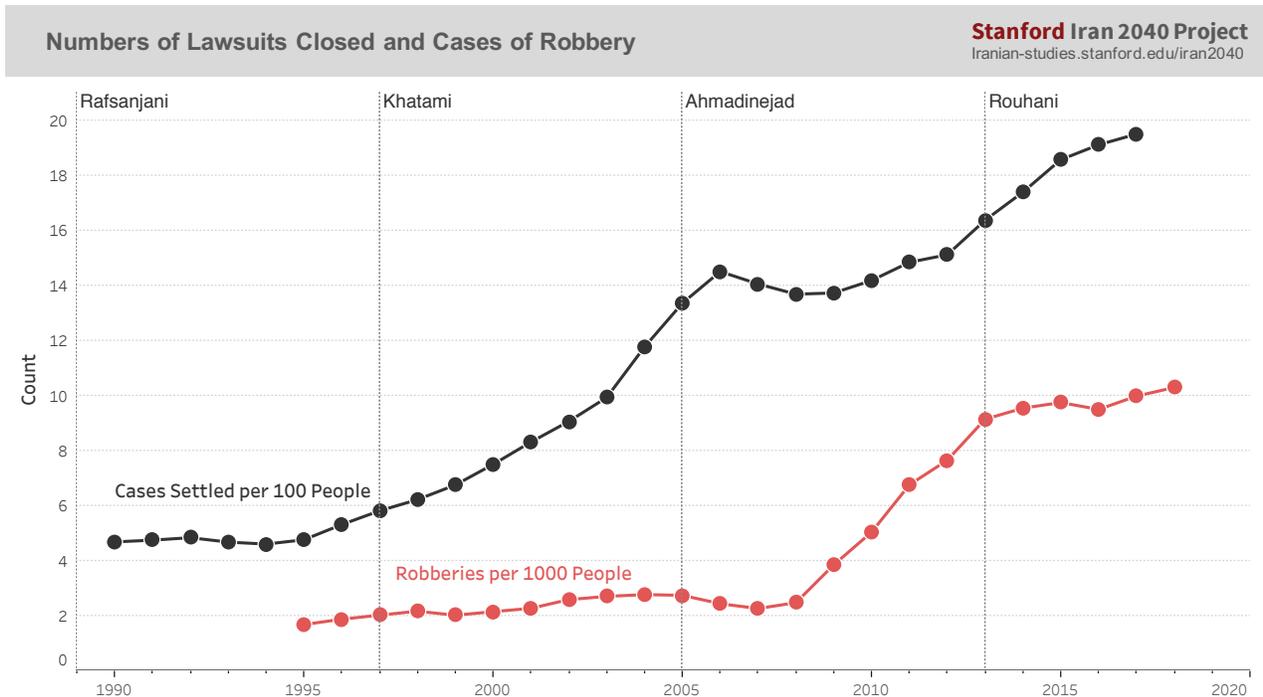
It is helpful to study which factors have contributed to the emergence and sustenance of corruption in its evolution to a systemic level in today's Iran. As I discussed in the previous section, failure to establish the rule of law and its different functions (political, economic, and social) has contributed significantly to this process, with the judiciary's lack of political independence the most crucial impediment to any serious reform. This deficiency has been exacerbated by factors such as the growth and dominance of the unofficial and unregulated part of the state and the state's lack of accountability and transparency. Since the beginning of the revolution, the unofficial, unregulated part of the state has constantly increased its presence and influence, thanks to the nation's constant state of crisis. This started with the chaos resulting from conflicts between different revolutionary factions in the political void after the revolution and culminated in the eight-year war between Iran and Iraq. It is still present, especially when international conflicts are heightened, and manifests itself the most when sanctions are imposed, compromising the normal operation of the state. The constant crisis in the political arena has nourished an abnormal regime of governance, whereby the official part of the political order remained smaller than—and secondary if not subordinate to—the unofficial part. In fact, aware of the necessity of the state of crisis and emergency for its existence and proliferation, the unofficial part of the government has actively tried to disturb the normalcy of the political arena

with every tool at hand, especially in the international domain. This has therefore kept a large part of the state out of the scope of transparency and regulation and has created a political and financial system which is inherently prone to corruption.

The second contributing factor to the genesis and entrenchment of systemic corruption is a constant crackdown on parties and civil organizations in the past four decades along with suppression of free media and the press, which inevitably limits the transparency and accountability of governance. As I mentioned above (see State), and will discuss in more detail below (see Accountability), this has led to the formation of a circle of “insiders” which simultaneously reinforces the circulation of power and rent within a limited body of loyal supporters and blocks a meaningful competitive rotation of political groups in power.

The spread of corruption is mirrored in the number of crimes occurring in the society as well. As shown in **Figure 6**, there has been a dramatic rise in the number of robberies and lawsuit cases in Iran in the past decade (note that the values are normalized by population). Although economic factors have played a role in this phenomenon, the rather sharp rise in the number of robberies that started around the 2009 presidential election implies that the public perception toward the law and legitimacy of the state has significantly contributed to this social issue.

Empirical data from other countries suggest that, at the level of corruption that is facing Iran, mere improvements in transparency and accountability is not sufficient to meaningfully reduce corruption. At the current stage, measures that aim to improve transparency can only increase the perception of corruption, which is in fact needed, but intensifies the sense of despair in individual people without enabling any specific collective action mechanism. The source of (grand) corruption in Iran is profoundly political, and it only has political solutions. This would mean that Iran needs a strong anti-corruption commission with the full political support and protection by the head of state and independence from corrupt institutions (e.g., judiciary and police) to investigate and prosecute corrupt officials and address loopholes. However, indirect strategies based on informal institutions (i.e., culture) will be needed in the long-term to fight the deeper causes and trends underlying systemic corruption [29].



**Figure 6.** Number of lawsuits closed (per 100 people) and number of robberies (per 1,000 people) [28].

### 3.4. Accountability

Accountability, the process of holding power accountable to external authorities, can affect the quality of governance in different ways. It can improve the responsiveness of the government to economic and social demands of the citizens, hence boosting state's legitimacy and creating a productive social environment which can foster growth. Moreover, transparency and accountability institutions can help create strong institutions of rule of law and control various forms of corruption including patronage, clientelism, rent-seeking, and prebendalism. In particular, accountability can reduce patronage appointments by incentivizing meritocratic recruitment, which can in turn improve state's capacity.

This section evaluates the status of accountability institutions in Iran using the vocabulary and definitions provided in the Theoretical Framework section. In brief, *vertical accountability* is concerned with the relationship between citizens and elected officials, *diagonal accountability* is related to active civil society and independent media, and *horizontal accountability* is concerned with the separation of power and the oversight of different political institutions on each other [18]. All three mechanisms of accountability can be evaluated on the basis of their procedural (de jure) and substantive (de facto) dimensions which can be subsequently used to gauge the *implementation gap* that may exist between the constitutional provisions and the reality of the accountability institutions in a country [10, 18].

#### *De Jure and De Facto Accountability*

**Table 2** summarizes the overall status of the accountability institutions in Iran, de jure and de

facto, and across the vertical, diagonal, and horizontal mechanisms. Although Iran's current constitution is endowed with some elements of accountability spanning across all three mechanisms, these provisions are woefully inadequate to establish a meaningful level of procedural accountability. Furthermore, except for the universal suffrage—which was granted during the Pahlavi era in 1963—the government in reality is far more unaccountable in all other major aspects compared to the de jure institutional framework. A recent empirical study by the World Bank has shown that a common historical pattern in the development of de facto accountability often starts with creation of vertical accountability institution which is then followed by development of diagonal accountability, which itself precedes the creation of de facto horizontal accountability [18]. This would imply that, unless Iran can create meaningful de facto electoral accountability institutions, one cannot expect from the diagonal and horizontal institutions of accountability to hold the government more accountable in the foreseeable future.

**Table 2.** Status of procedural (de jure) and substantive (de facto) accountability in Iran by mechanism (vertical, diagonal, horizontal). The framework was adapted from reference [18].

Mechanism	Indicator	Procedural	Substantive Outcome
Vertical	Universal suffrage	✓	✓
	No vote buying, clean elections	✓	Weak
	Existence of programmatic parties	Limited	×
	Multiparty election for the head of state	×	×
	Limits on term of office for the head of state	×	×
Diagonal	Freedom of assembly	Limited	×
	Freedom of press and expression	Limited	×
	Freedom of civil society	Limited	×
Horizontal	Legislature investigate executive	✓	Weak
	Legislature control resources	✓	Weak
	Judiciary independence	Limited	×
	Judiciary accountability and oversight	Limited	×

Concerning the vertical mechanism of accountability, freedom of political parties, albeit with some serious preconditions, are recognized in the constitution. However, in reality, there has been a great implementation gap between de jure and de facto dimensions of electoral accountability in Iran. Dominant clientelistic relationships and insufficient social demand for accountability institutions (at least until recently) are among the contributing factors to creation of this gap. As a result of this actual chasm, the scope and structure of substantive elements of vertical accountability do not lend themselves to meeting conventional minimum standards for democracy and fail to provide any meaningful mechanism to remove incompetent and corrupt

officials. The potential benefits of real competitive elections are thus never really materialized due to shortcomings in both procedural (constitution) and substantive (implementation) factors. As such, the Islamic Republic should be recognized as an *electoral autocracy* or *competitive autocracy* and should not be placed in the same basket of countries known as *transitional democracies* [30,31].

Accountability institutions in Iran suffer from the lack of established programmatic political parties. An important component of accountability, whether downward (democratic multiparty system) or upward (within a centralized autocratic party), is the presence of enduring structured political institutions which shape the collective decision-making process in the political arena, provide feedback to political actors, and substantiate the long-term stability of the political system. Analysis of the political landscape in contemporary Iran reveals the absence of stable programmatic political parties with long-term principles and visions.<sup>3</sup> One of the most notable examples was the main party of the Islamist wing of the revolution, the Islamic Republican Party, which had the endorsement of the charismatic Khomeini and survived through postrevolutionary conflicts by sidelining all other organized rivals. Yet, it did not even last for a decade (1979–87) and was dissolved due to “internal conflicts” before the end of the war. This is in stark contrast with authoritarian countries like China (cf. the Communist Party of China, 1921-present), where a centralized party provides some stability and continuity and ensures a minimum level of accountability (first to the party bosses, but ultimately, to some extent, to the people). After the revolution in Iran, the major ideological cleavages (e.g., secularism vs. religious fundamentalism) were deactivated and demobilized [16] and the cleavages over which the parties have been constructed were limited to the Islamic bloc’s intra-elite issues (modernizing Islamist vs. conservatives). Over the past two decades, parties are mainly reactivated (or newly formed) transiently near the time of elections to win short-term political gains, without providing a ground for long-term planning and accountability. Such shallow and short-term political structures have, therefore, not been functioning properly to make the elected bodies more responsible and competent nor to shape their decision-making process to be less short-sighted. Hence, they have failed to help the government increase its capacity in a meaningful way. For example, besides their lack of any economic plans during the election campaigns, none of the Iran’s presidents (and prime ministers) of the past four decades had a basic understanding of economic principles at the time they assumed office.

