



**Gulf Research Center**  
Knowledge for All

# Iran's Domestic Political and Economic Challenges

**Dr. Sara Bazoobandi**

**GRC GULF PAPERS**

**November 2012**

© Gulf Research Center 2012

All rights reserved. No part of this publication may be reproduced, stored in a retrieval system, or transmitted in any form or by any means, electronic, mechanical, photocopying, recording or otherwise, without the prior permission of the Gulf Research Center.

The opinions expressed in this publication are those of the author alone and do not state or reflect the opinions or position of the Gulf Research Center.

# Iran's Domestic Political and Economic Challenges

**Dr. Sara Bazoobandi<sup>1</sup>**

## Introduction

Recent political developments in Iran have revealed the increasing divisions among the Islamic Revolutionary elite. President Mahmoud Ahmadinejad, once strongly backed by the Supreme Leader Ayatollah Ali Khamenei, no longer seems to enjoy his full support or that of Khamenei's supporters in the parliament. In addition to domestic political challenges, the difficult economic situation in Iran due to international economic sanctions has aggravated the problems facing the country. The government has been struggling to protect its revenues and keep the country's consumption at a steady level. As a result, it has been forced to adopt various back channel methods and alternative policies to maintain financial stability. Furthermore, the government is facing two important leadership issues. In the short run, the biggest political challenge since the controversial presidential election of 2009 will come in June 2013 when the country chooses a new president. In the long run, a bigger leadership challenge awaits – choosing the successor to the supreme leader. Meanwhile, the reformist movement, which gained momentum after the victory of former President Khatami, has been crushed with two of its leaders under house arrest. This paper will examine various possible scenarios in Iran relating to the internal power struggle, the issue of choosing a successor to the supreme leader, and the presidential election of 2013. It will also analyze the key events which have affected Iran both from the political and economic perspectives.

---

1. Dr. Sara Bazoobandi is a Visiting Research Fellow at the Middle East Institute of the National University of Singapore

## Internal Balance of Power Challenges

The power struggle within the Islamic revolutionary political system has become more apparent since the 2009 presidential election crisis. The opposition group backed by former Iranian president Akbar Hashemi Rafsanjani – the ‘old friend’ of Ayatollah Khamenei, as he once said at a Friday prayer in June 2009 – challenged the supreme leader’s support for President Ahmadinejad and questioned the credibility of the electoral process. However, for nearly two years after the start of his second term in office, Ahmadinejad enjoyed the unlimited power delegated to him by Khamenei over the economic and political policies of the country. Then disagreements started to surface between the two over a number of issues including Ahmadinejad’s attempt to dismiss Heydar Moslehi, the Minister of Intelligence, in April 2011, and the fraud charges which were brought against some of the president’s closest allies. Subsequently, the political divide widened and in October 2011, Ayatollah Khamenei even proposed a radical change of the country’s constitution to abolish the presidency saying, “If deemed appropriate, Iran could do without a president.” According to the proposal, Iran would be ruled by Khamenei working in tandem with parliament, which would continue to be directly elected and would appoint one of its members to serve as prime minister.<sup>2</sup> The supreme leader’s statement prompted a public response by former president Rafsanjani, who said: “The proposal strongly undermines the ideal of an Islamic republic, in which the people elect their leaders.” A few days after the supreme leader’s statement, Ahmadinejad, in an indirect reference to the issue, said during a public speech in the city of Birjand (in Eastern Iran): “We are not going to respond [he did not clearly mention respond to what] but the people are awake... they will bring down whoever wants to stand in their way.”<sup>3</sup> A pro-Ahmadinejad daily *Iran* condemned the proposed change as a trick for power-hungry factions that have difficulty getting popularly elected<sup>4</sup> and reportedly mocked the supreme leader’s comments in an article which was soon removed from the newspaper’s website.<sup>5</sup>

2. T. Erdbrink, “Iran’s Supreme Leader Floats Proposal To Abolish Presidency,” *Washington Post*, October 25, 2011, [http://www.washingtonpost.com/world/middle\\_east/irans-supreme-leader-floats-proposal-to-abolish-presidency/2011/10/25/gIQAAsOUKGM\\_story.html](http://www.washingtonpost.com/world/middle_east/irans-supreme-leader-floats-proposal-to-abolish-presidency/2011/10/25/gIQAAsOUKGM_story.html) (accessed August 15, 2012).

3. Ayeene-i Rooz, “Gozaresh-i Washington Post dar bare-i tagheer-r ghanoon-i asasi,” October 27, 2011, <http://www.ayenehrooz.com/?p=13579> (accessed September 14, 2012).

4. Y. Alem, “Is the Islamic Republic of Iran on Its Last Elected President?” *Al-Monitor*, August 7, 2012, <http://www.al-monitor.com/pulse/originals/2012/al-monitor/is-irans-presidency-on-the-brink.html> (accessed September 14, 2012).

5. R.F. Worth, “Iran’s Power Struggle Goes beyond Personalities to Future Presidency Itself,” *New York*

Following Ayatollah Khamenei's public quarrel with the Iranian president, the parliament, backed by the supreme leader, has started to officially criticize Ahmadinejad's administration for both its economic and political decisions. This trend gathered steam after the victory of pro-Khamenei candidates in the March 2012 parliamentary election for the 9th Islamic Consultative Assembly (Majlis). The supporters of the supreme leader took more than three-quarters of the 290 seats in the parliament. In Tehran alone, 19 out of 30 seats were won by pro-Khamenei candidates. Gholam-Ali Haddad Adel, a key ally of Khamenei and a former speaker of the parliament, received the highest vote in Tehran. Pro-Khamenei candidates won in the other important cities including Qom and Mashhad, where, according to official data on the 2009 presidential election, over 90 percent of voters had backed Ahmadinejad.<sup>6</sup>

The victory of Khamenei's supporters confirmed a shift in power that has undermined the role of President Ahmadinejad. This shift leaves very little room for the administration to initiate major policy changes even as Iran faces external sanctions and several hurdles in the domestic economic sectors. The Iranian economy is struggling with issues such as lack of credit, chronic high unemployment, structural weaknesses, and crony capitalism in the private sector. While there has been no major change on either the domestic or foreign policy fronts, the composition of the new parliament has increased policy delays domestically.

On a number of occasions, Ahmadinejad clashed with the previous parliament over his administration's economic policies, which has cost him supporters and may well have decreased his chance to put up a candidate in the 2013 presidential elections. Besides, many Ahmadinejad supporters have been edged out of parliamentary roles and are being investigated for fraud. Ahmadinejad was summoned for a hearing in parliament on March 14, 2012, to answer questions focusing on his handling of the economy and face accusations that he disobeyed the supreme leader. The hearing of the Iranian president was the first of its kind since the 1979 Islamic Revolution.<sup>7</sup> During the hearing, Ahmadinejad ridiculed parliament's questions and insisted that his decisions were in accordance with the law, denied that he had challenged the supreme leader, and insisted that inflation was not the result of his

---

*Times*, October 26, 2011, [http://www.nytimes.com/2011/10/27/world/middleeast/in-iran-rivalry-khamenei-takes-on-presidency-itself.html?\\_r=0](http://www.nytimes.com/2011/10/27/world/middleeast/in-iran-rivalry-khamenei-takes-on-presidency-itself.html?_r=0) (accessed September 14, 2012).

