

Election time: How to get the most from the next four years

Iran will go to the polls this month to choose its President and the winner will face an urgent set of priorities, particularly in the economy and financial sector. The international business community would endorse a second term for the incumbent President Rouhani. His administration has successfully stabilised the economy, is committed to the JCPOA and Iran's continued integration into the international financial system, and is positioning himself as Iran's best hope at tackling a major weakness, the stifling state presence in the economy.

On the 19th May, the Iranian people will cast their votes in the Islamic Republic's 12th Presidential election. The man they elect will face an urgent set of priorities and his ability to deal with them will determine Iran's economic prospects over the next four years and beyond. Investors are watching closely as the race reaches its final stages.

The successful candidate must move quickly on a number of vital, structural economic reforms. Some economists argue that after four years of sensible and pragmatic economic policy, Iran is entering a period of balanced growth. Even if this is true, the next administration must do better at creating jobs. The stubbornly high levels of unemployment are a "dark cloud" hanging over the Rouhani administration's economic record and a phenomenon that cannot stagnate for four more years. But with 1.2 million young people entering the workforce each year, tackling unemployment is no mean feat. The key to unlocking long-term, employment-generating growth is in the private sector, and effective privatisation will require significant structural reforms.

Three decades of poorly managed privatisation policy have created an unbalanced and non-transparent business environment in Iran, characterised by unfair competition and a lack of dynamism. Previous efforts to boost privatisation have been blighted by corruption, patronage and a lack of openness. Economists know that inward investment brings with it new technologies and know-how that could revive Iran's industries. But despite the huge potential of the Iranian economy, the levels of inward investment Iran needs are not forthcoming. There are financing problems as a legacy of pre-JCPOA sanctions framework, which are slowly being improved,

Fig 1. Real GDP Growth (2005-2016)

(% change y-o-y)

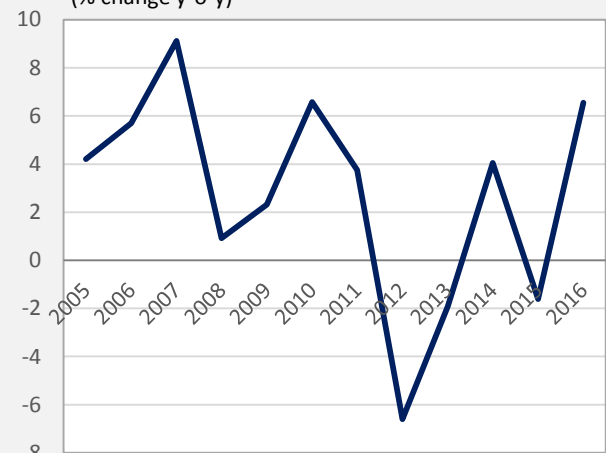
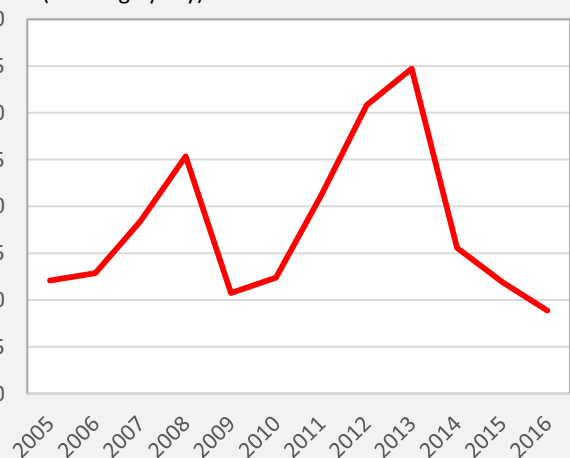


Fig 2. Consumer Price Index (2005-2016)

(% change y-o-y)



but over and above those difficulties there is also a general lack of faith in the rule of law and the independence of the judiciary that acts as a real stumbling block for foreign businesses. This has to change.

The domineering presence of the state in Iran's economy also has a direct impact on business dealings.