In the absence of programmatic parties and strong civil society and given the near-monopoly of state over media, social media has emerged recently as a powerful platform for grassroots anticorruption efforts in the country. Massive expansion of communication technologies in recent years, combined with the constant censorship and suppression of free expression in official media, has made the internet and social platforms the major arena for criticizing the

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<sup>3</sup> Even the Tudeh Party, which seemed to be an organized and stable party for decades, was not an independent party formed inside Iran and had clear affiliations with the Soviet Union.

policies of the government and its officials. In fact, the officials are ironically very conscious of their “image” in the social media, to the extent that they typically respond—either as individuals or as institutions—very rapidly to critical comments that go viral in social platforms. Given the paucity of other means of accountability, the process of consolidation and expression of public opinion in social media has provided the only mechanism to ensure a minimum level of transparency, responsibility, and accountability. However, it is not entirely clear if the result of such an “institution” would be more than its short-term yields. Although officials’ sensitivity leads to their rapid responses to the “highlights” of social media, this response is typically quite superficial. It primarily aims to alleviate public concerns with the most ostensible and populist moves—and not necessarily the most relevant or fundamental measures needed to solve the problem in the long term, as the latter does not appeal to the very mechanism of accountability embodied in the short-term attention span of social media. Thus, although social platforms provide some scarce and short-term mechanisms of accountability, they are not likely to significantly increase the capacity of the state to address its fundamental challenges in the long-term.

Similar to many other autocratic regimes, in the absence of a free press and multiparty system, and even lack of effective upward accountability in the hierarchy, corruption in Iran has intensified. Over time, more opportunities for rent-seeking and corrupt activities have become available for the elites tied to the regime. But a more fundamental problem seems to be the natural decline in the supply of benevolent officials who would be able to climb the power ladder to reach high-ranking positions. This is, in turn, a natural consequence of the weakness of various mechanisms of accountability, as the lack of meaningful competition and of rotation of officials severely limits the potential human capital and hence adversely affects the capacity of the state. On the other hand, the political structure (e.g., in the form of an organized party) lacks the right feedback mechanisms to regulate and filter out corrupt and incompetent officials. This means that the recruitment process is devoid of the meritocratic elements necessary for preserving a minimum level of effectiveness. The result is a situation where the state in Iran may in reality prefer not to embark on a genuine campaign to address corruption, since regardless of the severity of the punishment imposed on the identified corrupt officials, such anticorruption campaigns would ultimately do more harm to the legitimacy of the state by eroding public trust in the entirety of the system, compared to the small gains in public support by signaling good faith. In fact, in order to avoid the buildup of bottom-up anticorruption pressure against the vested interests of powerful rent-seeking groups and corrupt officials, the state in Iran has never been transparent about the activities of its main economic institutions such as the national development fund, the privatization organization, *bonyads*, IRGC-affiliated corporations, the Central Bank, and the state-owned banks.

The state’s capacity for implementation of radical reforms has also been heavily compromised by the decline of social capital. Lack of trust between the state and the people, along with the

fear of further social turmoil given the fragile conditions, resulted in a situation where the government increasingly deviates from prudent long-term policies which inevitably entail short-term austerity for the people and hence may exacerbate public discontent. Desperate attempts at “responding” to any apparent sign of social dissatisfaction, as exemplified in the case of social media outlined above, highlight the severity of this deadlock. The state is therefore trapped in a situation whereby the combination of political (horizontal) and social (bottom-up) pressures does not allow it to undertake the critical long-term reforms necessary to deal with fundamental challenges. On the one hand, the state does not have the uniformity and political will needed to decide independently in order to act upon major problems, as the government needs to constantly compromise and accommodate other factions (often unofficial and existing in the shadows) to survive. The result of this political disarray and social fragility is that the fundamental challenges of the country are inevitably piling up and solutions are being deferred to the future.

### *Recruitment*

Accountability has also affected the state’s capacity in a more direct manner, namely via recruitment. One of the key dichotomies introduced from the early days of the revolution was the distinction between being *committed* (*mote’ahed*) and being *qualified* (*motekhases*) with the former distinctively prioritized and valued over the latter. Originally, this was used to distinguish the revolutionaries (who were mostly of low capacity and inexperienced) from the old executives and bureaucrats of the past regime (who were not aligned with the ideology and principles of the revolution). Forty years later, this demarcation still persists to filter outsiders from insiders. In fact, the dichotomy has been persistently employed in past decades to serve ideological filtering (e.g., cultural revolution), effectively turning in recent years to an instrumental tool to protect the closed circle of insiders. One way this works is by blocking political rivals from strategic positions or by biasing the appointment of faculty toward those with “proper” affiliations in universities. This has added a new dimension of patronage appointments and promotion to nepotism and kinship that were historically prevalent in the Iranian bureaucracy.

The problem of recruitment in the Islamic Republic goes beyond the quality of individuals who are appointed for managerial positions. For example, in recent years, some of the state’s high-level officials have offered mid-level technocratic positions to young Iranian academics at Western universities. Although the primary motivation was the officials’ hope that such moves can help depict a progressive and open-minded picture of themselves to the public, the outcome could have been productive regardless of the unguine intention. However, due to the following reasons, this has not been the case so far. First, given the historical sensitivity of the Islamic Republic to collaboration with the Iranian diaspora (and foreigners), only those academics are invited who have not been seriously critical of its policies in the past, and hence most likely lack the aspiration to fight for significant reforms. Moreover, given the situation of

Iran in the past years, in most cases, only those invitees respond positively to such offers who not only have a great appetite for a political career but also feel comfortable defending the past and future policies of the bosses who hire them. As a result, even employing highly educated and talented individuals does not endow the system with any significant capacity for real reform through this type of recruitment, as the faulty system dominates the potential merits of such individuals and even takes advantage of their presence by aligning them with the needs of the system.

Another way to look at the problematic link between accountability and recruitment is by highlighting the faulty system of rewards and feedback in bureaucracy, whereby the rewards are not distributed (and hence the incentives are not shaped) in proportion to the efficiency of units and agents. In fact, instead of promoting and encouraging the most efficient and creative individuals and structures, there seems to be a consistent tendency in recent years to suppress any emerging potential (in different social, political, and cultural arenas) that passes a certain threshold. The most likely explanation for such a counterintuitive attitude seems to be the dominance of a paranoid mindset which sees anything too powerful as a potential threat to its security and stability. Such a mindset leads to a vicious cycle of insecurity and lack of capacity. The state finds itself in a weak and insecure position and as a result it perceives any powerful individual or organized structure as a serious threat to its integrity. By suppressing such capacities as potential threats, the state eventually becomes even weaker and more paranoid. Such a vicious cycle therefore inherently represses the potential and limits the capacity of governance by favoring a perceived notion of stability and security over capacity-building and growth. In summary, the capacity of the state has been heavily compromised, as factors other than efficiency and functionality (e.g., loyalty, subservience, security, and stability) played the main role in the recruitment process. Needless to say, such a faulty system is a recipe for corruption and fuels the vicious cycle of corruption and trust [32] which in turn makes the state less efficient in undertaking any fundamental reform.

The exclusion of a large part of society as “non-committed outsiders” has resulted in the state’s inability to exploit the huge capacity of the new generation, particularly at the peak of the golden demographic window of opportunity [2]. Instead of tapping into this huge potential, Iran’s undemocratic and unmeritocratic purge has deprived the society and economy of some of its best talents, as manifested in its massive brain drain in recent decades. Despite the sporadic mention of the issue by top officials, it seems that in reality the state is indifferent to human capital flight or even favors the process as most of the emigrants are deemed critical of its major policies. Perceptions of exclusion and disparity have also exacerbated the issue of trust between the public and the state and have further undermined social capital. In conclusion, it appears that had the state been more politically inclusive and not been too worried about preserving its existing structure, it could have obtained the support of more social actors to help persuade the public to accommodate the kind of painful reforms necessary for long-term gains.

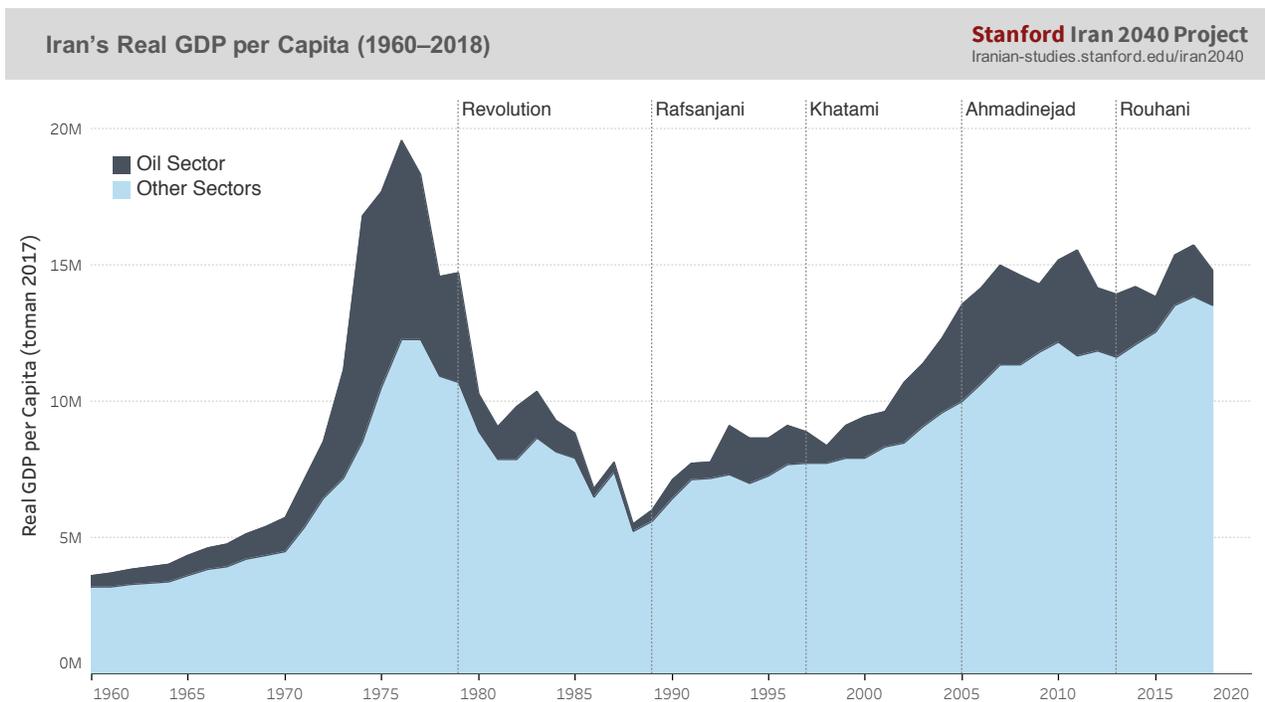
### 3.5. Economic Development

Economic growth and macroeconomic stability, as the ultimate goals of a state's economic policy, constitute important objective measures correlated with the state's capacity when considered over prolonged periods of time. This section thus focuses on the macroeconomic performance of Iran and its relationship with the state's capacity and other aspects of governance. More specifically, I overview the trends in output growth, capital formation, inflation, employment, and the situation of the pension funds.