6. Fars News, "Final Results of Iran's Parliamentary Election Announced," 2012, <http://english.farsnews.com/newstext.php?nn=9012131422> (accessed August 15, 2012).
7. R. Gladstone and Alan Cowell, "Iran's President Unfazed in Parliamentary Grilling," *New York Times*, March 14, 2012, <http://www.nytimes.com/2012/03/15/world/middleeast/iran-ahmadinejad-questioned-before-parliament-majlis.html?pagewanted=all> (accessed August 15, 2012).

government's decision to cut subsidies. Parliament could impeach Ahmadinejad if his explanations were seen as unconvincing, but doing so would require Khamenei's unofficial approval.

The power struggle between the supreme leader and President Ahmadinejad peaked early last year when Ahmadinejad asked Minister of Intelligence Heydar Moslehi to resign. Moslehi resigned on April 17, 2011, but his resignation was rejected by Khamenei and he was reinstated.<sup>8</sup> On April 27, 2011, the parliament endorsed Moslehi in his position. There has been some speculation that Ahmadinejad's team took advantage of the 10 days during which Moslehi's resignation was discussed and took classified documents out of the Ministry of Intelligence in order to blackmail the supreme leader's camp and undermine Khamenei's attempt to limit presidential power.<sup>9</sup>

Another attempt by Ahmadinejad to assert his power was made in the case of Saeed Mortazavi, the former Tehran Prosecutor. Khamenei ordered the head of judiciary to remove Mortazavi from his post after the scandal about the death of three political detainees and the abuse of dozens of others in the Kahrizak detention center during the 2009 post-election crisis. Ahmadinejad immediately appointed him as the head of Iran's Task Force against Smuggling and later as the head of the Social Security Fund. The Majlis, unofficially ordered by the supreme leader, has challenged his appointment on the grounds that positions cannot legally be entrusted to someone who has charges pending against him.<sup>10</sup> The turn of events has led to widespread speculation on the role that Mortazavi may be playing between Ahmadinejad and the supreme leader.<sup>11</sup> To what extent Mortazavi is supported by whom is an issue that falls outside the context of this paper, but the most important point one can draw from these incidents is the opacity and complexity of the regime and the obvious internal conflict between the two main power centers of the Islamic establishment in Iran.

Despite the power struggle and Khamenei's stated view on removing or devaluing the presidency, Ahmadinejad remained in his position, as the supreme leader frequently

---

8. W. Yong, "Iranian Leader Asserts Power over President," *New York Times*, April 23, 2011, <http://www.nytimes.com/2011/04/24/world/middleeast/24iran.html> (accessed August 3, 2012).

9. A. Milani, "Is Ahmadinejad Islamic Enough for Iran?" *Foreign Policy*, April 29, 2011, [http://www.foreignpolicy.com/articles/2011/04/29/is\\_ahmadinejad\\_islamic\\_enough\\_for\\_iran?page=0,1](http://www.foreignpolicy.com/articles/2011/04/29/is_ahmadinejad_islamic_enough_for_iran?page=0,1) (accessed September 14, 2012).

10. Peyvand Iran News, "Former Iranian Prosecutor Saeed Mortazavi Summoned to Court," April 10, 2012, <http://www.payvand.com/news/12/apr/1086.html> (accessed August 1, 2012).

11. Y. Baji, "The Strange Case of Saeed Mortazavi," *Asia Times*, May 10, 2012, [http://www.atimes.com/atimes/Middle\\_East/NE10Ak01.html](http://www.atimes.com/atimes/Middle_East/NE10Ak01.html) (accessed August 3, 2012).

stated that any divide within the Islamic Revolutionary establishment would be seen by the 'enemies of the revolution' as an obvious sign of internal political instability. Equally and despite losing the support of the supreme leader and the parliament, which is heavily influenced by the leader, Ahmadinejad has remained one of the centers of power in the political landscape in Iran. At the same time, Khamenei has held ultimate control over Iran's affairs particularly on the foreign policy front, and since March 2012, he has put more pressure on the Ahmadinejad administration to keep domestic issues, mainly economic issues, more aligned with his own views.<sup>12</sup>

The tension among the Iranian political elite, particularly the divisions between the Ahmadinejad and Khamenei camps, is expected to further deepen in light of the presidential election in 2013. Ahmadinejad has, through various signals, indicated that his team is not planning to fully hand over power to the next president. While the many scenarios for the next presidential election are discussed later in this paper, suffice it to say that based on various public discussions, the scenario most favored by Ahmadinejad seems to be to keep at least a partial hold on power either by himself or through one of his closest allies.

## The Reformist Movement

The reformist movement gained power in Iran for the first time when former President Sayed Mohammad Khatami assumed office in 1997. Khatami's government pushed for major reforms in the country's political system during its eight years in office. The most controversial reform plan was initiated through the so-called 'twin bills' proposed by the Khatami administration to the parliament.<sup>13</sup> The bills were designed, firstly, to protect the right of everyone to be a candidate or elect a particular candidate in the parliamentary election,<sup>14</sup> and, secondly, to reinforce presidential powers by enabling the president to warn the three constitutional powers (executive, judiciary, and legislative) against any violation of the constitution and administer punishment if his warnings were not observed.<sup>15</sup> The first bill would curb the power

12. M. Casey and Tom Kutsch, "Ahmadinejad Faces Unprecedented Questioning by Iranian Parliament," *Opinions Foreign Policy* March 14, 2012. [http://mideast.foreignpolicy.com/posts/2012/03/14/ahmadinejad\\_faces\\_unprecedented\\_questioning\\_by\\_iranian\\_parliament](http://mideast.foreignpolicy.com/posts/2012/03/14/ahmadinejad_faces_unprecedented_questioning_by_iranian_parliament) (accessed August 1, 2012).

13. BBC News, "Iran Parliament Backs Reformist Bill," November 10, 2002, [http://news.bbc.co.uk/2/hi/middle\\_east/2436427.stm](http://news.bbc.co.uk/2/hi/middle_east/2436427.stm) (accessed August 15, 2012).

14. *Arab News*, "Khatami Refuses To Back Down over Key Reform Bills," June 2, 2003, <http://www.arabnews.com/node/232413> (accessed August 14, 2012).

15. Peyvand Iran News, "Iran's Parliament Agrees To Withdraw Khatami's Twin Bills," April 18, 2004, <http://www.payvand.com/news/04/apr/1120.html> (accessed August 14, 2012).

of the Guardian Council, whose members are appointed by the supreme leader, by limiting its right to vet parliamentary election candidates.<sup>16</sup> Through the second bill, Khatami sought to push his plan for expanding his executive powers, allowing him to intervene, prevent, and reverse actions by the three constitutional powers.<sup>17</sup> The bills were approved by the Majlis in November 2002.<sup>18</sup> Both bills were rejected by the Guardian Council, which acts as the upper house in the Iranian legislative system, as the move was seen as an attempt to increase the executive power of the president in the country's political system as well as limit the Guardian Council's influence in parliamentary elections, thus undermining the ultimate power of Ayatollah Khamenei over the country's pillars of political power, and so was strongly rejected by the supreme leader.

