Mr. President, Iran is in a Stagflationary Trap

Iran's economy is in a stagflationary trap: zero/low GDP growth; 12% unemployment; chronic inflation. How can the new Government get us out? How to ensure growth with full employment, help lower income groups, and meet the 5th Five-Year Development Plan's goal: Decade of Progress and Justice. Seemingly challenging, but possible. What investment rule should it follow? Public investment solutions, with some institutional restructuring, programming around labour-intensive approaches at the District (shahrestan) level provide a feasible solution.

Current 5th Plan Solution: "Pro GDP Growth"

The 5th Plan intends to resolve through pro-GDP-growth strategies. Aimed at improving performance, through funding, pricing and private sector mechanisms, it gives weight to national GDP growth per se. It is expected to raise GDP growth from average 3.5% to annual 8%, thereby raising employment growth from 3% to about 5% and reducing income inequality Gini from average 0.42 to 0.35. This should improve productivity, reduce unemployment (from 12% to 7%) and inequality.

Instruments foreseen include: price reform-liberalization; funding mechanisms (National Development Fund; insurance systems; improved banking); higher savings (40% GDP – raising investment possibilities); support to private business (raising profitability; Article 44 mechanisms) and small-and-medium-sized enterprises (SME's); new "results based management" practices complementing institutional development; Regional and District targeting modes (the Plan suggests that District –shahrestan-becomes the future unit-scale for five-year development planning). Inequality reduction is through allocations to under-developed areas and income groups, by distributing nationalized wealth/cash through "justice shares", "cash transfers" and "deprived area development".

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However, the emphasis on improving productivity through financial mechanisms (price adjustments) misses out on another necessary requirement: quantity adjustment. This is the investment dynamics: without initial "capacity development" (investment) getting out of low activity/output trap conditions is difficult. The solution below takes such an approach.

What Public Investment Rule should the New Government Follow to Ensure Gdp Growth and Employment Generation, Especially for Lower Income Groups.

A Complementary Solution: "Inclusive GDP Growth"

The 5th Plan's objectives should be complemented by "inclusive growth" targeting: giving equal weight to GDP growth, full employment and inequality reduction; based on District level unit-scale. To ensure this, a combined multi-pronged, targeted, medium and short term investment strategy is required, over a four year period: the concept being that only appropriate public investment in capacity development will raise us out of the economic trap.

Why planning for "inclusive growth" at the "District" (shahrestan) level? With around 400 Districts, the 5th Plan mandates them to produce five-year development plans; programming for combined efficiency, equity and sustainability is easier there as problems-solutions are better identified: current national administrative system has the District Governor (farmandar) and Planning Committee (shorayeh barnameh-rizi) in place; etc.

The instrument for achieving results is public investments in the District: the development indicators being inequality adjusted GDP/capita and local capacity-to-work[1]. What this means as a public investment planning rule is that appropriate/sufficient investment in various capacity be made first, before price adjustments can become effective[2]. Further, the time-wealth-income (i.e. stock-flow) relationships, their inter-actions, multipliers and adverse-conflicting trade-offs and outcomes are more easily identified beforehand[3].

Utilizing such approaches, the consequence of District public investment outcomes on local GDP (value added) growth, equality and employment (efficiency, equity and sustainability) can be identified/calculated/planned to ensure local "sustainable development paths".

Public Investment in the District

The public investment approach would require combining medium and short term targeting. It also builds upon previous Government's "pro-poor" socio-economic transfer efforts in distributing resources to lower income groups, poorer areas, poorer skills and poorer sectors.

The medium-term District public works strategy aims to develop future supply-side growth capacity (general infrastructure and/or strategic manufacturing). The short-term strategy aims specifically at joint employment generation and poverty alleviation (i.e. improved income distribution) by focusing on labour intensive practices, for example "social-mobilisation and micro-credit" techniques.

To work, the District strategy requires: identifying how much capacity-to-work could be generated over a specific/sequenced period to achieve specific amounts of "inclusive growth"; good design and implementation quality; new institutional mechanisms (laws/regulations enabling employment generation); new technical practices (clean energy technologies, improved functionality of cooperatives system, etc); participatory planning (budgeting); enabling conditions for community-based SME type growth; and involvement of poorer groups, especially, in SME development (e.g. utilizing "social-mobilisation and micro-credit" techniques).

