FORUM: Economic and Social Council

ISSUE: Measures to mitigate Iran's increasing inflation and promote economic stability

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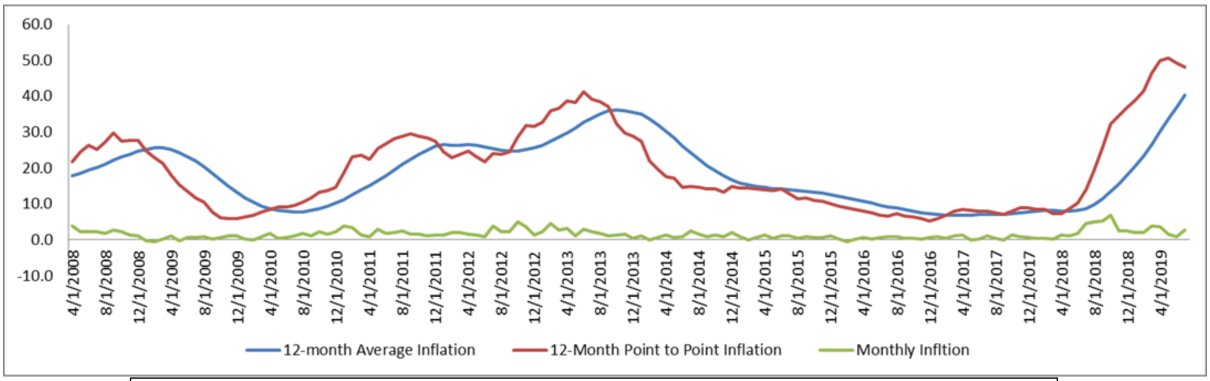
Introduction

Iran is a nation that has been wrought with political, economic, and social stability since 1979 because of the radical Islamic revolution, which changed diplomatic relations and internal governance. In recent years, Iran's inflation rates have soared to over 30% as per Tehran Times, and this issue has only been further worsened by crippling sanctions that have succeeded in isolating Iran from foreign aid or investment. Weaknesses within the country's governance system itself has caused the Iranian economy to be heavily reliant on oil exports, a sector weakened by sanctions, and general fiscal mismanagement have made it increasingly difficult for the economy to rebound. This report will delve into the history behind Iran's inflation, explore past and present attempts at alleviating the issue, and will finally, evaluate potential future solutions to restore economic stability to the country once more.



Graph showing Iran's growing rates of inflation from 2008-2019

Background

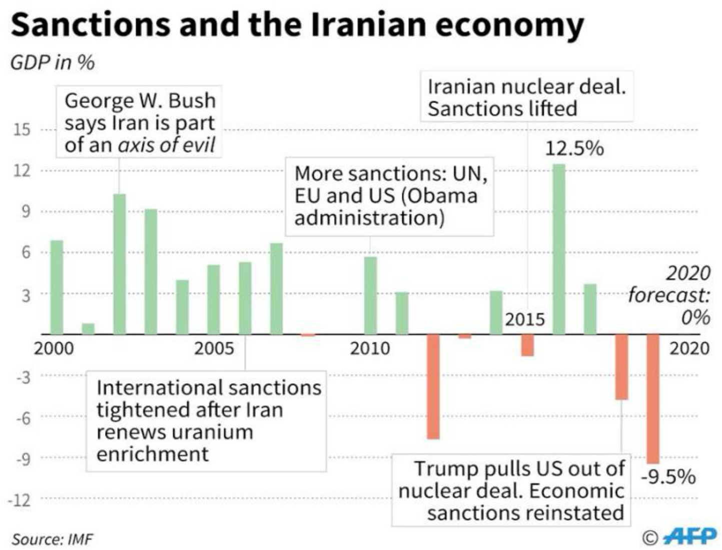
1979 Islamic revolution and Iran-Iraq war

Prior to the Islamic Revolution in 1979, the economy was dominated by the decisions made by Shah Mohammed Reza Pahlavi. The Shah modernized the economy, prioritizing extreme Western approaches like industrialization as a means of shifting the country from one originally being dependent on agriculture, to one based on foreign exports and other industries. Such policies indeed worked, making economic growth rise to around 2 times the average of another country of same standing (The Collector).