Ayatollah Khamenei has on several occasions refused to share power with the political institutions in Iran, and this has alienated some of his closest allies and strong supporters of the establishment. The most important allies of the supreme leader who have taken opposing views over the past few years include former president Akbar Hashemi Rafsanjani, who has clearly criticized Khamenei's foreign and domestic policies since the presidential election crisis of 2009, and Mehdi Karroubi, the speaker of the sixth Islamic Republic parliament which approved the twin bills of 2002, who became one of the leaders of the Green Movement in 2009. Most recently, Ahmadinejad has also opposed the supreme leader's interference in his government's affairs and elicited strong reactions from Khamenei on a number of occasions. Consequently, with the supreme leader showing a strong determination to monopolize political power, there has been very little room left for political reforms in Iran.

Since the beginning of the Khatami administration, when the reform debate gained momentum in Iran, the supreme leader has relied heavily on the Islamic Revolutionary Guard Corps (IRGC) and the Iranian para-military group, Basij, to maintain his monopoly on power. Khamenei, strongly and openly, opposes economic liberalization and rejects the idea of an Iranian open society, as both are seen by him as signs of western colonialism. He has frequently depended on IRGC and Basij forces to block reform initiatives, both political and economic. In the 1999 student protests and the 2009 post-election crisis, both IRGC and Basij played key roles in the crackdown

---

16. A. Moaveni, "Why Iran's President Has Forced a Showdown," *Time*, August 28, 2002, <http://www.time.com/time/world/article/0,8599,345297,00.html> (accessed August 2, 2012).

17. *The Economist*, "Last Chance Saloon," September 19, 2002, [http://www.economist.com/displaystory.cfm?story\\_id=1338551](http://www.economist.com/displaystory.cfm?story_id=1338551) (accessed August 2, 2012).

18. BBC News, "Iran Parliament Backs Reformist Bill," November 10, 2002, [http://news.bbc.co.uk/2/hi/middle\\_east/2436427.stm](http://news.bbc.co.uk/2/hi/middle_east/2436427.stm) (accessed August 2, 2012).



on the pro-reform popular movements. Besides, the IRGC involvement in blocking economic reform initiatives in Iran was evident in the Imam Khomeini Airport crisis in 2004 when the transportation ministry in the Khatami administration awarded the operation of the new airport to a consortium of Austrian and Turkish companies. The IRGC drove tanks onto the runways, stormed the control tower, and demanded that it – and not the foreign consortium – should be allowed to run the airport, as otherwise it would be a security concern.<sup>19</sup> Over the past few years, the IRGC with its subsidiary companies has become the largest corporation in Iran, particularly in the oil and gas sector. One key reason for the increasing power of the IRGC in Iran's political and economic landscape is the direct support of the supreme leader. While the relationship between the IRGC and other stakeholders in Iran seems to be opaque, the supreme leader often seems to have extended full support to IRGC activities in exchange for the support of the Corps' senior commanders for his ultimate power over the country's affairs.

On the other hand, the reformist movement has been further pressured since February 2011, when two leaders of the Green Movement, Mir-Hossein Moussavi and Mehdi Karroubi, and their wives, were put under house arrest. Given the government's heavy-handed actions during the 2009 crackdown, the popular protests in support of democratic political reforms in Iran have effectively fizzled out. At the same time, labor strikes due to delayed salary payments and job losses have worsened, particularly in 2012. In July 2012, 700 manual workers of the Sepahan Cement Company, one of the biggest government cement production companies in Isfahan, went on strike to protest the 'unjust salary ranges.'<sup>20</sup> A month later, in August 2012, the employees of a government steel production company, Sanaye Felezi Iran, gathered outside the headquarters of the Ministry of Mining Industry and Trade in Tehran to protest the eight months' delay in their salary payments.<sup>21</sup> Despite widespread dissatisfaction

19. There is widespread speculation that the IRGC received equipment and goods illegally through the airport and that if a foreign company took over the airport operations, the loopholes through which IRGC smuggled items into the country would have closed and, therefore, it wanted to block the move to bring in the foreign consortium. See A. Alfoneh, "How Intertwined Are the Revolutionary Guards in Iran's Economy?" American Enterprise Institute, October 22, 2007, <http://www.aei.org/article/foreign-and-defense-policy/regional/middle-east-and-north-africa/how-intertwined-are-the-revolutionary-guards-in-irans-economy/> (accessed August 2, 2012).

20. Deutsche Welle Persian, "Etesab-I Sad-ha Kar-i-gar-i Peymany-e Sherkat-i Siman-i-Sepahan," July 9, 2012, [http://www.dw.de/dw/article/0,,16084019,00.html?maca=per-rss-per\\_gesellschaft\\_kultur\\_volltext-5724-xml-mrss](http://www.dw.de/dw/article/0,,16084019,00.html?maca=per-rss-per_gesellschaft_kultur_volltext-5724-xml-mrss) (accessed August 12, 2012).

21. BBC Persian, "Tajamo-i Kargaran dar Tehran Moghabel-i Vezarat-i Sanaye," August 14, 2012, [http://www.bbc.co.uk/persian/rolling\\_news/2012/08/120814\\_rln\\_121\\_protest\\_worker.shtml](http://www.bbc.co.uk/persian/rolling_news/2012/08/120814_rln_121_protest_worker.shtml) (accessed August 12, 2012).

in society, however, there have been no large-scale demonstrations or strikes in Iran since 2009 when the government came down with a heavy hand against the reformist movement. The lack of any large-scale protests may also be partly attributed to a leadership vacuum in the reformist movement.

However, the effect of the international sanctions cannot be ignored. The economic hardship in Iran has weakened the middle class dramatically. Iranian society has been effectively divided into three groups: the indifferent rich, the urban and rural poor, and the silent urban middle class. The middle class is under a great deal of pressure as a result of the economic conditions, and the gap between the rich and the poor is widening significantly. Since 2005, the government has introduced various populist economic plans to empower the poor, particularly in rural areas. These moves are part of the government's key strategy to undermine the risk of potential unrest among the poor. To what extent such policies have proven to be successful will have to be analyzed in a separate study. So far, the backbone of the reformist movement in Iran has been the middle class which found room to prosper under the economic policies initiated by former Presidents Rafsanjani and Khatami. With the huge economic pressure on middle class Iranians, however, reform is expected to fall into a long period of hibernation.

### **The Succession Issue and the Future of the Supreme Leader's Position**

Iran's publicly discussed internal power struggle confirms a widening split between the Supreme Leader Ayatollah Khamenei and various other stakeholders and senior (current/former) figures. In addition to wanting to keep his hold on power, it seems that the supreme leader has another concern, which is to groom a successor. Although it seems unlikely that Khamenei will quit politics voluntarily anytime soon, there are some unpredictable circumstances which could be matters of concern for a 73-year-old leader. It is speculated that the supreme leader has been discussing the issue of potential candidates who could succeed him.

