

Rouhani landslide: a mandate for serious structural reform

With a landslide re-election, President Hassan Rouhani has been granted a powerful mandate to open Iran's economy up to the world. This means taking on vested interests, combatting corruption and reforming the banks. The government must take this opportunity to place business at the heart of its agenda, reining in non-productive spending such as costly military adventures made at the Iranian tax-payers' expense.

President Rouhani's landslide win in the 19 May Presidential election made a clear statement: the people of Iran want to open up and reengage with the world. Rouhani won 59% of the vote, closing off the contest in the first round with a very high voter turnout of 41 million; which equates to 73% of the potential voting population. Voters rejected the populist economic promises of conservative candidate Ebrahim Raisi and placed their faith in the incumbent Rouhani to deliver reform and modernization.

A demanding public will not wait forever for economic results, but Rouhani must prioritize achieving meaningful and sustainable long-term growth and employment. High levels of unemployment, especially youth unemployment, are a key concern for Iranian households. But this is a long term problem and there is no quick fix. Structural reforms are needed to create a level playing field for small to medium sized enterprises to flourish, and to attract much larger levels of foreign direct investment into Iran. These are the necessary conditions for achieving a lasting reduction in unemployment.

A lack of access to international finance clearly remains a significant obstacle for firms; but one that can be overcome. Despite the success of the JCPOA in dismantling international financial sanctions, foreign banks remain reticent about returning to the Iranian economy. Verity Iran's sources suggest this is just as much about the risks of doing business in Iran as it is about the fear of US sanctions. In order to truly reengage foreign banks, the Iranian banking sector must come much more closely in line with international banking norms, such as the Basel banking regulations and the standards of the Financial Action Task Force, which are designed to combat illegal money laundering. This means becoming transparent, compliant and well regulated. It also means casting a more penetrating light on the shady financial dealings and ownership network of some of Iran's large, state and IRGC affiliated businesses, which are a major turn-off to international

Fig 1. Results of Presidential Election (% of valid votes cast)

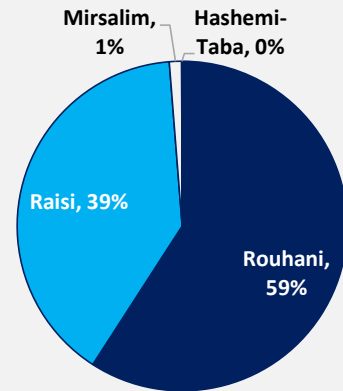
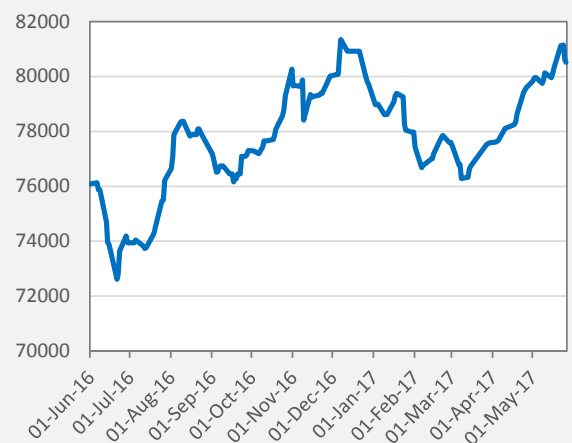


Fig 2. TEDPIX All Shares Index (June 2016 to present)



partners.

The electorate gave Mr Rouhani a mandate to clean up Iran's business environment, root out corruption and thus open the economy up to effective international interaction. The Rouhani campaign described corruption as one of the country's major problems. It deters investors, breeds inequality and suffocates economic dynamism and entrepreneurship in Iran. A recent poll by iPOS suggests 77% of Iranians felt the banks were corrupt or highly corrupt, placing it the top of a list of corrupt Iranian institutions (Fig 3). The unsettling news for the President is that despite the majority of Iranians feeling that striking the JCPOA should lead to a reduction in corruption, 57% feel that corruption has gotten worse in the past five years. One priority for Rouhani must be to finally extinguish the country's two-tiered exchange rate system, which is inefficient and one of the main sources of corruption exploited by those with access to cheap, subsidized foreign currency.

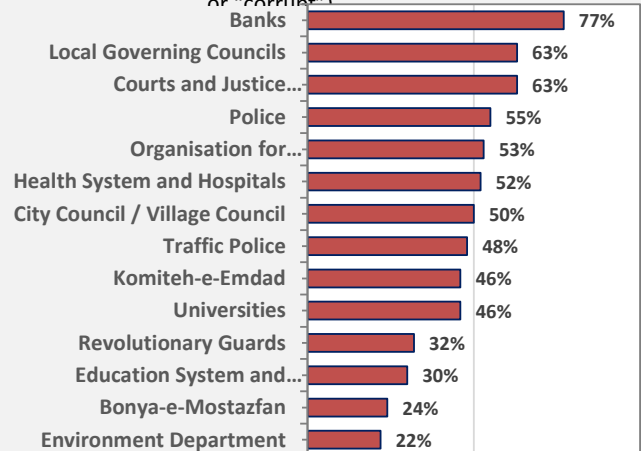
The President found great support for his plans for faster and more effective privatization, which will bring more opportunities for entrepreneurs and a fairer business environment: this means reducing the role of the IRGC and state entities in the economy. During the campaign, Mr Rouhani argued that the IRGC, the Basij and Iranian's armed forces should be for the service of the whole Iranian nation, not the special interests of the few. Many saw this as a signal that his government was willing to finally curb the rent-seeking behavior of these institutions. Powerful vested interests will continue to stand in the way of reform, but it is in the arena of structural economic reforms, better regulation, enforcing the rule of law and pursuing international best practices in business that this battle will be won.

Rouhani needs to place business at the heart of his agenda, this means reorienting spending and reconsidering expensive military adventures. Iran's involvement in the Syrian conflict is an example of the constraints placed on the Iranian budget. From an economic standpoint, the Iranian tax-payers' well publicized US\$5.6 billion "loan" to the Syrian government represents a considerable "opportunity cost": that is the value that could be derived from spending the money at home. Those championing the financial support argue that Iranian firms will be well placed in the reconstruction effort once the conflict is resolved: entities close to the IRGC have reportedly signed memorandums of understanding relating to roads, airports, sea ports, and power stations, as well as rights over mobile phone services and phosphate mining. This means it will be well connected IRGC enterprises that ultimately reap the rewards for the Iranian tax-payer's support for the Syrian government, not ordinary firms. Even then, these firms will be in fierce competition with their Russian and Turkish counterparts, whose support has been equally crucial to the Syrian government and carries just as much leverage. The Iranian tax payer might expect more for his investment.

Fig 3. Which Iranian institutions are corrupt?

(%of 1500 sample responding "very corrupt"

or "corrupt")



Source: Ipos



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