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Further, infrastructure/public works processes should ensure all local unemployed persons are employed in the investment process, and new institutional/legal systems should complement: a law may be passed to guarantee that at least one unemployed person per household be employed by District authorities for a specific period of time (e.g. one hundred days per year) at a poverty-line wage or a legally-set minimum wage.

Such medium-short term composite investment targeting strategies will raise both local demand (consumption) and local supply (capacity of poorer groups to work, innovate and expand): prompting local economic multipliers and dynamics to enable fast growth. Such an approach will raise local GDP growth, reduce inequality/poverty, ensure full-employment, instill higher productivity and lower local inflation. They also prevent migration. Further, it mandates and disciplines shahrestan level authorities to think and plan appropriately for full-employment oriented economic development.

What would remain is to ensure the overall stability of the economic system by preventing conflicting investments/outcomes and holding down inflation. Iran's National Accounts (and other information such as technical input-output tables) inform exactly of the composition and percentage of intermediate goods, labour and capital used up for producing goods/services: this may easily be calibrated for the District-level context. Once calibrated, District public investments could be targeted at goods/services that generate combined efficiency, equity and sustainability (not just financial gain or economic efficiency), to ensure full employment and good GDP growth. They can also help in establishing the required District-level and macro-economic linkages to ensure overall stability and sustainability[4].

Initial Cost-Benefit Estimates

Such public investment targeting approaches, focusing on inclusive growth at the District-level, help ensure full employment, are not costly, nor difficult to implement. Given 400 or so Districts in Iran, the adding up properties and benefits could be significant[5]. An example may help.

Generally, in 2010, Iran's GDP was about $400 billion; population 75 million; employed persons 25 million; GDP/capita $5,300; GDP/employed-person (i.e. productivity) $16,000. Investment in GDP was about $70 billion: $1,000/capita or $3,000/employed-person. Unemployment was 4 million. With 400 Districts, therefore the average District has: $1 billion GDP; about 190,000 population; about 65,000 employed-persons; the same per-capita and per-employed-person data as nationally (above); and 10,000 unemployed.

Given our multi-objective public investment strategy, the initial estimated direct cost is as follows:

1. Using the community-based "social-mobilisation and micro-credit" capacity development technique: for enabling 5,000 persons to become self-employed; will cost about $1,000/employed-person/ annum; total $5 million/annum.

2. The infrastructure-based (labour intensive) public works scheme: employing 5,000 persons; utilising an employment guarantee scheme (minimum-wage 4 million Rials/month at 2013 forex rate is about $2,500/annum); an estimated total of $12.5 million/annum.

Using such strategies, the full cost to the District is $17.5 million per annum. The cost/employed-person is on average $1,750 per annum: or $7,000 over a four year investment period. The total required budget for growth and employment is: only 1.75% of the average District GDP (of $1 billion); only 60% of the national level investment/employed-person figure (of $3,000) and, therefore, much less than the national average cost of making an investment.

Other projects in the District (private; cooperative; manufacturing; etc) would supplement their public investment budget. Each different District in Iran would follow a similar approach; allocate its resources relative to the actual local data (unemployed, income and productivity) that are obtained from National Accounts and made dynamic through participatory approaches.

As a whole, the cost of achieving such growth and full employment for a wealthy country as Iran would be small: a total of $7 billion for all 400 Districts per annum; or less than 2% of annual GDP; much less than the current annual $35 billion cash transfer compensation package; only 10% of recent years' average total investment in GDP; and, a small percentage of the Government annual budget. In other words, it is probably feasible. More importantly, given such experiences, the package has a good chance of success. It would probably result in an estimated 2% national GDP growth in the first four years: plus secondary-tertiary multiplier affects that would help Iran's growth go even higher, and help get it out of the low-equilibrium stagflationary trap. Further, it would remain sustainable – as communities are directly involved. ■

1 A good reference is Amartya Sen 1979 (The Welfare Basis of Real Income Comparisons - A Survey).

2 e.g. see works of economist Keith Griffin.

3 for instance, integer programming techniques for project selection based on multi-objective and multi-dimensional criteria; or non-optimisation approaches to generating "sustainable development paths". Planning approaches in Iran mainly utilize optimization techniques; while dynamic sustainability approaches prove more useful in far-from-equilibrium working contexts.

4 See the following for more details on such dynamic planning approaches: Luigi Passinetti, Lectures on the Theory of Production; Lance Taylor, Lectures on Structuralist Macro-Economics

5 Research on these aspects have recently been undertaken by the author – and are available upon request.