Mojtaba Khamenei, the second son of the supreme leader, and Ayatollah Seyyed Mahmood Hashemi Shahroodi are thought to be the favored candidates of Ayatollah Khamenei to succeed him as supreme leader. Mojtaba has started to play a more public role in recent years after years of remaining completely outside the spotlight like other members of the supreme leader's household. His name was publicly mentioned for the first time by Mehdi Karroubi after the 2005 presidential election. Karroubi claimed that the vote was 'engineered' by some people within the

establishment and that Mojtaba and his close allies played a key role in manipulating the result of the election in favor of Ahmadinejad. If the election of President Ahmadinejad in 2005 was seen as the first step by the supreme leader's camp to limit the power of those who might be less supportive or opposed to the leadership of Mojtaba, Shahroodi, or any other hardliner candidate supported by Ayatollah Khamenei, the government's aggression against the reformist movement in 2009, the proposal to scrap the presidential post, and a possible exclusion of pro-Ahmadinejad candidates from the parliament in 2012 may well be the supreme leader's tactic to orchestrate his succession and pave the way for his preferred leadership candidate. While Mojtaba has never served in any official capacity, Ayatollah Shahroodi, who is known to be very close to the supreme leader, has a stronger political profile as he has served in various government positions including as the Chief Justice of Iran. He is an Iraqi-born Shia who assumed the highest title in the Shia religious scholar ranks and became a 'Marja-i Taqlid' in 2010.

Although it is widely speculated that the appointment of Mojtaba Khamenei to the leadership position may not be well received by some senior members of clergy, it can be easily justified according to the Iranian constitution. Article 109 of the constitution lists the following attributes for the supreme leader: well qualified for issuing fatwa on various issues according to the Shia 'fiqh',<sup>22</sup> having sufficient justice and obedience to lead the Islamic 'Ummah' (nation), knowledgeable about social and political affairs, and having sufficient courage and management skills for leadership. In case there is more than one candidate, the person who has a better command of 'fiqh' and a stronger political background will be chosen. Furthermore, article 111 of the Iranian constitution sets the procedure for the election of the supreme leader in the case of the passing, resignation, or dismissal of the leader. In such cases, the Assembly of Experts would be responsible for choosing the new leader in a timely manner. Therefore, with the support of the Assembly of Experts, almost all of whom are close allies of Ayatollah Khamenei, anyone could be elected to fill the position.<sup>23</sup> That said, the appointment of Ayatollah Shahroodi to the supreme leader's position may well be easier than that of Mojtaba Khamenei who is widely unpopular for two main reasons: firstly, he is seen as one of the key figures who supported the violence during the post election crisis in 2009; secondly, the appointment of Ayatollah Khamenei's son as his successor is against the principles of an Islamic non-monarchical political system. All in all, given the split among the country's

22. 'Fiqh' is Shia interpretation of Islamic teaching applicable to current affairs.

23. Official website of Iran's supreme leader, "Rahbari az Negah-i Ghanoon," [http://www.leader.ir/langs/fa/index.php?p=leader\\_law](http://www.leader.ir/langs/fa/index.php?p=leader_law) (accessed August 10, 2012).

political elite, the process of appointment of the next supreme leader is likely to be a controversial one despite the supreme leader's efforts to ensure a smooth transition.

### 2013 Presidential Election

As noted earlier, Ayatollah Khamenei no longer sees it as being in his interest to support Ahmadinejad, who was once his preferred presidential candidate and whom he backed firmly following the election crisis of 2009. The parliamentary election of March 2012 was the first act of the most controversial upcoming political transition in Iran since June 2009: the presidential election of 2013. While the actual composition of the parliament did not change significantly, the political ambience has shifted to Ahmadinejad's disadvantage. Corruption scandals which undermine Ahmadinejad's populist reputation are expected to reduce his influence over the election of the next president of the Islamic Republic. After the widespread crackdown on the reformists in 2009, it became more apparent that the supreme leader favors a single-power political system with little challenge to his ultimate authority in the country from the parliament or the presidential palace. Khamenei has successfully managed to arrange the parliament in his own favor. Ali Larijani, head of the Iranian Parliament, announced in June 2012 that a special committee will be formed to ensure that the supreme leader's 'advice' is fully implemented in the decisions of the Iranian legislature.<sup>24</sup> The unconditional support for parliament from the supreme leader would not only balance the president's power but would also smoothen the process of selection of the next supreme leader, who, going by speculation, will be picked by Ayatollah Khamenei.<sup>25</sup> The next and perhaps the only main challenge would be, therefore, the next president.

The developments of the past few years prove the difficulty of forecasting political events in Iran. Although this paper does not intend to predict future developments, a few potential scenarios may be listed in the context of the next presidential election:

1. *The supreme leader's unconditional victory*: In this scenario, Ayatollah Khamenei will support one of his close allies for the presidential post while candidates supported by Ahmedinejad and others backed by the reformist camp will not

24. BBC Persian, "Tashkil-i Komite-i-e Peygiri-e 'Tahaqq-i Motalebat-i Rahbar' Dar Majlis-i Iran," June 26, 2012, [http://www.bbc.co.uk/persian/iran/2012/06/120626\\_139\\_larijani\\_leader\\_demands.shtml](http://www.bbc.co.uk/persian/iran/2012/06/120626_139_larijani_leader_demands.shtml) (accessed August 21, 2012).

25. R. Ziemba, Maya Senussi, Amir Kamel, and Sara Bazoobandi, "MENA Domestic Divides Raise Risks to Growth — and Oil Prices," *Roubini Global Economic*, April 5, 2012, <http://www.roubini.com/analysis/172712.php> (accessed April 15, 2012).

receive the approval of the Guardian Council. In addition to the influence of the Guardian Council, the general sense of disappointment among the Iranian public would lead to a low turnout at the elections and this would work to the best interests of the supreme leader and his preferred candidate. There is much speculation on the supreme leader's most favored candidate for president. The names that are oft mentioned in this context are two former speakers of the parliament: Gholam Ali Haddad Adel, who is also Mojtaba Khamenei's father-in-law, and Ali Akbar Nategh-Nouri.

2. *The supreme leader's disputed victory:* In this scenario, the candidate supported by Khamenei will be challenged by a pro-Ahmadinejad rival. The supreme leader may well choose to let the Guardian Council approve a pro-Ahmadinejad candidate to avoid controversy over the transparency of the election. Or it might be the case that the Ahmadinejad camp gets the approval of the Guardian Council issued for a neutral rather than a pro candidate and then persuades him to contest. In any case, it is unlikely that the supreme leader will allow Ahmadinejad's camp an easy victory. This scenario might be more controversial than the first one. In either case, the defeat of a pro-Ahmadinejad candidate might lead to popular protests instigated by Ahmadinejad supporters. Providing an answer to questions like which side would compromise or how far the dispute between the two groups would be taken is a rather difficult task. Two outcomes look most plausible based on the events at the time of writing this paper: firstly, the reformists will not have a heavy presence in this election; secondly, a candidate backed by the supreme leader will have the highest chance of victory in this election.
3. *Ahmadinejad's unconditional victory:* It has been rumored that President Ahmadinejad has been grooming one of his closest allies, Esfandiar Rahim-Mashaei, for the presidency. In what may be widely interpreted as a 'Putin-Medvedev'-like scenario, Ahmadinejad will officially hand over power to one of his close allies, while his camp will more or less run the country over the next presidential term, then he will run again for election in 2017. The constitution does not allow three consecutive presidential terms for one candidate; however, as long as there is a four-year gap between the second and third round, it is constitutionally authorized. The speculation on this issue was triggered by a state television interview with President Ahmadinejad on September 4, 2012. In this interview, he stated: "This government will be continued." The statement prompted an outcry among some of the members of the parliament who interpreted Ahmadinejad's statement as a signal of his agenda for the upcoming election. Should Ahmadinejad push for grooming his preferred candidate, the possibility of a postponement of the election will increase.