However, the Shah regime was not equipped to handle political and social unrest, and in 1979, following the takeover of Ayatollah Khomeini, all industries became state-owned. Given the nature of the philosophies behind the Islamic Revolution, Khomeini wanted the economy to be entirely self-sufficient, and the government evenly distributed opportunities to all citizens so that there would be no excuses of not having a relationship with God. As time went on, the economy began to stagnate, and after Khomeini's death, while there were attempts to privatize the economy, none particularly succeeded. As a result of the Irani-Iraqi war, around 500 billion dollars went into fueling the Iran war effort. However, the government did not account for post-war policies to help the economy rebound. This led to Iran consequently being dependent on oil revenue, an extremely volatile economy.

Economic sanctions

Following the Iran-Iraq war, Western powers became afraid of the Islamic revolution and the ideologies Khomeini were spreading despite originally backing Iran in the conflict. After a hostage situation that occurred in the American embassy in Iran involving radical students, the United States first imposed sanctions in 1979. Following the release of hostages, sanctions were temporarily lifted but were reimposed in 1987 on suspicions of terrorism. There have been multiple executive orders issued by the US, all sanctioning various aspects of the Irani economy, and later expanded to include sanctioning countries that engaged in deals involving Iran. However, sanctions have not only been imposed by the US, but by the United Kingdom in 2023 about the proliferation of weapons, and by most notably, the United Nations Security Council along with the European Union.



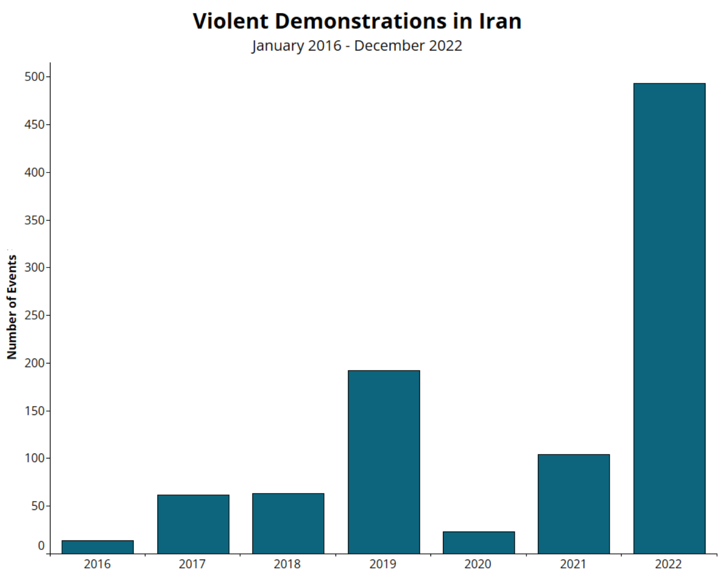
Timeline showing sanctions imposed by other countries on Iran

Growing dependence on the oil sector

After Khomeini's ascend to power, he disliked how the Shah had made the economy reliant on foreign investment, and wanted to make the economy self-sufficient, and sanctions imposed after the revolution made oil seem like a reliable sector to invest in. However, global oil prices tend to be highly volatile as they are subject to geopolitical tensions and international markets. When the Iranian government chose to rely mostly on oil, they did not look into developing any of the other industries like agriculture or technology- isolating the economy and limiting diversification. Furthermore, the oil sector is vulnerable to sanctions, essentially completely crippling the Iranian economy. Thus, while investing in the oil sector provided a temporary boost for the Iranian economy, it has only led to long-term instability.

Social unrest and emigration

Following the 1979 revolution, there has been a significant amount of political unrest and instability within the nation, caused by economic hardships, corruption, and political repression. This instability has led to protests, like the 2009 Green Movement, various economic protests in 2017-18 and 2019-20, and the 2022 Mahsa Amini protests regarding human rights. However, the protests come with periods of unrest, which restrict both foreign and domestic investment due to fears of further sanctions or other sudden policy changes. The government too has not listened to any forms of change, and has resorted to internet blackouts as retaliation, only crippling the technological sector. While there is already a lack of funds for basic sectors, the government redirects funding to suppress unrest through investing in surveillance and other forms of internal security, simply fostering a vicious cycle for citizens and the economy.



