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Measuring Iran's economic misery

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Since Mahmoud Ahmadinejad first became Iran's President in August 2005, the economy has gone from "bad" to "worse". A misery index provides a clear picture of the economic conditions experienced by the majority of Iranians.

The index is the sum of the inflation, interest and unemployment rates, minus the annual percentage change in per capita GDP. It must be stressed that Iran's true inflation, interest and unemployment rates are probably higher than those reported. In consequence, the true level of the index is probably higher than the one in the accompanying chart. That said, the pattern of "ups" and "downs" in the index is reliable.

Several things stand out: the level of the index has been quite elevated during the 1991-2008 period; the Rafsanjani years were a bit of a rollercoaster ride, with a dramatic increase followed by a sharp reduction and then a final up-tick in the level of "misery"; the Khatami years were characterised by relative stability and a mild improvement in the state of economic affairs; and the Ahmadinejad period has been marked by a steady deterioration in economic conditions.

The misery index is not the only metric that measures economic wellbeing. Since 1989, when Rafsanjani became president, the rial has lost 99.3 per cent of its value against the dollar. The maxi-devaluations during the Rafsanjani and Khatami periods didn't buy Iran anything - except misery.

While the rial's depreciation against the greenback during the Ahmadinejad period has been modest (9.6 per cent), the rial has come under increased pressure as capital flight has intensified since 2007.

Not surprisingly, Iran ranks near the bottom - 137 out of 183 countries - in the World Bank's Doing Business 2010 - a recently released (9/9/2009) report that measures the vitality of free markets and the ease of doing business. Table 1 indicates where Iran ranks relative to countries in the Middle East and North Africa (Mena) region.

Poverty is a scourge which leaves those in its grip to lead lives that are brutish, dangerous and short. Economic growth is a poverty elixir. From the works of the earliest economists - Richard Cantillon (1680-1734), Adam Smith (1723-1790) and Jacques Turgot (1727-1781) we have learned that economic liberty is a crucial precondition for sustained economic growth and a concomitant reduction of misery. But what are the elements that produce such a liberal economic order?

Private property and contract rights should be established. The following criteria should guide the establishment of private property: universality, exclusivity and transferability. Universality guarantees that all resources are either owned or ownable by a private person or entity. Exclusivity guarantees that those who own property have the exclusive right to use their property as long as that use does not harm other property owners. And transferability guarantees that owners can freely transfer their property rights.

Fiscal order and transparency should be established. To establish control over public spending and reduce waste, fraud and corruption - governments should publish a national set of accounts that includes a balance sheet of its assets and liabilities, and an accrual-based annual operating statement of income and expenses. These financial statements should meet international accounting standards and should be subject to an independent audit.

Budget deficits and government spending should be kept under control. One way to achieve control over the scope and scale of government is to require "super majority" voting for important fiscal decisions: taxing, spending and the issuance of debt.

Inflationary pressures should be kept under control. To encourage economic development, inflation rates should be kept low and predictable.

For many developing nations, this inflation objective can best be achieved by abolishing their central banks and replacing them with currency boards that issue fully convertible, stable, domestic currencies, or by simply doing away with domestic currencies and replacing them with convertible stable foreign currencies.

The advantages of open international trade should be exploited. Liberal trade policies facilitate the efficient allocation of resources and stimulate economic growth. This is particularly true in small economies, where real competition can only be obtained by allowing foreign producers to compete freely in domestic markets.

Complex tax systems and excessive tax rates should be avoided. Complex tax systems coupled with excessive tax rates distort behaviour and create large disincentives to economic activity, while yielding little revenue.

Subsidies and tax incentives for private industry should be avoided. Subsidies and tax incentives that are designed to achieve particular objectives may or may not actually assist in obtaining those goals. One thing is certain: they distort economic choices and resource allocation, and retard economic growth.

Privileges and immunities should be avoided. For example, state-created monopoly privileges and immunities for unions, such as exclusive representation, compulsory union membership and immunity from antitrust laws, should be avoided. Privileges and immunities distort markets and act as a drag on economic growth.

Price controls should be avoided. Price controls, including interest rate ceilings, cannot be justified on economic grounds. They tend to vitiate the signalling role that prices should play. Hence, price controls impede the movement of resources from lower-valued to higher-valued uses and result in resource misallocation and lower economic growth.

Market interventions and restrictions on competition should be avoided. Market intervention and restrictions on competition, such as the use of marketing boards, result in the politicisation of economic life, inefficient enterprises, resource misallocation and the retardation of economic growth.

State-owned enterprises should be privatised. State-owned enterprises are inefficient. For example, sales, adjusted profits, and productivity per employee are lower for state-owned enterprises than they are for private firms. Sales per dollar of investment are lower, profits per dollar of assets are lower, wages and operating costs per dollar of sales are higher, sales grow at a slower rate, and, with few exceptions (petroleum), state-owned enterprises for which accounts are presented properly generate accounting losses that are passed on to taxpayers.

Unclear boundaries between public and private activity should be avoided. When boundaries between the public and private sector are unclear, it is symptomatic of poorly defined property rights. Ill-defined property rights distort resource allocation and retard economic growth. Government bailouts of insolvent private firms are but one example of unclear boundaries between public and private activity.

The manipulation and repression of private capital markets should be avoided. The manipulation and repression of private capital markets distort the savings and investment process, retard foreign direct investment, promote capital flight, and generally act as a drag on economic growth.

Iran has not only ignored the preceding enumeration, but its populist President Mahmoud Ahmadinejad has flaunted all economic principles. In Iran, private property and contract rights are not secure. This lack of security, particularly for foreign investors, has thrown Iran's oil and gas development into a cocked hat. For example, the lack of an integrated domestic pipeline system forced Iran to cut gas exports to Turkey last year, casting doubt on Iran as a secure energy exporter.

Fiscal order, transparency and control are nowhere to be found in Iran. Government expenditures are estimated to have increased - in line with President Ahmadinejad's populist proclivities - by 55 per cent during the fiscal 2007-08 through 2008-09 period.

Price controls are widespread. These result in implicit subsidies equal to about 25 per cent of GDP. Explicit subsidies are equal to another 5 per cent of GDP, or about 16 per cent of the central government's expenditures.

Banks are mandated to extend credit at below-market rates to certain favoured sectors of the economy. The specific sectors and levels of credit are laid out in Iran's five-year development plan.

Even things like privatisation are perverted in Iran. For example, when state-owned enterprises are privatised, the majority of the shares are often purchased by other state-owned entities, such as pension funds.

Iran's economic policies have put it in a death spiral whose speed is governed, in large part, by the price of oil.

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Sources: International Monetary Fund, World Economic Outlook, April 2009; Economist Intelligence Unit; Central Bank of the Islamic Republic of Iran; and author's calculations

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