



PERSPECTIVES

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Iran Faces Economic Challenges as Its Currency Plunges

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EXECUTIVE SUMMARY: The sharp decline in the value of the Iranian currency is causing upheaval in the Iranian economy and challenging the government and the banking sector. The local currency's plunge to a rate of 6,000 tomans to the dollar, despite the high level of oil and gas revenues, reflects a lack of trust between the citizens and the banking system. A consideration of Iran's economic policy sheds light on the limitations of the "dual economy" practiced by the Islamic Republic since its inception.

At a time when Iran's moves in the geopolitical sphere are getting the lion's share of public attention, economic processes are occurring that will bear consequences for the power of the Islamic Republic. The recent sharp decline in the value of the local currency against the dollar reflects the severity of Iran's economic plight. When the local currency plummeted to below the benchmark of 6,000 tomans to the dollar, currency trading came to a halt. The efforts of Iran's central bank to stabilize the rate at 4,200 tomans failed, prompting the closure of the currency conversion market.

A look at the local-currency exchange rate in the early days of the Islamic Republic highlights the dire straits of the currency relative to today's global market. In the wake of the revolution, the Iranian currency's exchange rate stood at seven tomans to the dollar, while on the free market the dollar was traded for [ten tomans](#). It is no surprise, then, that the recent plunge in the currency's value and the distrust between the citizens and the banking system have led some members of parliament to demand the immediate dismissal of Vally Allah Seif, president of the central bank.

There is an apparent contradiction between the nadir the local currency has reached and the state's revenues from oil and gas. The Iranian oil market is fifth

in the world, with a production capacity of four million barrels per day. In addition, Iran's natural gas reserves are estimated at 17.5% of all known gas reserves, second in size globally after Russia. According to the CIA's *The World Factbook*, Iran's GDP is estimated at [\\$1.63 trillion](#) and its GDP per capita at \$20,000.

However, these figures do not reflect the reality faced by the Iranian population, which suffers from unemployment, inflation, growing gaps between average family income and the basket of household expenditures, a severe housing shortage, and more. Why the discrepancy?

An analysis of the political-economic equation can shed light on the reasons for the crisis in the Iranian exchange-rate market. Western experts tend to categorize the Iranian economic regime as a "command economy," wherein the ruling establishment is the decisive and exclusive actor when it comes to the production and consumption of goods and services. This kind of economy is epitomized by that of the Soviet Union before its demise.

It is true that there is a certain similarity between Iran's economic regime (which has weakened the private sector) and a "command economy," but this perception is insufficient as it ignores the characteristics of the dual economy practiced in Iran.

The Iranian economy is comprised of two parallel axes: the official economic regime implemented by the government and the "charity foundation economy" (the *Bonyads* economy). The largest of the foundations is the "Oppressed and Disabled Foundation" – the second-largest economic entity in the country after the national oil company. The work of the charity foundations, which originated in the revolutionary regime's confiscation of the assets of the Pahlavi Foundation, involves supplying the needs of the lower classes, helping the families of those fallen in battle, rehabilitating prisoners of war, providing assorted forms of welfare, and inculcating Islamic education, culture, and so on.

Over time, the charitable foundations have become a powerful economic axis that is not subject to governmental monitoring, taxation processes, reporting, or registration in the state accounting system. Not surprisingly, the inability to monitor these entities has given rise to corruption, tax evasion, and resource allocation outside the framework of the approved annual budget.

Furthermore, the Iranian constitution explicitly delineates the balance of power between the Supreme Leader and the president, putting the Supreme Leader in charge of agenda-setting and resource allocation. As a result, a large proportion of state revenues are channeled to entities that are directly under Ayatollah Khamenei's aegis – such as the Revolutionary Guard Corps, which has evolved

not only into a formidable security establishment but also into a powerful economic conglomerate.

The dual economic structure has created consequences that are unique to the Iranian economy. For example, the current president of the Foundation of the Oppressed and Disabled, Muhammad Saeed-kia, has no less power (some claim he has even more) than the minister of economic affairs and finance, Masoud Karbasian.

The charitable foundations' power and influence over the Iranian economy are a source of incessant wrangling between governmental power brokers. The foundations' activity is clearly aimed, among other things, at bolstering the religious establishment in Iran's political balance of power. For example, the "Ostan-e Quds-e Razvi" Foundation serves as a support base for Ebrahim Raisi, who challenged Rouhani in the presidential elections.

As usual, the Iranian ruling establishment is pinning the blame for the drop in the currency's value on external factors, notably the West, claiming that the turmoil stems from Washington's threats to pull out of the nuclear agreement. Various spokespersons say the Trump administration's policy on renewing sanctions is fostering uncertainty that is deterring European countries from signing trade agreements with Iran. Yet local traders accuse Iran's central bank of deliberately slowing the flow of foreign currency into the exchange trade in order to create a shortage. Moneychangers also claim that the shortage is aimed at boosting demand for foreign currency and filling budget shortfalls.

Citizens' desire to convert their money into foreign currency in order to retain its value attests to a lack of popular trust in the banking system. Inflation and rising prices on the basic basket of goods impel a constant search for solutions in the absence of a banking alternative. The fall in the currency's value is accompanied by an ongoing slump in local market production that stems from the government's lack of encouragement. High unemployment figures and the preference for imports over local products also contribute to the currency's distress.

In the view of industrialists and economists, the stagnation stems from both the sense of security fostered by high revenues from natural resources and the regime's preference for setting the economic agenda. Moreover, the establishment's flouting of basic principles of a free economy – in which private owners make their own decisions on what to produce, how to price it, and what to invest in in the first place – exacerbates the weakness of the Iranian economy.

The trouble now besetting the Iranian currency cannot be seen in isolation from the social unrest that began at the end of 2017. The protests that swept about 80

towns across Iran stemmed from the growing gaps between massive investments in the military sphere (with the aim of expanding Iran's regional influence) and the population's desire for a better standard of living. This movement was driven by the rising cost of living, high poverty and unemployment levels, a housing shortage, and increasing crime. The travails of the currency need to be analyzed in the wider context of developments affecting Iran.

From the moment the Iranian Republic was established in 1979, its leaders called for the rejection of all aspects of Western life, including the use of foreign currency. Iran's citizens have taken the opposite tack. The Iranian economy's source of strength – its gas and oil revenues – could turn into a weakness because of the fragility of the economic regime. The leadership's ignoring of society's needs and funneling of massive resources into the military sphere, while averting its gaze from the liabilities of the dual structure, could create serious challenges for the revolutionary regime in the future.

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