Graph showing the rising number of protests and unrest in Iran over an 8 year time period

As the situation in Iran has not drastically changed, many intellectuals and other educated Iranians have opted to emigrate in search of a better living standard, leading to the region having one of the highest rates of brain drain. Losing so many valuable people within the work force has consequently contributed to a loss of human capital, and a smaller work force. More affluent people are also choosing to shift their capital abroad- lessening the availability of it within the country and contributing to the devaluation of the rial as well.

Ongoing Israel-Hamas conflict and impact on Iran

It is known that Iran openly supports proxy groups like Hamas, Hezbollah and the Houthis, both politically and monetarily, which has drawn criticism from the US and EU. leading to sanctions that have targeted the oil sector, banks and financial establishments, and people within the Islamic Revolutionary Guard Corps (an elite branch of the Iranian military). By diverting funds to support these groups, it has again, weakened the capacity of the government to fund domestic development projects, thus fueling both economic instability and public discontent. Most notably, the Houthi attacks within the Red Sea have caused major rerouting of trade routes and has led to Iran's oil trade routes also being threatened. Diplomatic relations, particularly with Israel have also been threatened, as 12 days before a ceasefire was set to occur, Israel targeted and killed 30 Iranian commanders, 11 nuclear scientists, and more than 720 military infrastructure sites (Al Jazeera).

Problems Raised

Rising poverty and inequality rates

Increasing number of families living in poverty

As the overall prices for goods rise for the average Iranian earning in Iranian rial, a currency that is increasingly being devalued, salaries do not rise proportionately- meaning that a growing number of citizens fall below the poverty line. For Iranians with access to foreign currency or other assets immune to the effects of inflation (for example property), the effect of inflation is less pronounced, but this stark contrast leads to deepening rates of income and economic inequality, a situation hard to recover from. More and more basic commodities like meat and grain, which are Iranian staples, have also become less affordable, making those with lesser to middle incomes more vulnerable.

Currency devaluation of the Rial

Significant decline in value of the Iranian Rial (IRR) compared to foreign currencies

During inflation, the value of the currency decreases, but with such a high inflation rate of over 30%, the Iranian rial has lost most of its value- particularly within exchanges occurring on the black market. As the value of the rial also decreases, this makes imports more expensive, thus affecting inflation as well. Given the volatile nature of the rial as well, people have also opted to hold more stable foreign currencies like USD or Euros, which has led to a reduction in demand for the currency. Both the decrease in value coupled with the decrease in demand for the rial has therefore contributed to a vicious cycle with no clear end in sight.

Emigration of workers and shifting of capital

Like previously mentioned within the 'Background' section regarding social unrest and emigration, brain drain has affected the economy significantly by reducing the workforce and available capital within the country. With lesser amounts of educated people, there is also lesser talent that is vital for growth and innovation- which is essential if Iran wants to diversify its economy beyond just oil. There is also wasted investment in the education sector, as when Iranian graduates choose to emigrate to foreign countries, foreign economies consequently benefit, leading to an Iranian loss.

Growth of informal economy

Informal businesses do not pay taxes- leading to a considerable decline in public revenue generated. With lesser revenue, this again restricts the government's ability to fund other sectors. Since these businesses also operate outside the banking system, it makes it harder for the Central Bank of Iran to track economic activity and control prices- leading to inflation as there is no concept of a fixed price. Unfortunately, the informal economy also often involves smuggling networks, which leads to resource depletion and affects genuine businesses that are completely legal.

Lack of funding for subsidies

High inflation rates along with sanctions have hindered the Iranian government's ability to generate more revenue, which has led to less funding being available to invest in crucial sectors like infrastructure, healthcare and education. The smaller revenue coupled with more funding being allocated to support proxy groups has also led to inefficient maintenance of valuable government subsidies for food and energy, and this reduced financial assistance harshly affects vulnerable populations.