4. *Postponement of the election:* Domestic and international events might turn dramatically against the regime to force the supreme leader to announce a postponement of the presidential election because of considerations of 'Maslihat-i Nezam' (i.e., to maintain the best interests of the Islamic Revolutionary establishment). With the support of the IRGC and Basij, this may not be too difficult to achieve. However, such a move will certainly generate open criticism of the government. Besides, Ahmadinejad's camp is likely to resist the proposal unless the deal is sweetened with an extension of the government's time in office; and if there is to be a change in the arrangement of the government where an interim council will be put in charge also, the current government will most probably have a claim for a share in the power.
5. *Elimination of the presidential position:* Finally, in the remaining months to the presidential election, the supreme leader might push harder for parliamentary approval of his proposal to eliminate the presidential position from the constitution. This would not be the first time in the history of post-revolution Iran that a senior government position is removed. The positions of the prime minister and deputy supreme leader were removed from the government in the early years of the Islamic Revolutionary government in Iran. Though the proposal may not be well received by the people, with the support of the parliament, IRGC, and Basij, it may be strongly pushed by the supreme leader. In this case, a close ally of Ayatollah Khamenei will hold the executive power and the harmony of the establishment will be maintained. The costs of such a move will be relatively higher than the first three scenarios as it may prompt a strong reaction from the pro-Ahmadinejad camp as well as the people.

### Iran's Economy Faces International Sanctions

The political tensions in the Islamic Republic are also the result of a growing economic crisis that the country has had to grapple with in recent years. Although higher oil prices have boosted the country's hydrocarbon revenues since 2008, Iran is faced with toughened international sanctions and other difficulties in many economic sectors. The combination of rising fuel prices, loose monetary policy, and economic sanctions have fuelled inflationary pressures and pushed down the value of the local currency. For over three decades, Iranian banking institutions have been targeted by US sanctions but restrictions have severely tightened since 2011. All Western financial institutions have come under immense pressure from the US authorities to stop any interaction with the Iranian organizations. On March 17, 2012, SWIFT, an international organization which handles most cross-border payments, disconnected

Iranian institutions blacklisted by sanctions (the central bank and 20-30 other institutions) from its transfer system.<sup>26</sup> Then, in August 2012, one of the largest British banks, Standard Chartered, settled a case with New York's banking regulator at a cost of \$340 million. The bank came under scrutiny for concealing 60,000 financial transactions totalling \$250 billion for Iranian clients over a decade. From 2001 to 2010, the bank earned hundreds of millions of dollars in fees by moving money through its New York branch for Iranian financial institutions under US sanctions.<sup>27</sup>

While bypassing the sanctions has been rather costly for the Iranian economy, it has not been impossible. Following the exclusion from SWIFT, Iran's central bank has eased its foreign exchange policy, allowing money traders to exchange dollars for riyals at the unofficial market rate. The government set a quota for Iranian citizens who were traveling abroad to enable them to exchange riyals at a higher rate against the dollar; however, the scheme was abolished by the government in July 2012.<sup>28</sup> Faced with the shortage of dollars in their domestic market, many Iranians have also been turning to Iraq. Iraq's open foreign exchange system and relatively plentiful supply of foreign exchange enables the Iranians to exchange the declining riyal with stronger currencies outside of their home country. The extra demand from Iranians as well as from Syrians, who are facing similar problems, has had a marked effect on the Iraqi dinar, which tumbled from 1170 for a dollar to around 2000 between late December 2011 and early January 2012.<sup>29</sup> By August 2012, a growing number of Iranians started to transfer their riyals to the unrestricted currency market in Afghanistan, to trade for dollars. In Afghanistan, dollars function as a second national currency. Given the loose financial supervision in Afghanistan, billions of dollars in cash leave the country every year. Afghan and Western officials say they cannot put a precise figure on the trade with Iran. Nevertheless, they see it as a potential challenge to the sanctions and an easy way for the Iranians to bypass them.<sup>30</sup>

26. C. Main, "Swift' Iran Cutoff, Indonesian Mining, BTA Bank: Compliance," *Business Week*, March 16, 2012, <http://www.businessweek.com/news/2012-03-16/swift-iran-cutoff-indonesian-mining-bta-bank-ceo-compliance> (accessed August 2, 2012).

27. L. Rappaport, "Bank Settles Iran Money Case," *Wall Street Journal*, August 15, 2012, <http://online.wsj.com/article/SB10000872396390444318104577589380427559426.html> (accessed August 20, 2012).

28. Tabnak, "Arz-i Dolati Baraye Mosaferan-i Khareji Hazf Shod," July 25, 2012, <http://www.tabnak.ir/fa/news/260489/%D8%A7%D8%B1%D8%B2-%D8%AF%D9%88%D9%84%D8%AA%DB%8C-%D8%A8%D8%B1%D8%A7%DB%8C-%D9%85%D8%B3%D8%A7%D9%81%D8%B1%D8%A7%D9%86-%D8%AE%D8%A7%D8%B1%D8%AC%DB%8C-%D8%AD%D8%B0%D9%81-%D8%B4%D8%AF> (accessed August 20, 2012).

29. Economist Intelligence Unit, "Rial Pounding," January 26, 2012.

30. M. Rosenberg and Annie Lowrey, "Iranian Currency Traders Find a Haven in Afghanistan," *New York Times*, August 17, 2012, <http://www.nytimes.com/2012/08/18/world/middleeast/iranian->

Yet, the recent effort by the US government to impose ever more stringent restrictions has made such bypassing not only significantly more difficult but even for successful attempts, the cost has risen considerably. Dollars and precious metals like gold are in high demand in Iran as they provide a hedge against the weakening rial. The appetite for dollars has further exerted pressure on the rial since late 2011.<sup>31</sup> The value of local currency started to decline significantly in December 2011, before unofficial rates plunged 30 percent against the US dollar in January 2012, due to higher inflation and the prospect of tougher Western sanctions. The sanctions thus have increased the cost of financial transactions by forcing the government to go through various back channels. In addition, it hit Iranian foreign currency markets by reducing the supply of hard currency. This, in turn, has led to accusations by the local media that the government has pursued a deliberate and artificial devaluation to boost the rial value of its oil income.