Foreign investors look at Iranian industry and see blurred lines as to who they can and cannot deal with. US manufacturer, Boeing, is trying to sell US\$16.6bn worth of aircraft to Iran Air, a commercial airline whose fleet can be commandeered by the IRGC at any time to transport materials. The South Pars oil and gas programme – an Iranian success story this year after initiating gas and condensate recovery on phase 20 of the multi-phased development - is looking for US\$20 billion of investment to realise its expansion plans. But the programme is affiliated with the IRGC construction company, Khatam-ol-anbiya, which is still subject to sanctions. In fact, Khatam-ol-anbiya recently announced ten mega-projects across the breadth of the economy, from refineries to highways, buildings and high speed rail links. The state presence in the Iranian economy suffocates private enterprise and discourages foreign investment on a weekly basis.

The next administration will also inherit a financial system in need of urgent reform and repair.

The IMF's February report highlighted a public debt to GDP ratio in Iran of 42%, once government arrears to the banking sector are taken into account. Iran's latest budget suggested 22% of the bank lending is swallowed up by state-run enterprises, "crowding out" lending to private firms. The Central Bank of Iran Governor said recently that structural reform of the banking sector, in order to establish discipline in bank lending, is the most important objective for the next fiscal year.

Considering the field of available candidates on the 19th May, the international business community would endorse a second term for President Rouhani.

The President has stated clearly that preserving the JCPOA and continuing to develop Iran's position as a fully functional member of the international trading and financial system is a priority. It may be imperfect and subject to constant political pressure, but the JCPOA is Iran's only ticket to competitiveness, economic dynamism and large-scale job creation. In Mr Rouhani's words, why elect someone who was against the JCPOA to be its guardian? The current administration also has a strong basis to argue that the economy will be safest left in its own hands for the next four years. This administration has tamed runaway inflation, stabilised the foreign exchange market and capably increased oil revenues. Central Bank Governor Seif reported on 5th April that the country has finally achieved single-digit inflation accompanied by double digit-growth, for the first time in 26 years.

If he wins a second term, Mr Rouhani would have to do more to tackle unemployment and boost the role of the private sector. Verity Iran believes these problems are closely connected. President Rouhani appears to be positioning himself as a champion of transparency and the enemy of corruption on the campaign trail. If he can successfully separate the functions of the state and military from the economy, he will unlock the jobs and growth the Iranian electorate sorely needs.

Fig 3. Unemployment rate (2005-2016)
(% of total workforce)

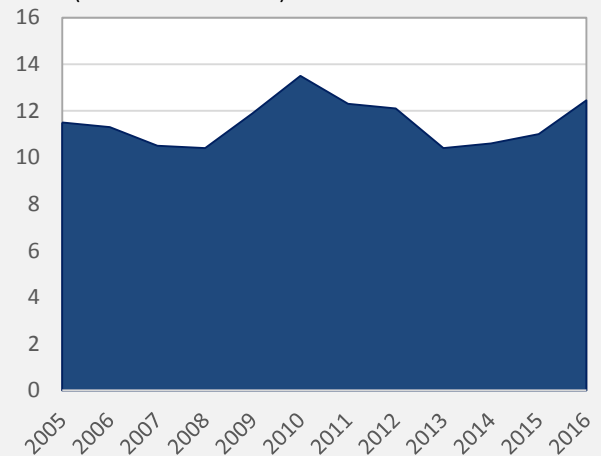
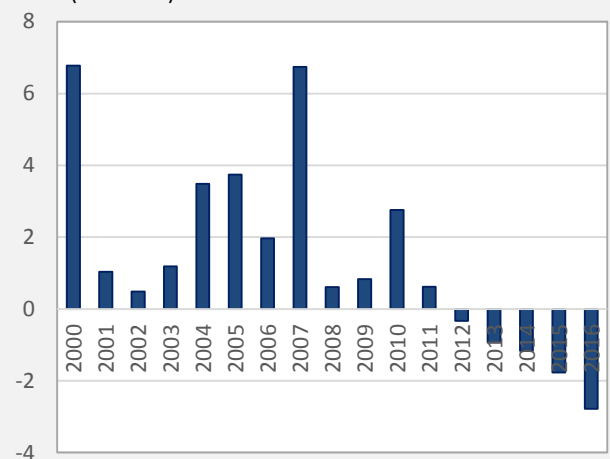


Fig 4. Government balance (2000-2016)
(% of GDP)





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