

Salary scandal the symbol of an economy stifled by corruption

The scandalously high salaries for well-connected state employees has made corruption the Rouhani administration's most pressing political and economic challenge with one year to go to the Presidential election. Meanwhile, potentially landmark bills for banking sector reform were submitted to Parliament for review.

One year away from the Presidential election, one year since the signing of the JCPOA, the Rouhani administration still has its work cut out to convince the Iranian people of the merits of the nuclear deal. The Rouhani government must take credit for a generally sound and stable stewardship of the economy but the economic dividends that many hoped would follow the signing of the JCPOA have been slow to materialise. The collapse in the oil price and the lack of real engagement from international banks and companies have dampened Iran's resurgence and many ordinary households are still struggling to see a real difference in their pockets.

Nevertheless, the administration can point to real progress since the JCPOA was implemented. Iranian oil production has expanded to pre-sanctions levels and exports of its oil and natural gas condensates have doubled. The exchange rate is stable (Fig 1), the economy appears to be growing again and inflation has been brought down to single digit levels, just as promised (See Fig 1). Next year's growth forecasts are more positive than the last. The Ministry of Industries, Mining and Trade recently forecast 7-8% growth for the sector in the current Iranian year. This contrasts greatly with last year's 2.2% contraction.

Verity Iran's sources continue to report the same obstacles to foreign investment: a lack of assurances about the rule of law, opaque ownership structures, the role of the security services and intelligence agencies in the economy and widespread corruption. Recent data suggests there may have been a long awaited uptick in foreign direct investment in recent months, thanks to deals signed in the automotive, oil and gas, transport and tourism sectors. But on the whole, despite the constant flow of visiting delegations, the government's stated FDI targets are unrealistic

Fig. 1 Iranian Rial to USD, dual exchange rates

1 January 2015 to present

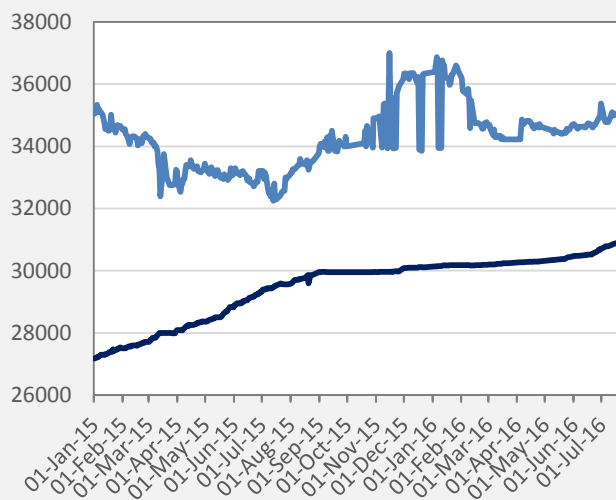
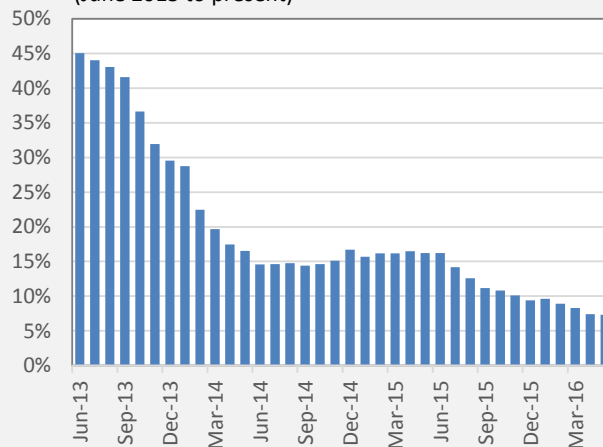


Fig 1. Iranian Inflation rate

(June 2013 to present)



for the foreseeable future. The authorities must urgently focus on improving the transparency and efficiency of the business environment.

The recent salary scandal in the state sector has poured fuel on the fire of public resentment over what appears to be an intractable corruption problem. The CEOs of four major banks – Refah Kargaran, Mellat, Saderat and Mehr – have been dismissed from their positions; the entire management team of the National Development Fund, including CEO Hosseini, has been forced to resign. Subsequent arrests at Bank Mellat have exposed an 800 trillion toman (\$258 million) corruption scandal, with alleged connections to President Rouhani’s own family members. In response, the President ordered the drafting of a *bill on transparency and personal interests* for reforming the state’s salary system, even going so far as to order the reporting of the lowest and highest salaries of military officials – despite recent claims by the IRGC that these were closely guarded for security reasons.

First VP Dr Jahangiri, who is charged with tackling the salary scandal, claimed that the problem was inherited from the previous administration. He said that the country’s supervisory and regulatory laws and institutions had been considerably weakened with “systemic corruption gnawing away at the regime” for years. To a large extent this is true. Ahmadinejad’s disastrous economic policymaking and patronage left a toxic legacy. Corruption and rent-seeking are so deeply embedded in the Iranian economy, small measures are futile, only a significant shift in the economic system can correct it. Some commentators believe Iran could learn from the former communist economies of Eastern Europe where a process of dismantling the state’s role in the economy led to greater competition better quality goods and services, and an erosion of the black market.

The Central Bank of Iran has published its roadmap for banking reform with two new bills set to enter Parliament that could shake up how banking and business are done. The bills will address the CBI’s independence from government, its authority over monetary policy-making and its control over the money markets, including possibly the power to set exchange rates. In an early July speech, President Rouhani said the new bills were designed to address the two main problems of the banking system: the high interest rates for loans, and banks’ weak capacity for providing credit.

As part of the reforms, the government will aim to strengthen the banking sector by deepening Iran’s capital markets. The government owes around 170 trillion tomans (\$55 billion) to the banking system, and in turn the banks owe more than 80 trillion tomans (\$26 billion) to the Central Bank. If the government can leverage the bond market to repay its debts to the banking sector, it could be a key step in stimulating lending activity in the economy. The government will issue US\$13bn worth of Islamic bonds in the

Fig 2. Tehran Stock exchange (TEDPIX All Shares Index) Jan 2016 to present

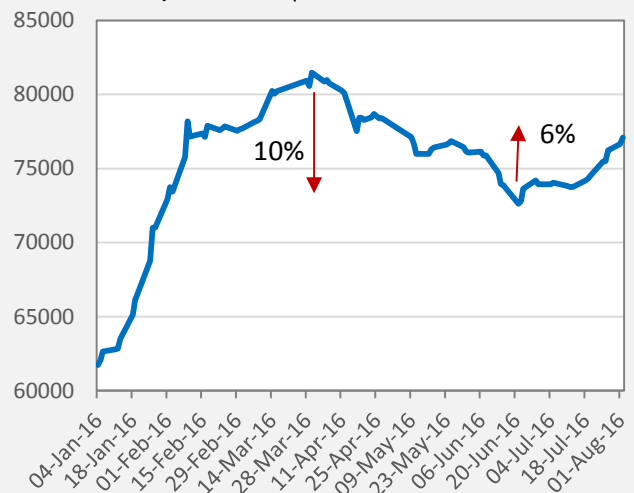


Fig 3. Brent Crude Oil Price \$/barrel (Jan 2015 to present)



current fiscal year.



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