Most recently, much of the Tehran's main bazaar, which has hosted the Iranian merchants for centuries and has been traditionally an important element of the Iranian economy, went on strike. As the Iranian rial declined by 60 percent (year-to-date) against the US dollar on October 3, 2012, clashes occurred between security forces and currency dealers. The protesters chanted anti-government slogans and gathered outside the headquarters of the Central Bank of Iran, shouting for the bank's governor, Mahmoud Bahmani, to step down. The political core of the bazaar is the Islamic Allied Society or 'Motalefeh,' which is a political group loyal to Iran's supreme leader. The protest in the bazaar underlined the huge dissatisfaction in the Iranian society which has been facing the painful effects of the economic sanctions. The dramatic devaluation of the Iranian currency, sometimes up to 15 percent per day, has fed the overall inflation and placed immense pressure on various social groups in Iran including the pro-Khamenei bazaar.<sup>32</sup>

The rial crisis, along with the sanctions on oil exports, has imposed huge budgetary problems on the government. Although the government has been reluctant to announce the actual crude export level and refused to confirm the decline in the level as a result of the sanctions, Iran's oil income has definitely dropped significantly since July 2012 when the EU oil embargo came into force. Some estimates show that by October

---

[currency-flows-into-afghanistan-markets.html?pagewanted=all](#) (accessed August 17, 2012).

31. R. Gladstone, "Strained by Sanctions, Iran Eases Money Policy," *New York Times*, March 19, 2012, <http://www.nytimes.com/2012/03/20/world/middleeast/iran-eases-its-currency-exchange-policy.html> (accessed July 29, 2012).

32. BBC, "Iran Police Clash with Protesters over Currency Crisis," October 3, 2012, <http://www.bbc.co.uk/news/world-middle-east-19812482> (accessed October 29, 2012).



2012, Iranian production reached its lowest level in the past 23 years. Mohammad Reza Bahonar, the deputy head of the Iranian Parliament, told the local media in late September 2012 that the country's exports have dropped from 2.5 million b/d to 800,000 million b/d.<sup>33</sup> Such a drop, which translates into a 40 per cent decline in oil revenues, has resulted in a \$10 billion loss in income in 2012 alone.<sup>34</sup>

The IMF calculated the fiscal break-even price of oil for Iran in early 2012 at about \$117 per barrel,<sup>35</sup> compared to an average Brent price that has not exceeded \$100 per barrel in 2012.<sup>36</sup> As a result of the gap between Iran's break-even price and the global market prices, Iranian officials have been trying to persuade OPEC members, particularly those with high break-even prices, to reduce quotas and push prices higher. In practice however, since the peak of the Libyan crisis, OPEC production has remained above quota keeping the global prices below Iran's break-even price.<sup>37</sup> Besides OPEC's strategy which is mainly influenced by Saudi Arabia, since the start of 2012, sanctions have squeezed Iran's oil exports which imposed further pressure on its oil income. Using the figure given by the Iranian deputy head of the parliament (800,000 million b/d) as a benchmark, since the beginning of 2012, the country's oil export has declined by about 32 percent which shows that this decline has pushed Iran's effective break-even oil price to \$154.

The response from the government has been uneven. While Mohammad Ali Khatibi Tabatabaei, director for international affairs at the National Iranian Oil Company, told the Iranian Students' News Agency in September 2012 that the government does not see anything "abnormal" in the oil sector and "almost everything is progressing routinely,"<sup>38</sup> even President Mahmoud Ahmadinejad, in a speech addressed to student unions in October 2012, acknowledged that "in some budgetary items, there are no resources available to fund those items and in some cases there has been a 25% decline."<sup>39</sup>

33. Fars News Agency, September 26, 2012, <http://www.farsnews.com/newstext.php?nn=13910705000249>

34. J. Blas, "Iranian Oil Output at Lowest for 23 Years," *Financial Times*, October 15, 2012, <http://www.ft.com/intl/cms/s/0/26dd1034-143d-11e2-8cf2-00144feabdc0.html#axzz29Kd2TSCm>

35. IMF, "Middle East and Central Asia Regional Economic Outlook Update," April 2012, [http://www.imf.org/external/pubs/ft/reo/2012/mcd/eng/pdf/mena\\_pp.pdf](http://www.imf.org/external/pubs/ft/reo/2012/mcd/eng/pdf/mena_pp.pdf)

36. Energy Information Administration, "Short-Term Energy Outlook Supplement: Brent Crude Oil Spot Price Forecast," July 10, 2012, [http://www.eia.gov/forecasts/steo/special/pdf/2012\\_sp\\_02.pdf](http://www.eia.gov/forecasts/steo/special/pdf/2012_sp_02.pdf)

37. Al Arabiya News, "OPEC Output Decision Legitimizes Over-production: Analysts," December 15, 2012, <http://english.alarabiya.net/articles/2011/12/15/182675.html>

38. Reuters, "Iran Says Oil Sector Unaffected by Sanctions," September 2, 2012, <http://in.reuters.com/article/2012/09/02/iran-oil-idINL6E8K21DH20120902>.

39. BBC Persian, October 9, 2012, [http://www.bbc.co.uk/persian/rolling\\_news/2012/10/121009\\_121](http://www.bbc.co.uk/persian/rolling_news/2012/10/121009_121)

In addition to the oil embargo, another challenge facing the Iranian oil sector is the shipment of crude and insurance of Iranian oil tankers. The governments in US and the European Union have been looking to tighten the sanctions designed to impede Iran's oil exports by targeting the shipment and insurance of Iranian crude. An EU ban on insuring Iranian oil shipments came into effect in July 2012 which has forced the vast majority of shippers to stop carrying the country's crude. The EU formally signed off a ban on the provision of flags to Iranian tankers and cargoes by European nationals and companies even when operating elsewhere. The US government is also reviewing policies to close loopholes which enable Iran to flag its tankers. The US administration is considering denying access of vessels to the US should their owner companies provide registry to Iranian tankers.<sup>40</sup> Since 95 percent of the maritime insurance industry goes through Europe, the ban will effectively shut down most of Iran's exports by sea.<sup>41</sup>

On the other hand, Iran has secretly used offshore tax havens to help register the country's oil tankers. The National Iranian Tanker Co. (NITC), the largest oil-vessel operator in Iran, has been hiding some of the ownership of tankers it controls in Central American tax havens by concealing their real nationality from flag registries. In early 2012, the nominal ownership of at least seven NITC tankers was transferred to entities incorporated in the Caribbean tax havens of Belize and the British Virgin Islands. NITC's shell companies pulled out of Malta and Cyprus in the spring because they would have been in breach of European sanctions banning Iran oil transportation. Ironically, the move pushed the incorporation of Iranian ships geographically closer to the US. In most cases, insurance companies which are still dealing with Iran are based in Asia.<sup>42</sup>

The government has released the high growth rates during 2011 and 2012 to highlight the country's resilience to Western sanctions. However, in practice, as a result of cuts in oil production and exports of crude oil because of the impact of tightening sanctions, the Iranian economy has started to shrink. Similarly, the fiscal balance is

---

rln\_sanction\_budget\_iran.shtml.