#### *Output Growth and Investment*

**Figure 7** shows the real GDP per capita of Iran between 1960 and 2018 and its breakdown by the oil and non-oil sectors. During the two decades leading to the revolution, the per capita GDP in Iran increased by about fivefold owing to massive oil revenues and, to a lesser extent, concurrent rapid industrialization. The combined effects of economic mismanagement of the new revolutionary government, the cost of war, lower oil exports and revenues, and an extremely fast population growth of the time (about 4% per year) caused a drastic decline in per capita GDP such that by 1988 it had plunged to the level last observed around 1970. Between 1989 and 2005, the economy expanded at an average rate of 6.5% per year while the population growth eased to about 1.5%, resulting in an average growth of about 5% in GDP per capita. Since then, per capita GDP in Iran has remained almost flat, which to some extent resembles the Brezhnevian Stagnation era in the Soviet Union.

While the real GDP per capita can be used to understand the overall trends in the economy and the average standard of living, it does not reveal anything about the distribution of income among different classes in society. Despite forty years of egalitarian rhetoric, Iran's income inequality is rather high. A recent study estimated that the top 10% of the population in Iran earns about half of the total income, while the share of income going to the next 40% of the population (often referred to as the middle class) and the bottom 50% are about 35% and 15%, respectively [33]. It is interesting to note that income inequality in the United States almost has an identical structure [33]. Finally, although data for measuring wealth inequality in Iran are not available, it is almost certain that wealth is significantly more concentrated than income, particularly given that taxes on capital gains, inheritance, and property in Iran has been virtually zero. Through a comparison of Iran and other countries with similar level of income inequality, it seems plausible that the top 10% of the population in Iran is likely to own upwards of 60% or potentially even 70% of private capital [33,34].

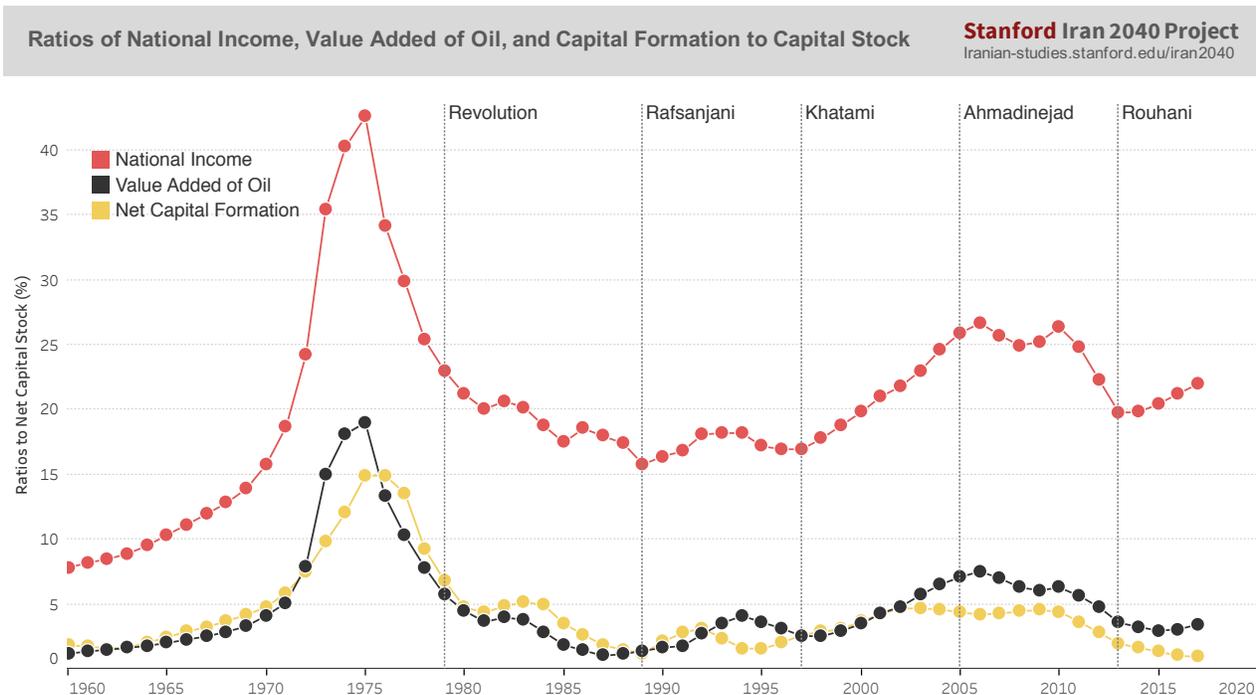


**Figure 7.** Real GDP per capita (constant 2017 *toman*) of Iran between 1960 and 2018 [1,3]. Shares of the oil and other sectors were estimated based on the national accounts data in current prices.

Decomposition of Iran's economic growth over the past half century reveals that, among the three sources of output growth (capital, labor, and productivity), rise in capital inputs has had the highest contribution to growth by a large margin [35]. For example, between 2000 and 2015, on average, the growth of capital inputs contributed 3.2% to Iran's annual GDP growth while the collective contribution of labor inputs and total factor productivity (TFP) was 0.6% [35]. **Figure 8** shows the annual growth rate of capital stock (i.e., value of the stock of fixed assets in the economy corrected for depreciation) in Iran since 1960. As can be seen in this figure, trends in net capital formation in contemporary Iran have undergone four distinct periods which roughly correspond to the periods I considered earlier for the analysis of governance. Owing mainly to the massive flow of petrodollars to the country (which is also shown in **Figure 8**), Iran's capital formation was extremely high in the decade leading to the 1979 revolution. Within the first decade of the Islamic Republic, the rate of net capital formation declined rapidly to reach about 2% of the total capital stock by the end of the war. During the period known as reconstruction and reforms, the ratio of net capital formation to national capital stock increased again to about 5% per year before it fell again to low levels over the course of the past decade. Today, net capital formation has reached its lowest point since 1960.

Since the 1979 revolution, the ratio of national income to capital stock (which is almost the same as the national wealth) has typically varied in the range of 15% to 25%. Historically, net capital formation was significantly higher in the past at the times when Iran had the same income to wealth ratio as it has today (approximately 22%). This would imply that Iranians, on average,

save less and consume more compared to the past. This change of attitude has far-reaching consequences for Iran's future growth, particularly considering that much of the output growth has been historically achieved through investment rather than improvements in productivity or expansion of the workforce.



**Figure 8.** Ratios of national income, value added of oil, and net capital formation to capital stock between 1960 and 2017 [1].

### *Inflation and Monetary Policy*

Performing effective monetary policy is among a government's most important tasks. Iran has suffered average inflation of 20% over the past decades (**Figure 9**). This means that the performance of the state in terms of ensuring price stability, a vital requisite for long-term economic planning, has been consistently among the worst in the world [36]. In any public institution, two intrinsic aspects determine the level of difficulty of improving its performance through reforms: the number of transactions and the extent to which outputs can be readily measured [9,37]. It is often difficult and time-consuming to improve the performance of institutions with a high number of transactions and low specificity, such as primary education and institutions of the rule of law, because they are inherently harder to codify. In contrast, the small variance in the form and functions of high-specificity institutions with low numbers of transactions, such as central banks, allows for the use of best practices from other countries, making them more susceptible to reforms. Therefore, besides the obvious link between macroeconomic management and the overall quality of governance, focusing on the performance of institutions such as central banks offers insights into not just the capacity of the

state but also the extent to which a state has had the political will to implement reforms. It has been a long time since economists have known both the causes of inflation and effective solutions to control it within a healthy range of about 2-4%. As such, one can conclude that the issue of high inflation has been of little concern to the state in Iran (insofar as it didn't seem to provoke social unrest). Chronic high inflation and the quality and attributes of statehood in the Islamic Republic are linked through multiple channels:

- ❖ **Rent-seeking:** The unwillingness of the state to make quasi-private organizations (e.g., bonyads and IRGC-affiliated corporations) subject to rules of competition in the market and to make them pay their fair share of taxes which has consistently contributed to fiscal deficit.
- ❖ **Legitimacy-related issues:** The unwillingness of the state to reduce energy subsidies and reform unsustainable pension policies due to fear of provoking social unrest threatening the entirety of the regime which has been another factor contributing to the chronic fiscal deficit; The lack of proper monetary instruments at the disposal of the Central Bank such as open-market operation practices which are perceived inconsistent with the principles of Islamic finance.<sup>4</sup>
- ❖ **Accountability-related issues:** Lack of transparency and accountability in allocation of the public budget to different public organizations and causes, some of which have no particular utility for the well-being of the nation; Handling the chronic fiscal deficit by increasing the money supply (printing money) instead of raising taxes or borrowing from the lenders in the market (from liquidity) as implementation of the latter solutions will inevitably demand higher levels of democratic accountability; Lack of the Central Bank independence which has made the bank a mere agent to fulfill the short-term demands of the state, often in contrast with the Central Bank's primary goal of price stability. This has effectively rendered the Central Bank as the bank of the government rather than the bank of the country.

