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# Iran Workshop Series: Domestic Dynamics and Economic Assessment

10 July 2020

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## Introduction

This meeting summary documents the discussions that took place during a half-day virtual workshop on Iran's domestic politics and the ongoing economic challenges impacting the country since the outbreak of COVID-19. The workshop was organized by the Chatham House Middle East and North Africa (MENA) Programme and the Near East South Asia (NESA) Center for Strategic Studies. This summary draws upon the themes discussed by the analysts and experts who participated in the event and presents the key takeaways. The meeting took place under the Chatham House Rule.

## Domestic dynamics

The Iranian state remains under significant strain due to the numerous issues stemming from Washington's maximum pressure campaign, including sanctions, declining oil prices, the killing of General Qassem Soleimani, and the downing of Ukraine International Airlines flight PS752. In an effort to mitigate these pressures and deliver the February 2020 parliamentary elections, Tehran delayed acknowledging the presence and spread of COVID-19 and as a result became the subject of significant domestic and international criticism. The Rouhani government has since implemented a pandemic management strategy that concentrates on controlling virus transmission while sustaining the economy. The result has seen COVID-19 cases continue to rise and the intermittent closing of nine Iranian provinces.

This tension can be seen in the evolving factional dynamics that are shifting within the political elite and at the societal level where ordinary people are gradually withdrawing from the political process. Declining levels of social capital and trust in the governance and administrative capacity of the state are seen in rising levels of anger on social media, public demonstrations and political apathy. Participants in the workshop highlighted that these dynamics are leading to political and social changes that will, over time, transform top-down and bottom-up political processes in Iran.

At the political level, factional trends are evolving away from the traditional labelling and grouping of conservatives, pragmatists and reformists that has long been used to categorize Iranian domestic political camps. There was broad agreement among participants that this is occurring because these groups are more fractured and can no longer neatly fit in united political camps. Conservative groups, which are divided between neo-conservatives, principlists, and traditional conservatives have disparate ideological and political agendas that will continue to become apparent as the newly elected parliament reveals its agenda. It remains to be seen how conservative groups will compete in advance of the 2021 presidential elections. Participants emphasized the importance of mapping the differing viewpoints of these conservative camps in order to understand their policy differences and future domestic and regional strategies.

Reformists are also divided on their agenda, their ability to be politically effective and their future political engagement prospects. As evidenced by the results of the 2020 parliamentary elections and the low voter turnout of 42 per cent, which resulted in an overwhelming conservative victory, the reformist project has been a failure. A number of prominent reformist parliamentarians who qualified to run were unable to retain their seats because they did not receive enough votes.<sup>1</sup> It remains unclear if and how reformists will try to rebrand themselves going forward. Participants in the workshop noted that reformist

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<sup>1</sup> Out of 276 MPs, 230 elected members are conservative, 30 have run on independent platforms, and 16 are reformists. Sixteen women also won seats. Only 104 members are incumbents and 144 members have a master's degree and 132 have a doctoral degree.

decline, which has been on a downward trend since the Khatami period, should not be attributed to US policy towards Iran, but rather recognized by reformists themselves as the result of their administrative failures in implementing economic and political campaign promises. In fact, under their tenure, the country has experienced economic decline, civil society repression and an increase of international tensions. Today, reformists face an existential crisis. Participants recommended that the group must either moderate their strategy and the goals of reform to remain relevant as political actors within the political system or they must completely alter their political platform, which supports reform from within, and take a more confrontational approach, potentially outside the political process.

Generational change is a principal driver of these political divides and shifts. Demographic changes have brought a new generation of Iranians who were born after the Iran–Iraq War (1980–88) into the social and political sphere. This younger generation has a weak relationship with the state, no connection to the Iranian Revolution and its ideology, and no political movement in which to channel their frustration. Two-thirds of Iranians also have lived with sanctions for the entirety of their lives. At the popular level, this group is connected to others via social media platforms where they express their grievances, challenge social norms and intermittently agitate against the government. The December 2017–January 2018 and November 2019 protests revealed the emergence of this block of youth.

Workshop participants highlighted that this younger generation is also engaging in the political process, with new faces joining the political elite. Two-thirds of Iran's new parliament are newly elected parliamentarians. This group of young conservatives are promoting new political conversations that are less ideological and more technocratic. Reflecting the economic pressures of the day and declining living standards, populist discourse is also on the rise. Former president Mahmoud Ahmadinejad is trying to remain relevant and represent this constituency, capturing frustration through populist interventions.