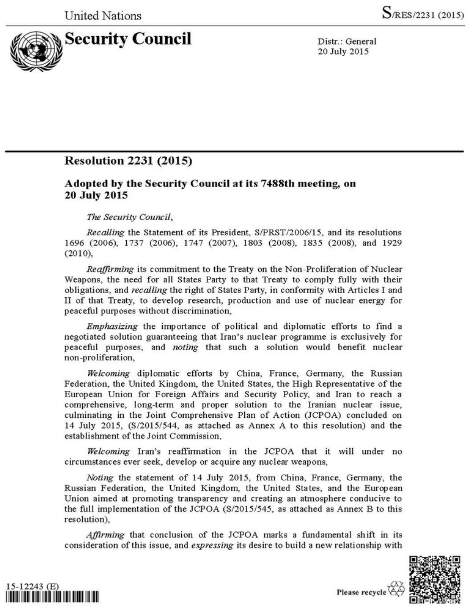
International Actions

Joint Comprehensive Plan of Action (JCPOA)

The JCPOA was a plan signed between Iran, the P5 countries, and Germany, where economic sanctions would be lifted as long as Iran limited its nuclear program. The aim of such a plan was to help revive Iran's economy as with less sanctions, Iran would be able to enter into foreign investment, and the facilitation of oil exports would also be much easier. However, in 2018, the United States decided to withdraw from the plan, as the Trump administration believed the JCPOA was only limited to Iran's nuclear program, and did not address its missile development or support for proxy groups. This basically led to the breakdown of the deal, as shortly after, Iran started refusing to comply with IAEA inspections, and considerably limited access and the extent of the inspections.

Resolution 2231

Similar to the situation with the JCPOA, Resolution 2231 was passed by the United Nations Security Council as a means of further lifting sanctions on Iran. In exchange for the removal of economic sanctions, Iran agreed to comply with inspections from the International Atomic Energy Agency (IAEA), and to limit their nuclear activities. Up until 2018, Iran fully complied with inspections, and the IAEA confirmed that Iran's nuclear capacity was following regulations. However, after the United States withdrew from the deal in 2018, Iran slowly began violating the conditions of Resolution 2231 through limiting access, disabling surveillance cameras at major nuclear sites, and refusing to explain why nuclear traces were discovered at undisclosed locations. This refusal continued until 2023, when after diplomatic pressure, Iran partially resumed cooperation through reinstalling some surveillance equipment and allowing limited inspections at some sites. However, complete inspections have still not been restored, which has weakened international trust in Iran.



United Nations S/RES/2231 (2015)

Security Council

Distr.: General
20 July 2015

Resolution 2231 (2015)

Adopted by the Security Council at its 7488th meeting, on 20 July 2015

The Security Council,

Recalling the Statement of its President, S/PRST/2006/15, and its resolutions 1696 (2006), 1737 (2006), 1747 (2007), 1803 (2008), 1835 (2008), and 1929 (2010),

Reaffirming its commitment to the Treaty on the Non-Proliferation of Nuclear Weapons, the need for all States Party to that Treaty to comply fully with their obligations, and *recalling* the right of States Party, in conformity with Articles I and II of that Treaty, to develop research, production and use of nuclear energy for peaceful purposes without discrimination,

Emphasizing the importance of political and diplomatic efforts to find a negotiated solution guaranteeing that Iran's nuclear programme is exclusively for peaceful purposes, and *noting* that such a solution would benefit nuclear non-proliferation,

Welcoming diplomatic efforts by China, France, Germany, the Russian Federation, the United Kingdom, the United States, the High Representative of the European Union for Foreign Affairs and Security Policy, and Iran to reach a comprehensive, long-term and proper solution to the Iranian nuclear issue, culminating in the Joint Comprehensive Plan of Action (JCPOA) concluded on 14 July 2015, (S/2015/544, as attached as Annex A to this resolution) and the establishment of the Joint Commission,

Welcoming Iran's reaffirmation in the JCPOA that it will under no circumstances ever seek, develop or acquire any nuclear weapons,

Noting the statement of 14 July 2015, from China, France, Germany, the Russian Federation, the United Kingdom, the United States, and the European Union aimed at promoting transparency and creating an atmosphere conducive to the full implementation of the JCPOA (S/2015/545, as attached as Annex B to this resolution),

Affirming that conclusion of the JCPOA marks a fundamental shift in its consideration of this issue, and *expressing* its desire to build a new relationship with

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First page of Resolution 2231 (this document can easily be found online)

Educational opportunities for Iranian scholars and students

While brain drain has significantly impacted the growth of Iran as a country, other Western powers and foreign institutions are offering a plethora of educational opportunities in the form of scholarships, startup visas and research grants among others for Iranian students and scholars. These efforts all aim to preserve Iranian talent, so that students can return and benefit their country. However, given the current state of affairs in Iran, it seems unlikely that students would be incentivised to return, leaving the future uncertain.