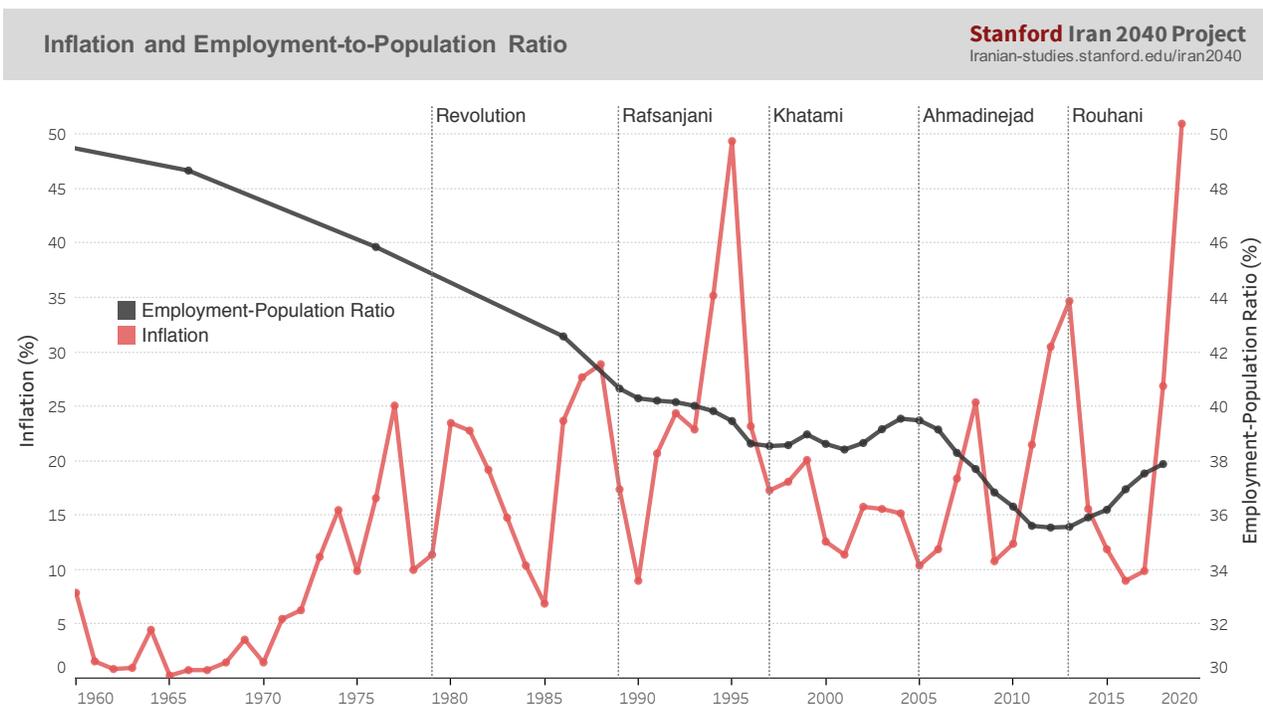
### *Labor Force and Employment*

With a low labor force participation rate of about 40% and a relatively high unemployment rate of 10–15%, three out of every five adult Iranians at any given point during the past decades were not employed in a job (**Figure 9**). In spite of a drastic decline in the female fertility rate and expansion of university education, women and educated youth are the largest constituents of the unemployed and discouraged workforce. Lack of job opportunities over a prolonged period is in fact transforming millions of university graduates of the past two decades from unemployed to unemployable—causing them to develop a sense of hopelessness and uselessness.

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<sup>4</sup> Apparently, open-market operation practices have finally been used in 2019 to control the country's unprecedented inflation.

On the demand side of the labor market, due to the absence of competition in a state-dominated economy, employers do not generally feel the need for higher quality, but more expensive, graduates to foster innovation. The ever-increasing divergence between the economic and social realities of the country on one hand and lack of opportunities for university graduates on the other hand persuades an increasing part of them, particularly graduates from top universities, to emigrate. These emigres have enjoyed tremendous success overseas, but the state has hindered meaningful financial investment and intellectual contributions from the Iranian diaspora due to its deep paranoia about their potential political and cultural influences.



**Figure 9.** Trends in inflation (left) and employment rate (right) of Iran (1960–2019) [1,28]. Employment-population ratio is defined as the percentage of employed people to adult population aged 15 and higher. Inflation in 2019 was estimated based on the first quarter data.

### *Pension Funds*

Another formidable socioeconomic challenge rooted in the state's unsustainable policies is the looming insolvency of Iran's major pension funds despite the country's favorable population age composition. For decades, the state has implemented generous populist policies with regard to retirement age and individual contribution mandates while failing to pay its own share of contributions. Over time, the buildup of a large public debt to pension funds has triggered a systematic transfer of the central government's assets (state-owned enterprises) to pension funds (which are public but nongovernmental). As such, these pension funds, as the majority stakeholders of the transferred enterprises, took charge of day-to-day operations at some of the country's largest industrial companies. In the new arrangement, while the firms still benefit from

government support (for example, in terms of regulations and licenses), they are now able to produce huge personal gains for their managers who are appointed by politicians often in a patronage relationship. The burst of Iran's pension time bomb will seriously damage the economic well-being of millions of vulnerable pensioners and their families and will also lead to an even smaller fiscal space for capital expenditure in the future.

Overall, the consequences of previous irresponsible actions and economic misconduct by the state, which have thus far been limited to low output growth, are now morphing into a full-fledged crisis that may result in a significant loss of output and economic collapse. The economic hardships of the lower and middle classes have coincided with the emergence of a new class of elites closely tied to the state who, in sharp contrast with society's past norms and the revolution's egalitarian rhetoric, make little effort to hide their wealth as money is increasingly becoming the determinant of social status. This recent phenomenon has done much to delegitimize the Islamic Republic regime in recent years. The longer the current situation persists, the less likely the state will be able to regain its vanishing grounds for legitimacy. Any meaningful economic reforms in Iran will inevitably entail severe austerity, job cuts, and elimination of subsidies on consumer goods which in the short term will contradict the goals of the reform and fuel public grievances. Such reforms will result in further delegitimization of the regime and destabilization of the political order.

### **3.6. Social Mobilization**

Social mobilization is a term that refers to a cluster of changes that often occur together in a large part of a society that is moving from a traditional to a modern way of life [38]. During the modernization process, the rates of urbanization, literacy, and political participation increase while the fertility rate and agriculture's share of the economy decrease. Also, as the size of the market increases with economic development, the division of labor becomes more specialized. As workers move to seek better jobs, economic productivity improves. In the meantime, social relationships shift away from ascriptive (based on kinship, social class, and gender) to voluntary (based on shared interests). In democratic countries, civil society and political parties are the two channels through which these social developments can influence governance.

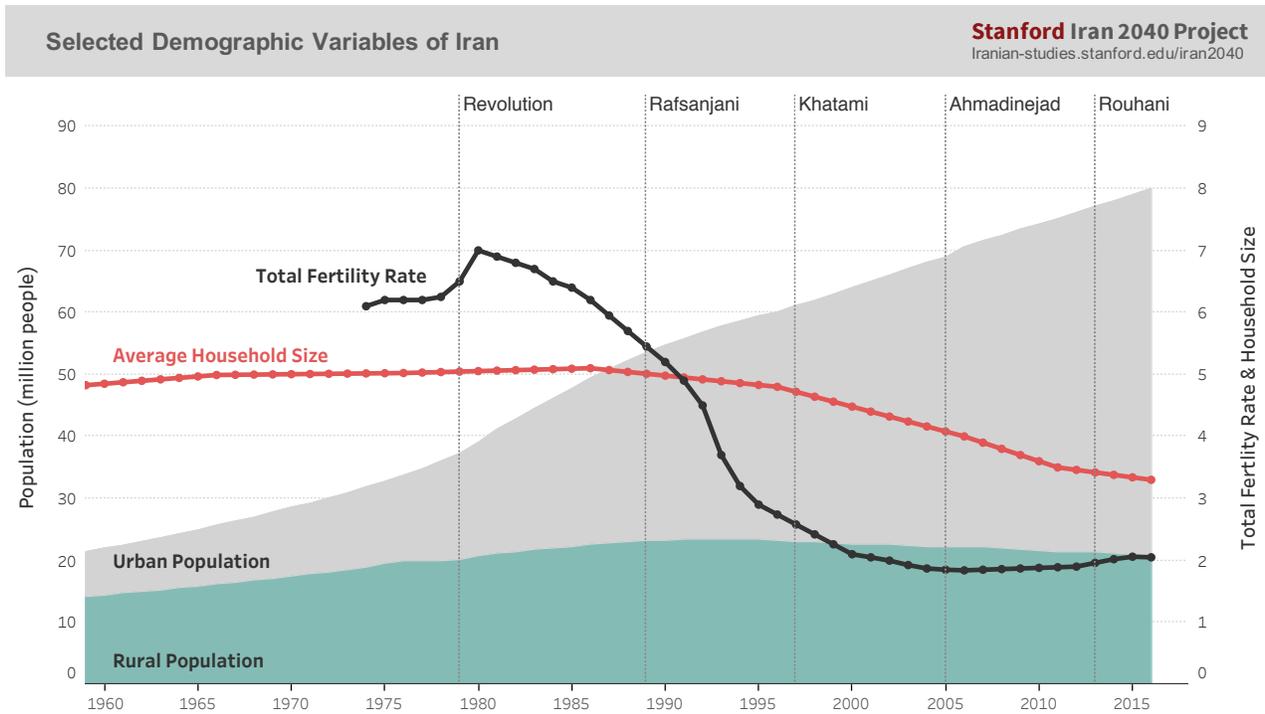
A common problem that many modernizing countries encounter is that the development of their weak political institutions lags behind the rapid evolution of their societies. According to Huntington's *gap hypothesis* [19], by increasing aspirations and expectations, rapid social mobilization can turn into social frustration, particularly when coinciding with unfavorable economic conditions. Social frustration, in turn, translates into higher levels of political participation as society demands that the government address new expectations. However, due to the lack of a sufficient degree of political institutionalization and capacity in modernizing countries such as Iran, political institutions often fail to fulfill the new, heightened demands. As

a result, under certain conditions, social mobilization in modernizing countries can lead to political instability and decay rather than political development. This is particularly the case for the authoritarian regimes that succeed in educating their people and creating a middle class as in such cases the population will sooner or later demand better institutions of rule of law and accountability [21,38,39]. The rest of this section describes socio-demographic developments in Iran and provides an overview of some of the major social movements over the past few decades.

### *Population*

Over the past half century, Iran's population has expanded from about thirty million to over eighty million and the urbanization rate increased from about 40% to 75% [2, 28]. Due to large migration to cities, the rural population has remained almost constant for decades despite the country's fast overall population growth. The demographic transition in Iran began with a relatively sharp decline in infant and child mortality rates. Between 1950 and 1980, the under-five mortality rate decreased from about 30% to 10% [40]. The fertility rate, which had been fluctuating in the range of six to seven births per woman, started to decline around the mid-'80s before reaching its new stable level at approximately two births per woman around 2000 [2,41,42]. As a result of the country's high fertility and improved life expectancy, the population growth rate in Iran was upwards of 4% per year in the early years of the revolution. This resulted in the creation of a massive bulge, currently in the age cohort of thirty to forty years. **Figure 10** shows trends in Iran's urban and rural population, total fertility rate, and average household size.