40. *The Daily Star*, "EU Mulls 'Full' Iran Financial Freeze, Shipping Ban," September 26, 2012, <http://www.dailystar.com.lb/Business/Middle-East/2012/Sep-26/189209-eu-mulls-full-iran-financial-freeze-shipping-ban.ashx#axzz29QxFlsjE>
41. Catalpa Capital Advisors, "The Saudi Sanction," May 29, 2012, <http://www.catalpacapital.com/dibs/19-june-2012-macro-insight/>
42. B. Faucon, "West Seeks To Plug Loopholes in Iran Shipping Sanctions," *Wall Street Journal*, October 15, 2012, <http://online.wsj.com/article/SB10000872396390443675404578057860497278752.html>

expected to record a deficit throughout the coming years. According to the Central Bank of Iran, real GDP grew to around \$41 billion, up 5.8 percent y/y, in the fiscal year ending March 2011. The estimate is lower than that of the Statistical Centre of Iran (SCI) of 6.5 percent for the same year.<sup>43</sup> Meanwhile, in April 2012, the IMF forecast that Iran's real GDP growth will decline to 0.4 percent in 2012, down from 2.0 percent in 2011 and 5.9 percent in 2010.<sup>44</sup>

Further, Iran has been struggling with high inflation, particularly following the removal of subsidies on a range of consumer goods and fuel at the end of 2010. The Economist Intelligence Unit predicts that inflation in Iran between 2012 and 2016 will be around 16 percent to somewhere slightly over 20 percent.<sup>45</sup> In March 2012, Iran's Central Bank announced that the inflation rate was declining and that it would not exceed 21 percent during the 2012-2013 fiscal year.<sup>46</sup> Although statistics issued by Iran's Central Bank show inflation at 21 percent, with the soaring cost of staple goods, the actual inflation is much higher. The price of bread increased by 40 percent in the month of June alone, causing a nationwide outcry. The price of chicken and vegetables rose by 3.7 percent and 10 percent, respectively, during the last two weeks of June 2012. Iranian households spend, on average, 50 percent of their monthly salaries on food items.<sup>47</sup>

In mid-January 2010, Iranian policy-makers enacted the Economic Transformation Bill so as to end subsidies for energy products and other necessities. The IMF expected that the reduction of government subsidies would increase fiscal savings, thereby helping to reduce inflation.<sup>48</sup> Initial plans were for the state to keep 20 percent from the cut in subsidies in the form of savings while 30 percent would be allocated to industries heavily reliant on subsidies and for development of more energy-efficient infrastructure. However, in view of the fact that about 70 million out of Iran's population of 75 million has received household rebates compensating

43. *Tehran Times*, "Central Bank: Iran's GDP Growth Rate at 5.8 Percent," March 6, 2012, <http://tehrantimes.com/economy-and-business/96130-central-bank-irans-gdp-growth-rate-at-58-percent-> (accessed August 2, 2012).

44. IMF, "Regional Economic Outlook: Middle East and Central Asia," April 2012, <http://www.imf.org/external/pubs/ft/reo/2012/mcd/eng/mreo0412.htm> (accessed August 2, 2012).

45. Economist Intelligence Unit, "Iran: Country Report," January 24, 2012.

46. Mehr News, "Iran Inflation Will Stay below 21% till Year End," March 04, 2012, <http://www.mehrnews.com/en/NewsDetail.aspx?NewsID=1551726> (accessed August 17, 2012).

47. Y. Issapour, "Inflation and Iran's Regime," *Wall Street Journal*, July 4, 2012, <http://online.wsj.com/article/SB10001424052702304211804577504400138905994.html> (accessed August 17, 2012).

48. IMF, "Iran To Cut Oil Subsidies in Energy Reform," September 28, 2010, <http://www.imf.org/external/pubs/ft/survey/so/2010/int092810a.htm> (accessed August 27, 2012).

subsidy cuts, it is generally considered that the cost to the government is more than the old subsidies. The combination of the rising costs of living and the decline in government income prompted the parliament to stop the second phase of the government's targeted subsidies program in September 2012. The program has been a key part of the economic reform initiative of President Ahmadinejad's administration aiming to liberalize energy and food prices while distributing cash handouts to the poorer Iranian citizens who will be vulnerable to such price changes. In the second phase, the government was planning to cut all the energy subsidies including for gasoline, petrol, and electricity. The parliament has frozen the implementation of the second phase of the policy because the Iranian citizens "do not have enough financial capacity to bear such price increase due to already high inflation caused by the sanctions."<sup>49</sup> Due to increasing pressure from the US and the European Union, Tehran has been forced to sell crude at discounted rates. Needless to say, the lower Iran's oil exports, the less the government's capability to meet its fiscal obligations.<sup>50</sup> And while Iran is not likely to run a fiscal deficit, it is equally unlikely to maintain the payment obligations of the targeted subsidies program due to the decline in oil exports in light of the international sanctions even if crude prices stay high.<sup>51</sup>

Another issue of concern for Iran is the high unemployment rate. The government's subsidy reform plan, launched in 2012, aims to reduce the unemployment rate. Central Bank reports show a decline in the unemployment rate to 11.1 percent in 2012, down from 13.6 percent in the same period in 2010.<sup>52</sup> According to the Statistical Centre of Iran, the services sector employs the biggest share of the country's labor force (47.8 percent), followed by the industrial sector (31.8 percent), and agriculture (20.4 percent).<sup>53</sup> Other figures reveal that by July 2012, unemployment in Iran's

49. AkharinNews, October 9, 2012, <http://www.akharinnews.com/last-news/item/26916-%D8%AF%D8%B1-%D9%81%D8%A7%D8%B2-%D8%AF%D9%88%D9%85-%D8%AE%D8%A8%D8%B1%DB%8C-%D8%A7%D8%B2-%D8%A7%D9%81%D8%B2%D8%A7%D9%8A%D8%B4-%D9%8A%D8%A7%D8%B1%D8%A7%D9%86%D9%87-%D9%86%D9%82%D8%AF%DB%8C-%D9%86%D8%A8%D9%88%D8%AF.html>

50. P. Mackey and Alex Lawler, "Iran Feels Sanctions Pain as Oil Income Slumps," Reuters, June 11, 2012, <http://in.reuters.com/article/2012/06/11/iran-oil-revenues-idINL5E8H78K120120611> (accessed September 14, 2012).

51. N. Bozorgmehr, "Iran's Handouts Prove Costly," *Financial Times*, April 28, 2012. <http://www.ft.com/intl/cms/s/0/9313c7c4-70e8-11e0-962a-00144feabdc0.html#axzz250rsXM4t> (accessed July 20, 2012).

52. MENAFN, "Iran's Inflation To Stay under 21% till Year end," March 5, 2012, <http://www.menafn.com/menafn/1093489651/Irans-inflation-to-stay-under-21-till-year-end> (accessed August 2, 2012).