Key Players (note since the issue is centered on Iran this section will cover other countries)

Russia

As one of the original P5 countries that helped in negotiating the JCPOA deal, Russia is in favour of Iran having the right to peaceful nuclear energy, provided Iranian capacity abides by IAEA regulations. Both Russia and Iran also benefit from each other- Russia has helped to both build and operate Iran's only civilian nuclear power plant, while in recent years, Iran has supplied Russia with armed drones to be used in combat in the Russo-Ukrainian war. Both countries have also both been heavily sanctioned by the West, and this has only caused Russo-Iranian trade and diplomatic ties to deepen. For example, the two countries have signed bilateral agreements for oil, rail and gas cooperation, and are coordinating alternative banking and shipping routes as a means of evading sanctions. Both countries are also allies militarily when it comes to the Syrian Civil War, which has made Russia value Iran as a strategic diplomatic partner in the Middle East.

Triple alliance between the leaders of Iran, China and Russia from 2022

China

Like Russia, China seeks to be a country that provides an alternative to Western markets when it comes to trade, resulting in the country being Iran's top oil buyer. In 2021, Iran and China signed a 25 year cooperation deal that has a valuation of up to 400 billion dollars in the years to come. By choosing to back Iran while the West has isolated the country, China strongly opposes the US' unilateral sanctions while also advocating for the return of both Iran and the US to the JCPOA. China is also known to have brokered a deal between Iran and Saudi Arabia in 2023 following years of hostility, and has therefore established itself as a major diplomatic player within the Middle East, like the United States originally. China also has veto power, which has come in handy for blocking US-led resolutions, and has partnered with Russia as well to diplomatically shield Iran.

United States

The US has drawn the ire of Iran, particularly after withdrawing from the JCPOA deal in 2018 and reimposing sanctions. The new sanctions were significantly harsher, but the US' influence has extended to other countries as well, making them fear foreign investment in Iran as well. As a P5 nation, the US has also used its veto power within the UNSC as a way of influencing other countries.Currently, the main reasons as to why the United States opposes Iran is because of Iranian support for proxy groups like Hezbollah and Hamas, and because of fears surrounding Iran's nuclear activity.

Possible Solutions

Reviving the Joint Comprehensive Plan of Action (JCPOA)

A main weakness As mentioned previously in the 'International Actions' section, the United States backed out of the JCPOA, essentially citing sunset clauses as the reason. These clauses had an expiration date after which Iran could resume military activities. Considering it was only this weakness within the deal, reviving and amending the deal could significantly improve Iran's diplomatic relations and help in improving economic stability through removing sanctions.

The new deal could include more

Encouraging foreign investment to revive the Iranian economy

opportunities to increase foreign investment, and could also offer ways to diversify the Iranian economy.

Fostering economic diversification

One of the main challenges that Iran now faces is a lack of diversification within the economy as the country is dependant on the volatile oil sector. Looking at further investment in other non-oil sectors like technology, tourism and agriculture like one of Iran's original strengths would help in creating more employment opportunities, and with further stabilisation of the economy, more foreign investors can be attracted to Iran.

Stabilizing the informal economy

The informal economy has proven to be a major loss for tax revenue generated by the Iranian government, making it crucial that more businesses are registered. Using incentives along with expanding different payment systems to help with tax collection could not only help with transparency, but also with cracking down on smuggling. It is also important to consider how regulation of the economy could be done, given that there is currently not much investment in the technological sector.

Glossary

Sanctions

Restrictions imposed on a country or group of countries by another country as a means of constricting their behavior (for e.g. imposing sanctions on trade and finance). Sanctions are normally imposed as retaliation to something the offending country has done- in this case Iran has been sanctioned recently due to suspicions over nuclear activities.

Informal economy

Economic activities occurring within the country that are not officially taxed, recorded or regulated by the government

Subsidies

Financial assistance that is being provided by the government to businesses, individuals and/or industries. This assistance is given in order to reduce their expenses, and to encourage further production or consumption within or for the country.

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