Around the mid-'80s, amid serious economic challenges, Iranians' desire for large families started to dwindle. Other factors that drove Iran's total fertility rate from about six to two births per woman included the diminishing pronatalist social environment that was prevalent in the war's early years, the gradual rise in female education and age at first marriage, a growing tendency of parents to provide more resources to nurture their children, and, most important, a reversal of the government's official population policy in the late '80s. As a result of the alignment of public policies and private interests between 1985 and 2000, total fertility rate decreased from about 6.5 to 2.0 births per woman. Average household size also decreased from 5.0 in 1985 to 3.3 persons in 2016, with virtually no difference remaining in this dimension between urban and rural families.



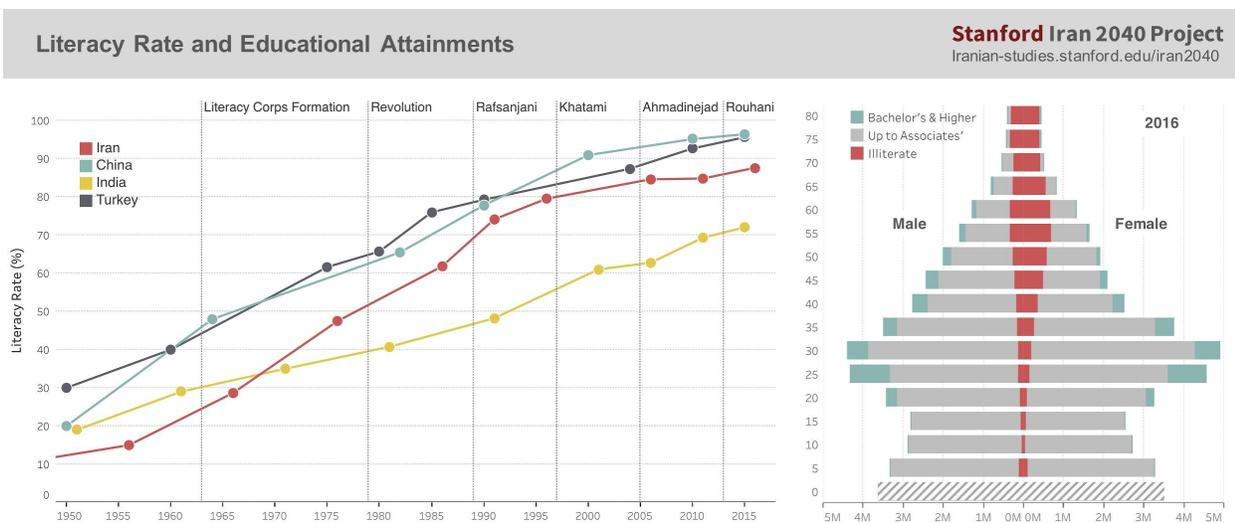
**Figure 10.** Trends in Iran's urban and rural population (left axis) and total fertility rate and average household size (right axis) [2,28,41,42].

### Education

One of the most important and consequential developments in contemporary Iran has been the steady and relatively fast improvements in educational attainments (**Figure 11**). Before the mid-twentieth century, the literacy rate in Iran was considerably lower than in countries like China, Turkey, and India. Similar to many other modern institutions in the country, mass education in Iran was introduced by the state-building actions of Reza Shah in the thirties—about a century after the introduction of compulsory education in Europe. This process accelerated later due in part to the formation of the literacy corps by the Shah in 1963 as a cost-effective method for improving rural education [43] and in part by the gradual transformation of the economy from agrarian into a diverse mix that increased the demand for educated and skilled labor. At the onset of the revolution, about half the population and less than a quarter of adults were literate, while today not only has the literacy rate reached nearly 90% but about half the youth are expected to hold a bachelor's degree or higher by 2025.

Beyond its traditional and universal benefits, the expansion of the educational system in the postrevolution era has served two important strategic purposes. First, schools and universities provide a country-wide platform for thought controls, thus affecting the deepest roots of society. Any Iranian citizen today under the age of about fifty has gone through a long, systematic educational agenda whose one of its chief aims was to turn him or her into a *committed* citizen who supports the revolution's ideology and beliefs. Thus, education, in conjunction with a monopoly on media, was perceived by the Islamic Republic as an opportunity to create a self-

perpetuating source of legitimacy. In addition, the rapid expansion of tertiary education over the past decade was a hasty fix for the inability of the government and economy to create jobs for members of the country's youth bulge as they entered the market. This manufacturing-like approach to higher education, particularly at the graduate level, has eroded the quality of education and research and has also resulted in various forms of academic corruption. These include outright purchases by students of theses from third-party content providers, authorship plagiarism by professors, and bribery. Moreover, despite the closure of the gender gap in education, female labor force participation has remained fairly low. This implies that, contrary to the society's fundamental undercurrents, Iran has stayed near the bottom of the U-shaped trend that typically exists between women's participation in the economy and their average educational attainment.



**Figure 11.** Changes in literacy rates in Iran, Turkey, China, and India (left) and the educational attainments of Iranians in 2016 (right) [2,28,44].

### Social Movements

The above changes in demographics and level of education, along with an increasing exposure to the elements of Western lifestyle, have led to gradual secularization and growth of individualism in society, particularly over the past two decades. These developments are causing an ever increasing divergence between the preferences and expectations of the people and the realities of the country—both at the level of ideas (e.g., delegitimization of Sharia as a source of law) and at the level of performance (e.g., higher economic expectations and a lower tendency for sacrificing welfare at the individual level for a promise of greater public achievement). In the meantime, the diminishing power of the institutions of family, religion, and law has destabilized the traditional social order which, in tandem with governance deadlock, has resulted in a state of anarchy as, for example, manifested in rising crime rates (**Figure 6**).

While the above changes occurred among Iranians at the individual level, Iran has also seen the

emergence of a few social movements in the past two decades, most notably the reform movement, the Green Movement, the women's rights movement, and the *Bread* Movement. Among them, only the reform movement (which started with Khatami's election) underwent all four typical stages of a social movement: emergence, coalescence, bureaucratization, and decline (which can be with success or failure) [45]. Notably, all these movements have been heavily suppressed by the state. The most full-fledged one—the reform movement—ended and brought about further frustrations because all avenues for effective reform were blocked. The Green Movement was repressed by the state before even reaching the bureaucratization stage. The women's rights movement is at the stage of coalescence and, despite massive repressions, seems to have a viable path for success, particularly given the expected increasing economic pressure on the state, which would most likely reduce the capacity for, and intention to, confront the public on nonexistential matters in the future. Most recently, the Bread Movement emerged with its first signs appearing in late 2017 when a protest focused on economic conditions emerged in the city of Mashhad. The protests spread like wildfire to some one hundred cities while their targets and demands went beyond economic issues and escalated to criticizing the entire political system. Within a year after the outburst of the Bread Movement, its main form of manifestation has changed from massive (but unorganized) street protests to more organized strikes which have been unprecedented during the Islamic Republic. The future of these social movements and how the governance system responds to them (including how much the state is willing to, or capable of, suppressing them) will be important in shaping the future of governance in Iran.

The discussion above provides a general analysis of the main components of the multidimensional governance model (legitimacy, state, rule of law, accountability, economy, and social mobilization) in Iran. Further specific examples are provided in **Appendix B**, with discussions on the implications of governance in three diverse sets of issues: oil revenue, food-water nexus, and scientific achievements. Finally, **Appendix C** demonstrates the application of the same framework for the analysis of governance and development to forecast the future of Iran under different scenarios.

## 4. Concluding Remarks

This paper has been an attempt to evaluate the quality of governance in Iran and illustrates its effects on economic development over the past half-century. Given the inadequacy of the conventional output measures (e.g., GDP per capita) and synthetic quantitative metrics (e.g., World Bank governance indicators) for this matter, a multidimensional framework was utilized which takes into account the dynamic interactions among various components pertinent to governance and development (state, rule of law, accountability, legitimacy, social mobilization, and economy). Looking through this lens, different time periods with distinctive patterns of interactions between these components were identified.

The impact of decades of poor governance can be seen in virtually all major challenges facing Iran: a sluggish economy, low employment ratio, chronic high inflation, water crisis, troubled pension system, human capital flight, and eroded social trust. Based on the analysis presented here, I conclude that the ineffectiveness of the governance system can be attributed to multiple factors:

- ❖ **State:** low capacity, large scope, parallel institutions, excessive institutional autonomy;
- ❖ **Rule of law:** decline in legitimacy of religion and tradition as a source of law, problem in transitioning from rule *by* law to the rule *of* law, systemic corruption, lack of independence of judiciary, unfavorable environment for private sector;
- ❖ **Accountability:** lack of programmatic parties and continuous crackdown on civil society, state monopoly of media, non-meritocratic recruitment, clientelism, and populist policies;
- ❖ **Legitimacy:** international isolation, waste of public resources on social engineering efforts, impediment to economic reforms due to fear of social unrest;
- ❖ **Economic situation:** problem in transitioning from a resource-based to a complex modern economy, unsustainable populist policies, low investment, declining productivity, favoring rent-seeking activities over entrepreneurship, brain drain;
- ❖ **Social mobilization:** rise of socioeconomic expectations due to trends in education and urbanization and increasing exposure to the developed countries.

When considering potential future scenarios, it is seen that one-dimensional reforms that only focus on single problems like the economy or international relations can only provide short-term relief and they are doomed to fail in the mid- to long term. Instead, what Iran urgently needs to stop the ongoing vicious cycle in political, social, and economic dimensions is an orchestrated transformational approach to governance that simultaneously addresses both internal and external challenges. However, a viable path for successful implementation of such reforms is not existing at the moment. First, it is not clear if there is a cohesive political will in the state to embark on these kinds of risky endeavors. Second, even if such political will emerges, it cannot be successful without the rule of law being applied to the ruling class. In the absence of the latter, corruption would continue to spread and further erode social trust—without which the reforms would potentially become even more destabilizing.