## Economic assessment

Against the background of sanctions and low oil prices, the COVID-19 crisis has exacerbated the troubled Iranian economy, which has seen inflation rise to 34 per cent and unemployment to 16 per cent. The International Monetary Fund (IMF) predicts that Iran's economy will contract by 6 per cent in 2020, creating a wider budget deficit. Despite these bleak figures, for the time being, Iran has been able to develop sanctions survival strategies to withstand US economic pressure. The main approach has been to encourage growth in Iran's manufacturing and services sectors, which have grown while sanctions have constrained the petroleum sector. Participants pointed out that sanctions have inadvertently facilitated the diversification of the Iranian economy. Iran has sought to repatriate foreign reserves, requested IMF aid, which is unlikely to materialize, and has withdrawn \$50 billion from its National Defense Fund. Iran's charitable foundations, known as *bonyads*, are also taking a larger role in assisting the needy by providing more financial aid and subsistence loans. Despite the multitude of economic and political pressures that many thought would lead to political or social disruption, participants described the Iranian government as more confident economically.

Among other measures used to manage the economic pressure and tackle its budget deficit, Tehran has sought to tap public liquidity through the privatization of state assets on the Tehran Stock Exchange (TSE) and through the issuance of domestic government bonds. In April 2020, the Iranian government announced that Justice Shares issued under the Ahmadinejad administration would now be tradeable. This move allows more people to become active in the market. Since the outbreak of COVID-19, Iran's gold and foreign exchange markets have also been closed while the real estate market has been beset by huge losses, leaving few attractive investment opportunities. In this climate, the government has sought to offer discounts for stocks of state-owned companies, for instance, shares of big banks and insurance

companies have been offered to investors at a 30 per cent discount. The largest development in this privatization push came on 15 April, when the Social Security Investment Company – the country's largest pension fund for public sector employees, known locally as Shasta – listed 10 per cent of its shares on the TSE.

Participants pointed out that inviting the general public to engage in trading activity enables the government to tap public resources at a time when it is fiscally constrained, while taking advantage of the limited investment climate. With public and government investment more intertwined, this could also be a political opportunity for the government to rebuild lost legitimacy. On 9 June, President Rouhani further hailed the rise of the market, in spite of continued US pressure, encouraging public participation.<sup>2</sup>

Participants in the workshop highlighted that this strategy also carries risks. As suggested by one analyst, 'most investors are not aware of the market risks, nor of the corporate debt levels. Instead, they are looking for investment opportunities to manage against the wave of economic pressure and uncertainty.' Amid ongoing economic sanctions, tensions with the US, and patterns of repeated public protests, significant market volatility could ignite further rounds of unrest.

An increase of regional trade has also been important to help the government access liquidity. Iran has managed to form strategic partnerships with Turkey, Iraq, Russia, China and Venezuela to circumvent sanctions. The durability of these relationships has given the Iranian political establishment a sense of confidence and is resulting in greater regional economic integration. In 2019, Iraq was Iran's most important non-oil export market. Annual trade between the two countries is worth \$10–12 billion while the Iran–Iraq Bank has become a platform for financial transactions. The private sector has also become an instrumental actor in facilitating regional trade. There was broad agreement among participants that these patterns will likely grow and expand to the Caucasus region as well.

### Future developments

Tensions with the US and the potential for dialogue continue to cloud the Iranian political horizon. Some participants expected Tehran to wait for the outcome of the US elections before deciding on its negotiation strategy. The 2021 Iranian elections also remain a critical and unpredictable variable that could swing negotiating outcomes. In the coming months, it is expected that Iranian elites will slowly develop a consensus around next steps. Should conservatives win the Iranian presidential elections, an outcome that has been predicted by many, a more united political elite will lead any negotiations.

At the same time, participants also warned that Iranian presidential elections remain notoriously hard to predict reminding observers that they tend to be black swan events. Indeed, no electoral presidential outcome has been obvious for two decades. Even President Rouhani was not expected to win in 2013 and was only elected when supporters of Hashemi Rafsanjani united behind him.

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<sup>2</sup> Bozorgmehr, N. (2020), 'Iranian stocks reach new high as retail investors pile in', *Financial Times*, <https://www.ft.com/content/7f7366d0-93a5-4fb2-8572-c7556a4a025a> (accessed 10 Aug. 2020).