53. News Peyvand, "Iran's Unemployment Rate at 12.3%," February 2, 2012, <http://www.payvand.com/>

industrial sector had soared to an unofficially estimated 35 percent because factories are unable to import vital goods and equipment due to sanctions and consequently are forced to sack their workers.<sup>54</sup>

High gasoline consumption has also been a major challenge for the Iranian government. However, thanks to higher prices and growing compressed natural gas use, gasoline consumption has started to fall rapidly. For example, gasoline consumption averaged 57.7 million liters per day during April 2012 showing a decrease of 200,000 liters compared to February 2012.<sup>55</sup> Until 2007, Iran's inadequate refinery infrastructure and rising demand made it increasingly dependent on imported gasoline. Western governments have blocked gasoline supplies to Iran over the last few years to pressure Tehran on its disputed nuclear program. Petrol production in the nine domestic refineries stands at 48 million liters a day. Government officials have made various claims about the country's self-sufficiency in petrol production, following the introduction of rationing in 2007.<sup>56</sup>

## Corruption, Financial Fraud, and the Wealth of the Nation

Supreme Leader Ayatollah Khamenei and former president Rafsanjani had frequently clashed publicly over Rafsanjani's support for the reformists' camp, since the last presidential election. To highlight his support for Khamenei, Ahmadinejad has launched a series of attacks against various former senior figures, particularly former president Rafsanjani, who he accused frequently for lack of financial transparency, illegal accumulation of wealth, and fraud. Despite the populist rhetoric of the Islamic Republic regime and President Ahmadinejad's strong stand against corruption and his criticism of the previous government's failure to address the issue of financial corruption, Ahmadinejad's government has not been successful in protecting the national wealth or in ensuring its equal distribution. In mid 2011, the biggest financial

---

news/11/dec/1316.html (accessed August 3, 2012).

54. R. Tait, "Iran's Food Costs Soar and Unemployment Spirals as Nuclear Sanctions Begin to Bite," *The Telegraph*, July 1, 2012, <http://www.telegraph.co.uk/news/worldnews/middleeast/iran/9368117/Irans-food-costs-soar-and-unemployment-spirals-as-nuclear-sanctions-begin-to-bite.html> (accessed August 3, 2012).

55. *Tehran Times*, "Iran's Weekly Gasoline Consumption Drops by 200,000 Liters," April 22, 2012, <http://tehrantimes.com/economy-and-business/97176-irans-weekly-gasoline-consumption-drops-by-200000-liters-> (accessed August 22, 2012).

56. I. Lakshmanan, "Iran Gasoline Imports Fall as Nation Adapts To Tighter Sanctions, GAO Says," *Bloomberg*, February 2, 2012, <http://www.bloomberg.com/news/2012-02-01/iran-gasoline-imports-fall-as-nation-adapts-to-tighter-sanctions-gao-says.html> (accessed August 27, 2012).

fraud in the history of Iran hit the country's banking system, with officials alleging losses of over \$3 billion. A private investment company, owned and established by an Iranian financier named Amir Mansour Arya, reportedly embezzled \$2.6 billion from seven Iranian banks over a period of several years by using fraudulent letters of credit. The company owned various businesses in Iran, and its owner was known to have close links with President Ahmadinejad's camp. Since the scandal broke, over 30 people have been jailed and the head of Bank Melli, one of the large state-owned Iranian banks, has fled the country.<sup>57</sup> Members of the Central Bank have come under investigation and the CEO of Bank Saderat, another state-owned bank in Iran, was fired on the grounds of insufficient risk management.<sup>58</sup>

The financial losses put additional strains on the Iranian banking system as sanctions have narrowed the financing options. Lending rates have been negative in real terms for many years, and many loans are granted based on political relationships, and not on economic merit. For some time, the government required the banks to extend loans at subsidized rates, which cut into bank profitability, created a property bubble, and weakened the balance sheets of banks. Moreover, the government has used banks as policy instruments for dishing out credit to unprofitable projects. Many of Iran's key banks are suffering under sanctions and have limited access to foreign capital. In 2009 and 2010, the Central Bank governor expressed concern about the level of non-performing assets, triggering worries of a banking crisis.<sup>59</sup>

Not only has the fraud hurt the already vulnerable balance sheets of banks, but it could also add to divisions among the elite. However, while the supreme leader backed the anti-corruption campaign in the aftermath of the latest banking fraud in Iran, he also discouraged the public debate around the scandal by saying that the media should not "drag out the issue."<sup>60</sup> Ayatollah Khamenei has, on various occasions, been papering over the conflict among the elite, for what he frequently refers to as "maintaining the best interests of the Islamic Revolutionary establishment."

---

57. *Tebran Times*, "Defendants in \$2.6 Fraud Case Stand Trial in Tehran," February 19, 2012, <http://www.tehrantimes.com/component/content/article/95588> (accessed August 10, 2012).

58. M. Shuster, "Iran's Largest Banks Swindled out of \$2.6 Billion," National Public Radio, October 27, 2011, <http://www.npr.org/2011/10/27/141729872/irans-largest-banks-swindled-out-of-2-6-billion> (accessed August 12, 2012).

59. Roubini Global Economic, "Fraud Exposes Vulnerabilities of Iran's Banking System," October 31, 2011, <http://www.roubini.com/critical-issues/100835.php> (accessed April 3, 2012).

60. Y. Torbati, "Iran Sentences Four People to Death for Bank Fraud," Reuters, July 30, 2012, <http://www.reuters.com/article/2012/07/30/iran-fraud-idUSL6E8IU8WC20120730> (accessed August 20, 2012).

## Conclusion

The political and economic environment in Iran has become extremely complex since 2009. In the aftermath of the 2009 presidential election, the divide between the reformist and conservative camps has become more apparent. Internal political divisions only deepened further when disagreements surfaced between the supreme leader and Ahmadinejad on a number of occasions. The supreme leader has increasingly shown his desire to monopolize political power. His proposal for the removal of the president's position from the constitution underscores his reluctance to share executive power with another political figure.

The Iranian economy is going through a critical period. With less than a year to the next presidential election, sanctions have severely impacted the economy and reduced government income. Moreover, people's dissatisfaction has been growing over the past few months due to rising inflation and unemployment, and worries about the economy have encouraged capital outflows. The economic situation in Iran, despite the government's effort to minimize the impact of the sanctions, is likely to see more inflation, corruption and financial instability. Therefore, regardless of all the disagreements between the government of President Ahmadinejad and the supreme leader, given the current economic and political climate of Iran, the 2013 presidential election will undoubtedly require close collaboration between the two.

The supreme leader has been plotting a multidimensional strategy to counter the power of President Ahmadinejad and his allies within the system, while he has frequently used a language of moderation due to considerations of 'Maslihat-i Nezam'. It is not clear to what extent such restraint was influenced by President Ahmadinejad's actual power. But one major fact is that the supreme leader surely needs the support of IRGC, Basij, and the government (i.e., the president and his team) in order to retain his hold on power.

The issue of who will be the next supreme leader is a matter of concern for the Islamic Revolutionary establishment, and especially for Ayatollah Khamenei. Although he is unlikely to propose a voluntary change of position, unpredictable circumstances could well create a vacuum of leadership at the highest political level in the Islamic Revolutionary system. In order to avoid such a vacuum, the supreme leader, it is believed, may groom a candidate of his choice for the position.

To sum up, Iran will continue to face multiple domestic economic and political challenges in the coming years. The deep divisions among the ruling elite will only make it more difficult for the Islamic Revolutionary government to address the challenges. Conflict of interest among various stakeholders could place the country in a state of unrest. The presidential election of 2013 and its aftermath will definitely be a turning point for Iran. Whether it is for better or for worse, only time will tell.



**Gulf Research Center**  
Knowledge for All

---

[www.grc.net](http://www.grc.net)