Besides domestic challenges, three looming global trends—beyond the control of the state and society—will have dramatic effects on Iran’s future in the coming decades. First, climate change will likely have a broad range of impacts on Iran such as extreme weather conditions and agricultural losses. Second, the new paradigm in the global energy markets will likely result in lower oil export proceeds for Iran in the coming decades. As the global economy gradually decouples from oil consumption, it is becoming increasingly more likely that a significant portion of Iran's proved oil reserves will never be produced. The amount of wealth that Iranians will lose due to stranded oil reserves could be in the order of ten to twenty times the worth of the

current size of Iran's economy. Third, new trends in artificial intelligence and automation will make it increasingly difficult for countries like Iran to pursue labor-intensive, manufacturing-oriented growth in the future. In the long run, the combined effects of the above three external factors (climate change, new global energy landscape, and automation) will by no means be less dramatic than the threats caused by Iran's internal challenges.

I would like to finish my concluding remarks by putting more emphasis on the urgency of deep reforms in governance institutions to be able to cope with the country's rather difficult challenges which will persist well into the future regardless of the prevailing political regime. The experience of the past decades has shown that a state dominant development strategy in Iran does not yield satisfactory outcomes. In order to put an end to the current vicious cycle and improve the country's future trajectory, Iran should instead implement a transformational governance strategy to shift expectations to positive direction, reduce the autonomy of political institutions, and allow for the creation of strong civil society. To this end, the future development plans of the country should include a clear strategy for sequencing and pacing of structural reforms in both political and economic institutions rather than merely being numerical expressions of politicians' wish lists for the next five or twenty years. Finally, given the spread and depth of corruption in the country, in addition to measures aimed at improving transparency, Iran also needs a strong anti-corruption commission, independent from the judiciary and the police, to investigate and prosecute corrupt officials at any level.

## Glossary

**Adverse Selection:** a transaction in which the seller or buyer has information about product quality that the other side does not have.

**Corruption:** as defined by Transparency International, “The abuse of entrusted power for private gain. Corruption can be classified as grand, petty and political, depending on the amounts of money lost and the sector where it occurs.”

**Externalities:** side effects (positive or negative) and consequences of an activity experienced by a third party who does not pay or receive compensation for that.

**Institutions:** stable, valued, recurring patterns of behavior that can be more or less complex, adaptable, autonomous, and coherent [10,19].

**Governance:** “a government's ability to make and enforce rules, and to deliver services, regardless of whether that government is democratic or not” [7].

**Market Failure:** a situation in which the market economy does not allocate the optimum amount of resources for the provision of particular goods or services.

**Moral Hazard:** taking more risks because someone else will bear the costs.

**Power:** “the ability of groups and individuals to make others act in the interest of those groups and individuals and to bring about specific outcomes” [11].

**Regulatory Quality:** “the ability of the government to provide sound policies and regulations that enable and promote private sector development” [17].

**Rule of Law:** “the impersonal and systematic application of known rules to government actors and citizens alike” [11].

**State:** the executive branch of government and its associated bureaucracies.

**State-building:** “the creation of new government institutions and the strengthening of existing ones” [9].

**Total Factor Productivity (TFP):** is a measure of efficiency that corresponds to the portion of output growth that cannot be explained by changes in the amount of labor and capital inputs.

**Total Fertility Rate (TFR):** “the total number of children born or likely to be born to a woman in her life time if she were subject to the prevailing rate of age-specific fertility in the population” [46].

**Voice and Accountability:** “the extent to which a country’s citizens are able to participate in selecting their government, as well as freedom of expression, freedom of association, and a free media” [17].

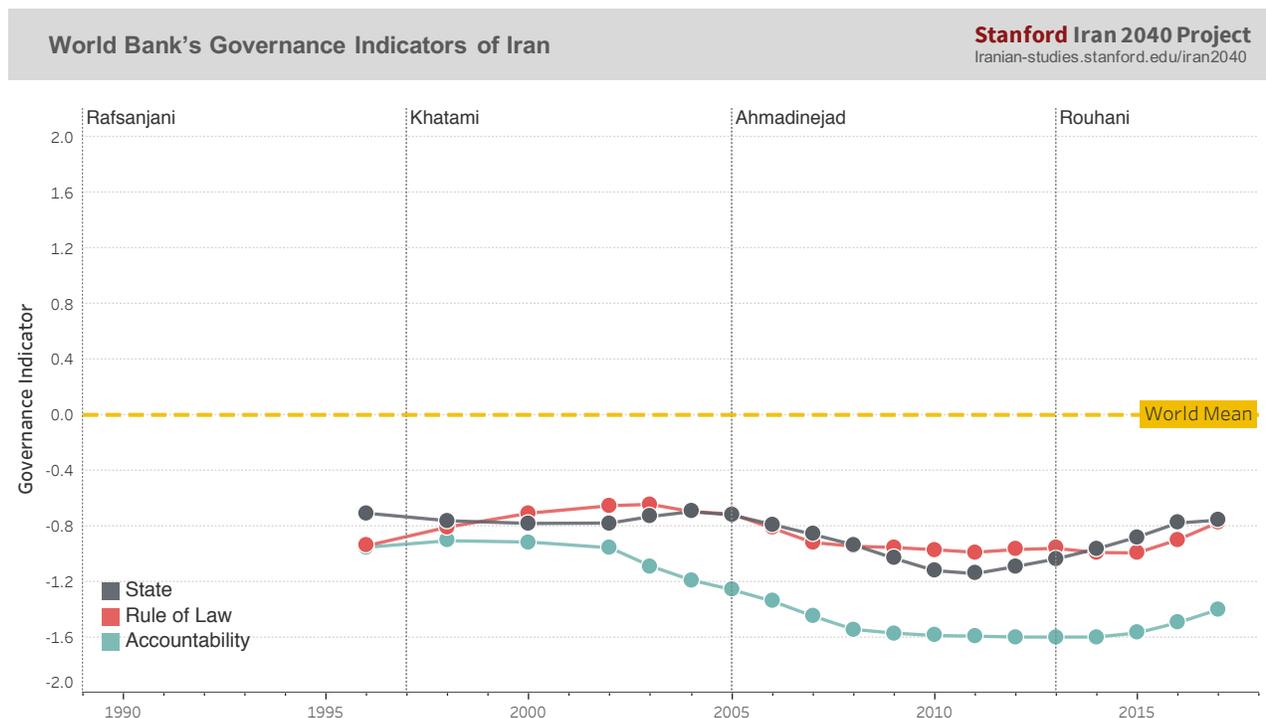
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## Appendix A: Quantitative Governance Measures

Several attempts have been made in recent decades to measure the quality of governance across time and countries. One such project, widely used in scholarly research and in development policy discussions, is the World Bank's World Governance Indicators [4]. These indicators are produced by aggregating a large number of signals into six composite measures: government effectiveness, political stability and absence of violence, regulatory quality, control of corruption, rule of law, and voice and accountability. Four of the World Bank governance indicators are related to the quality of state institutions (i.e., government effectiveness, political stability, regulatory quality, and control of corruption) and hence can be grouped together to represent the state, while the other two directly correspond to the other two sets of institutions in the conceptual framework introduced earlier (i.e., rule of law and accountability). **Figure A1** depicts the trends in Iran's governance indicators as reported by the World Bank since 1996.



**Figure A1.** Trends in the World Bank governance indicators of Iran between 1996 and 2017 [4]. The variables were originally processed such that each has a standard deviation of one and a zero mean (typically varying from -2.5 to 2.5), with higher values indicating more desirable outcomes [17]. A two-year moving average was applied in this study.

In my view, the only solid conclusions one can draw from these trends are those that are in line with conventional wisdom: (i) in relative terms, the quality of governance in Iran is significantly poorer than the world's mean; (ii) no radical shifts have occurred in the state and rule-of-law institutions in recent decades; and (iii) democratic accountability in relative terms has undergone a large decline over the last two decades. However, this negative trend has

somewhat improved recently, presumably due to growth in the use of social media and the rising share of university graduates in the population. Overall, while these indicators can be useful for broad cross-country comparisons, they do not seem to provide detailed information that is needed to study the evolution of institutions in Iran across time.

Another commonly used indicator from which the quality of governance are sometimes inferred is the real GDP per capita and other output metrics. While the per capita income, as shown in **Figure 7**, can be used as a proxy for the average standard of living (and hence economic satisfaction/grievance in the society), its applicability for evaluating the quality of governance in Iran is limited. Besides the general shortcomings of the output measures for the purpose of revealing the underlying quality of governance (as they ignore the amount of utilized resources or inputs in the calculations [7]), contemporary Iran represents a case in which the evolution of people's incomes, particularly in the short term, has been somewhat independent of the quality of governance, *vide infra*.

The first reason for the poor correlation between income level and quality of governance in Iran is related to the decisive role that oil revenue plays in the national income. Oil revenue depends on the amount of oil extraction and on global prices whose historical baseline (see **Appendix B**), with the exception of a few time periods, has been independent from the actions of an individual medium-size market player such as Iran. Moreover, beside the direct and indirect roles of the government in the development of the oil fields, the per capita income from oil depends on other exogenous factors such as global oil prices, ease of extraction of the existing oil reserves, and the size of the population itself. In the absence of a well-functioning sovereign stabilization fund, such as the case of Iran, the fluctuations in oil revenue distorts the economy to the extent that income measures cannot be considered suitable indicators for capturing the evolution of the state's quality in short- or mid-terms.

The second reason for the poor correlation between per capita income and quality of governance in Iran is related to the massive impacts of war and demographic factors on per capita income. The long and devastating war with Iraq, along with a high population growth rate, caused a drastic decline in real GDP per capita in the first decade after the revolution. In contrast, the economic catch-up in the postwar period (due in part to the existence of unused production capacity) and a favorable population age structure were among the important (but perhaps less visible) driving forces of the economic growth of the second and third decades of the Islamic Republic.<sup>5</sup> As important aspects in each of these developments are exogenous to the state, their large economic implications render the use of per capita income for evaluating the quality of governance problematic.

The third factor that divorces per capita income and the quality of governance in Iran is related

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<sup>5</sup> A similar phenomenon occurred in the Western Europe in the two decades following the Second World War [34].

to heavy subsidies and seemingly pro-poor economic policies. While these policies have improved access to certain goods and services (e.g., fuels and electricity), neither their immediate contribution to household purchasing power nor their negative implications in terms of inefficiencies and opportunity costs are captured well by simple output measures such as the real GDP per capita.

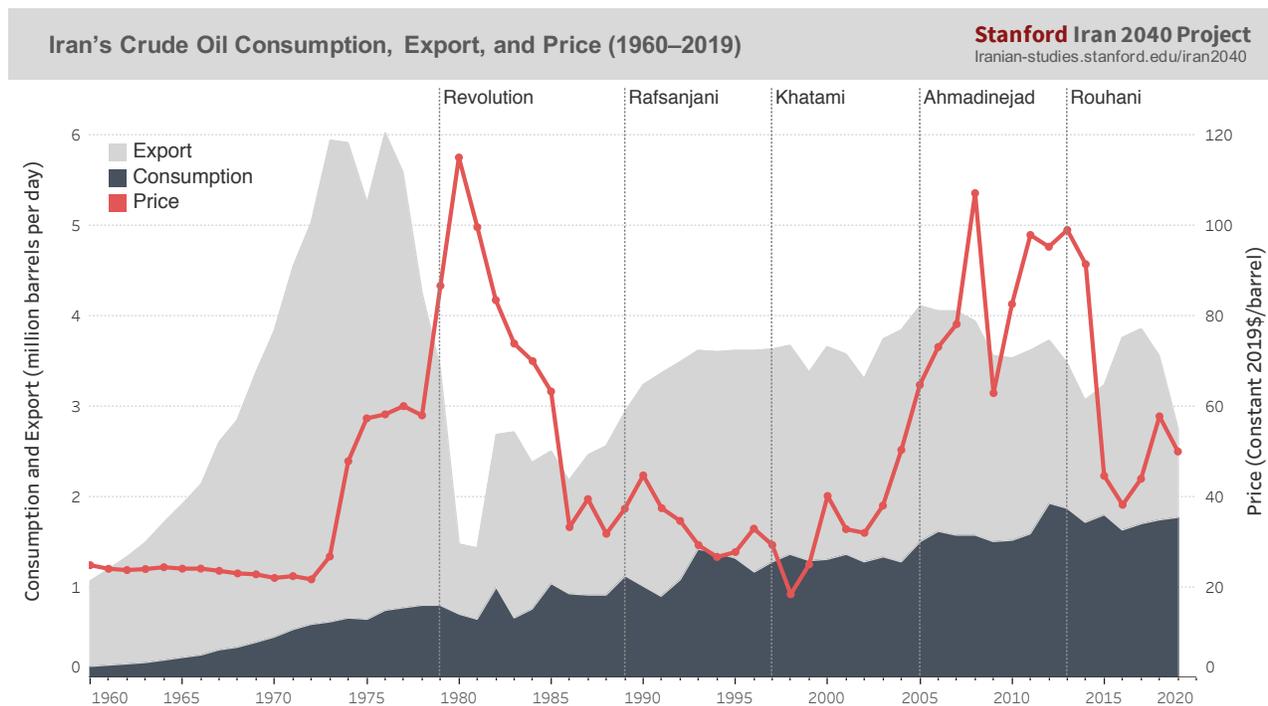
The fourth factor that can render the use of output measures into a misleading indicative signal for the quality of governance in Iran is the massive and growing indebtedness of the current generation to future generations that manifests itself in various forms. In fact, a considerable share of the past and current economic well-being of the present generation has been attained by exploiting what belongs to the future generations while failing to replace them with durable physical or financial assets. Although Iran's intergenerational indebtedness extends over a wide array of resources, the dire effects of the unsustainable and irresponsible policies of the past are most evident in the country's dwindling hydrocarbon and groundwater resources, loss of fertile soil, insolvency of pension funds in spite of favorable age structure, bank insolvencies, and a massive buildup of the public debt itself.

## Appendix B: Sectoral Case Studies

### Oil and Gas

Oil export proceeds have played a decisive role in Iran's state-building process over the past century and have shaped the elites' attitude toward entrepreneurship and rent-seeking activities. The production and export of crude oil in Iran peaked in the '70s while domestic consumption has been on a constant rise (**Figure B1**).

Iran's oil and gas sector is plagued with chronic underinvestment and prolonged lead time between final investment decisions and project completion. As a result, the country's oil and gas production was small relative to the amounts of proved reserves. Although no intergenerational saving was ever intended by the state, smaller production of oil was not perceived too negatively until recently as it would have left more oil for the future when the value of oil in real terms was forecast to be significantly higher than today.



**Figure B1.** Iran's crude oil consumption, export, and price per barrel [1,48]. Data for 2019 are only based on the first quarter.

However, in a mere decade, the outlook for the relative price of oil has entirely changed. Climate policies to decouple the global economy from fossil fuel consumption along with the shale revolution and a massive reduction in the costs of electric vehicles and renewable energy are leading to a paradigm shift in the oil markets from scarcity to abundance, hence a more competitive market and lower margins in the long run. Ultimately, given Iran's large reserves-to-production ratio (about 86 years [47]), it is likely that a large share of Iran's crude oil reserves will

never be produced. At a \$60/bbl crude price, Iran's national wealth loss due to stranded oil reserves is estimated at ten to twenty times the country's current GDP.

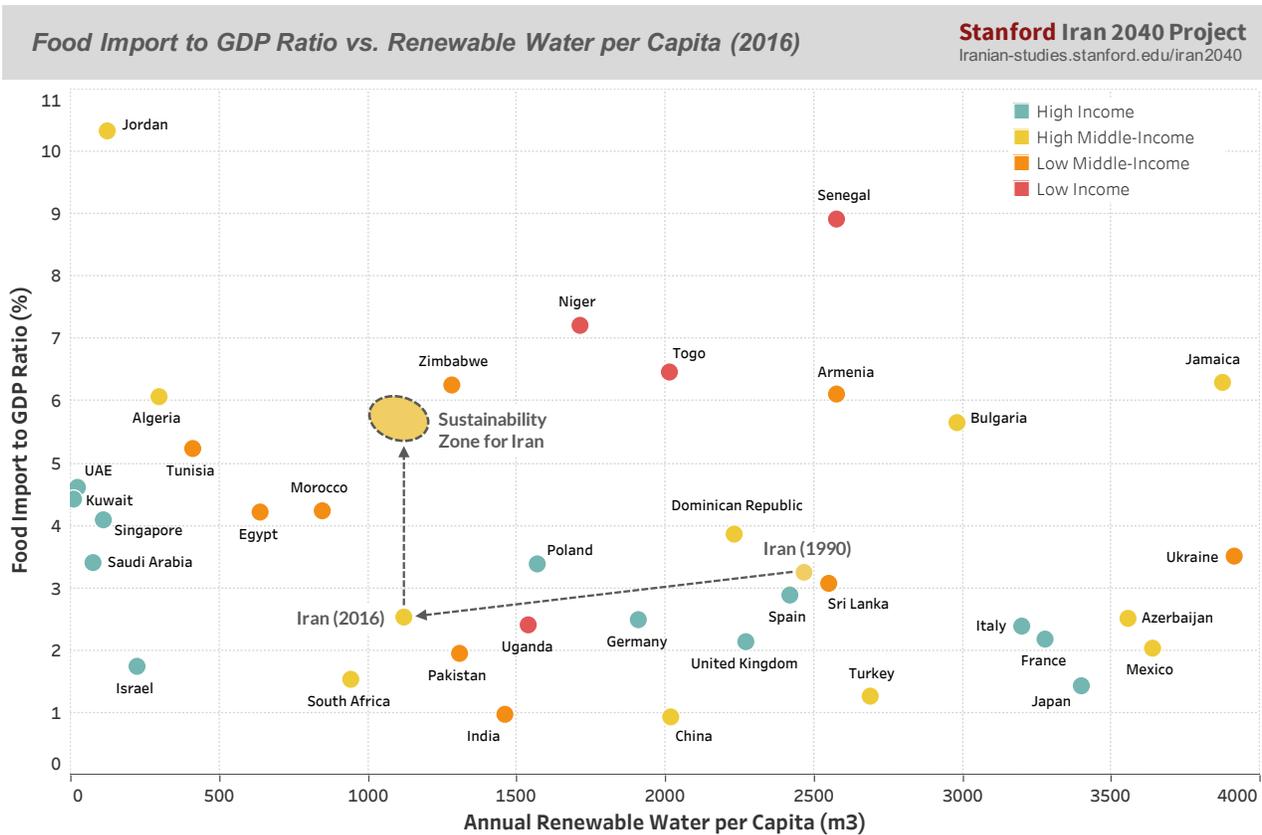
Overall, even in the absence of sanctions, the contribution of oil in financing public expenditures is expected to shrink in the future. This would first lead to exacerbation of the fiscal deficit but would gradually force the state to collect more taxes from citizens and quasi-public organizations, which can improve accountability.

## Food-Water Nexus

Since the early days of the 1979 revolution, food self-sufficiency was perceived by the state as a strategic goal to reduce vulnerability to international embargoes. To achieve this goal, the state has heavily incentivized domestic production to maintain a high level of food self-sufficiency for a large and growing population while overlooking the sustainable capacity of the country in terms of water and land resources. While Iran's population has increased 2.5-fold since the 1979 revolution, total agricultural output has increased five-fold (primarily by the expansion of irrigation).

Due to agriculture's massive water demand, Iran's water consumption has exceeded its sustainable capacity by a large margin—causing significant damage to the environment and depletion of underground water resources. The government thus far has failed to make sufficient interventions to reduce farming as such interventions not only jeopardize the food self-sufficiency goal but also can create social unrest in the regime's political base. On the one hand, the longer the current situation persists, the more the damage to the environment and the more the number of people who will eventually be displaced due to water shortages. On the other hand, if the reduction in agricultural output will not be accompanied with sustained economic growth in other sectors, Iran will suffer a higher level of undernourishment and hunger in the future.

In order to put Iran's water-food nexus into a broader context, I compared the ratio of food imports to GDP for a number of countries with different levels of income and water availability (**Figure B2**). Iran can adapt to water scarcity by increasing imported food by about 3% of its GDP.



**Figure B2.** The ratio of food imports to GDP (2016) versus total annual renewable water per capita for selected countries [49].

## Scientific Achievements

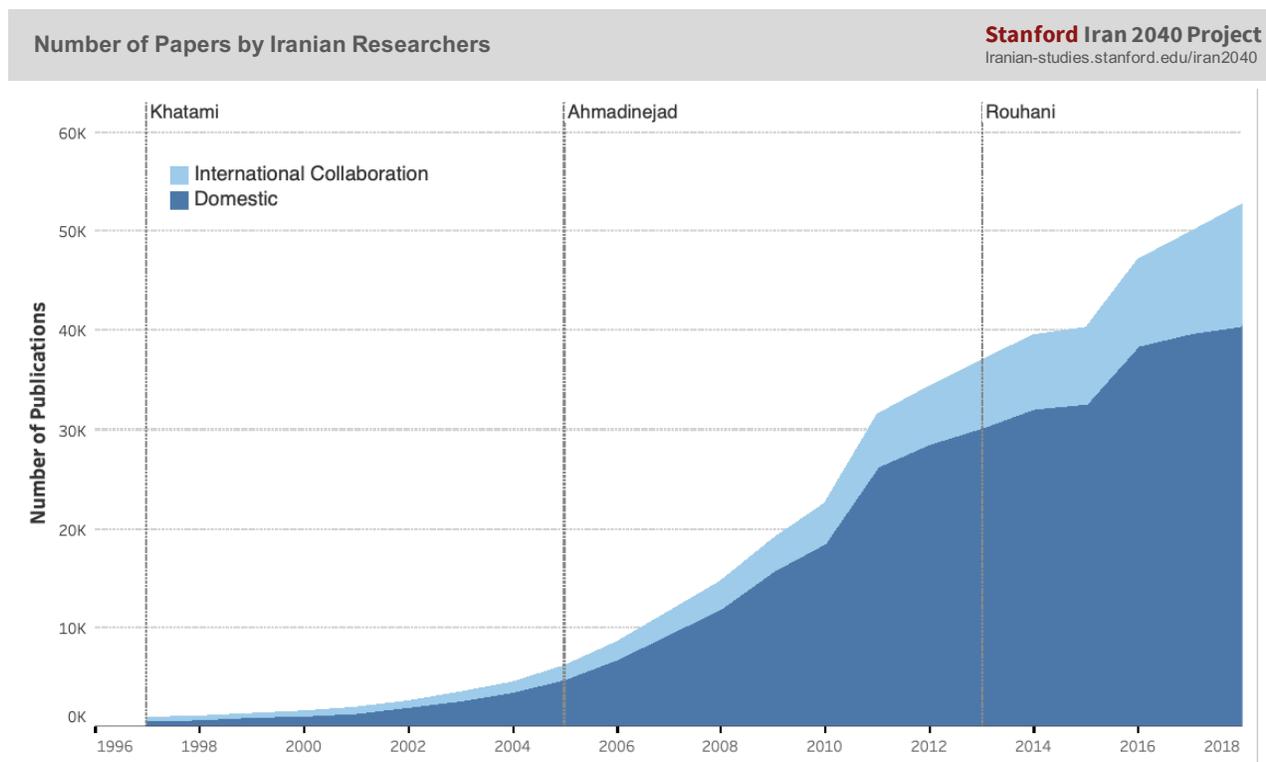
Despite Iran's low research expenditures and the difficulties caused by sanctions, the growth rate in the country's annual number of scientific publications (**Figure B3**) over the past two decades has been higher than virtually all other countries in the world [50]. As discussed in a recent paper [50], this unusual rise in the number of publications is primarily driven by a massive increase in the number of graduate students—which is itself due to demographic factors and an unwelcoming job market—and official policies that necessitate a minimum number of publications for graduation.

Failing to create enough jobs, the state has seen university expansion as an easy, cheap solution to postpone the entrance of the country's youth bulge into the job market. Moreover, often expressed in numerical terms, the state uses the country's seemingly spectacular scientific achievements as a pillar of its propaganda to depict a developmental picture of itself on a par with superpowers.

The overemphasis on quantitative measures of scientific productivity has given rise to a publication bubble with two undesirable consequences: inefficient use of the country's human resources and the growth and entrenchment of academic corruption. Despite the fact that

Iranian researchers have published some 450,000 papers over the past two decades, very few papers (none in some areas) provide a holistic and insightful analysis of the major challenges facing the country (e.g., governance, banking system, water scarcity), which is exactly what is most crucial for the country. With regard to governance and its corresponding institutions, the insights obtained from this case study reveal the importance of proper sequencing in the creation of the institutions.

In summary, the state's overemphasis on superficial aspects of scientific advancements—rather than thinking about their actual outcomes and impacts—fits into a range of sociopolitical behavior that is commonly referred to as *modernity without development*.



**Figure B3.** Trends in the number of scientific publications by Iranian researchers [50].

## Appendix C: Future Scenarios

In this part, I explore a number of potential scenarios for the future of governance and development in Iran. These scenarios serve as examples to highlight the potential sequences of change and development that can cause a substantial shift in the trajectory of the country. Some scenarios that I found most important and relevant to the future of Iran's governance are illustrated in **Figure C1**. Each scenario is triggered by a different event or decision which could be endogenous or exogenous to the governance system and which entails a sequence of events described below.

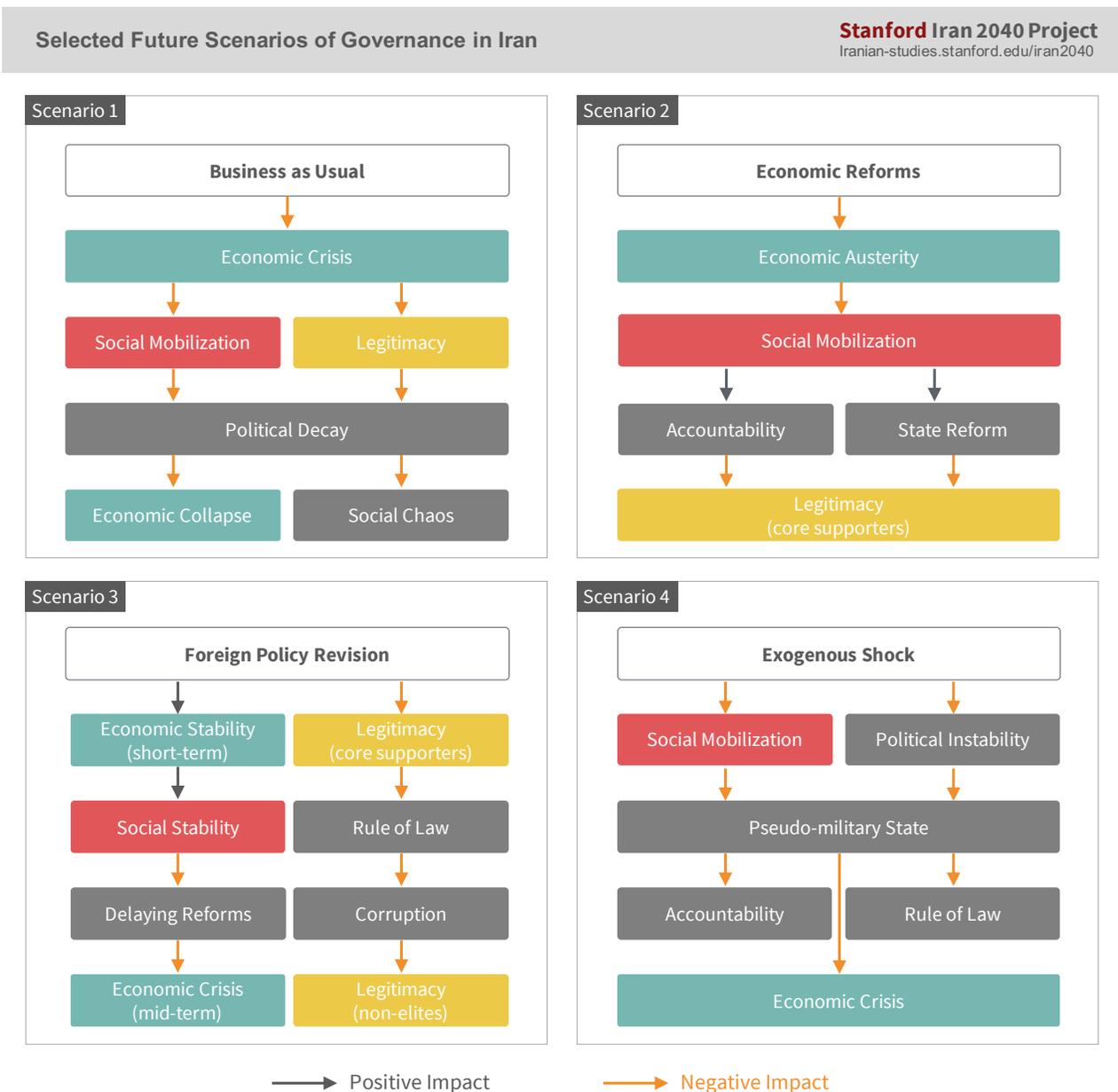
**Business as Usual:** This scenario assumes that no major economic or political reforms are undertaken while other pressures including the oil sanctions will remain in place. This path will exacerbate the ongoing economic crisis which will, in turn, trigger mass mobilization of people and erosion of the state's legitimacy. These developments will paralyze the state and its functioning in imposing its will on the people, ultimately giving rise to total economic collapse and social chaos.

**Economic Reforms:** This scenario assumes that high-level political willpower will emerge to embark on meaningful economic reforms (e.g., true privatization, higher taxes and smaller subsidies on food and energy) to address various forms of inefficiencies and imbalances that exist in the economy. In the short- to mid-term, such measures will likely result in even deeper and more widespread grievances which will mobilize the public across all economic classes. To accommodate such unintended consequences of economic reform, the state would need to show more accountability and undergo some major reforms in other aspects of governance (e.g., by relaxing some of the strict religious regulations imposed on public lifestyles, such as clothing). However, this could in turn decrease the legitimacy of the state among its core supporters.

**Foreign Policy Revision:** Another possible scenario would be an attempt to mitigate the current governance deadlock and economic crises by foreign policy revision to avoid the destabilizing consequences of internal economic reforms. This would provide some elbow room and alleviate some of the most pressing forms of public dissatisfaction in the short term, although the fundamental problems in the economy will persist. However, it may come at the price of weakening the legitimacy of the state among loyal supporters, who will see such a compromise as a sign of weakness and deviation from the core values of the revolution. The failure of a fundamental pillar of legitimacy would cause deterioration of morality considerations among the regime's political elites and the bureaucracy, which will further undermine the rule of law and increase corruption. This will in turn weaken the legitimacy of the state among the non-elite. Thus, focusing on foreign policy revisions without serious internal reforms only defers the fundamental problems of economy and governance and does not solve the governance deadlock.

**Exogenous Shocks:** In contrast to previous scenarios, here I consider a case where major

destabilizing exogenous shocks would trigger a series of events in the future of the country and the governance system. Examples of such shocks could include the appointment of the next leader after Khamenei or more direct involvement of the country in military conflicts with regional countries or the United States. These shocks will create a period of political chaos and social unrest in the short term. The reaction of the state to this chaos would be to exert a pseudo-military control over all aspects of governance. This would in turn undermine the rule of law and accountability. The uncertain nature of such an environment would intensify the economic crisis. In the long term, the economic situation will not improve unless the political environment becomes demilitarized and people perceive the prevailing system as the new norm.



**Figure C1.** Projections of future developments under four different scenarios: business as usual, structural economic reforms, foreign policy reform, and exogenous shocks such as leadership change or military conflict.