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An investigation into the impact of oil price on Iranian economic growth by comparing the performance of economic sectors

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Abstract: One of the main problems of Iran economy is the fluctuations in oil price and their impacts on economic growth after the 1970's oil crisis and especially the crisis resulted from all-out sanctions against Iran's economy that recently stem from nuclear energy issue. The present study, in fact, deals with the relationship of oil price and economic growth in Iran. The findings reveal that oil price shocks in Iran, as one of the biggest oil exporter countries, have led to remarkable negative outcomes. These harmful outcomes have made the Islamic republic statesmen to think of reducing the country's economy dependence on oil by a set of manageable plans and also by achieving the resistance economy policy based on economic programs.

Key words: Oil price; Economic growth; Iran's economy

1. Introduction

Oil and gas global markets do not usually act based on reasonable and rational thoughts and any change in the oil market has always been in a halo of hope and dismay. The ever-increasing demand of oil-dependent industries to oil and oil products on from one hand and the extant obstacles in oil supplying from the other hand have raised the oil price. However, oil market has never stayed steady. Furthermore, the existence of abundant geopolitical cases signals an increase in oil price and its products. The geopolitical issues mainly pertain to the middle-east issues and its reason is nothing but the fact that from among four main sources of oil production and supply in the world, three are in this area. These three sources are located in Iran, Iraq, and Saudi Arabia. All these countries have faced different problems since the 1980s. Given the above-raised points, it seems that oil market would be unsteady at least in terms of supply and as a result, more pressure would be exerted to increase its price.

On the other hand, Iran is still taken as a single-product country and its economy is considerably dependent on oil incomes. This dependence has become established in different economic sections which, in turn, have disrupted the country's natural process of internal growth in economic sectors during the last three decades mainly due to the foreign currency fluctuations from oil export. Additionally, the country budget is directly influenced by oil incomes. Therefore, the lack of neutralizing the oil price fluctuations has imposed negative detrimental impacts on the country's economy.

2. The importance of oil in Iran's economy

The economy of Iran has suffered from lack of balance in macro level for a long time and before discovering oil this lack of balance was mainly compensated by getting loans from foreign sources. After discovering oil and injecting its incomes to the budget, the need for foreign loans decreased to some extent and Iran was removed from the list of loan-getting countries. In the first program (1327-1334) it was predicted that receiving loan from foreign sources would provide 31 percent of the whole program incomes and 60 percent of the whole borrowing.

However, in the second program, foreign loan-receiving was planned to provide 27 percent of the whole income sources and 86 percent of the whole borrowing. This percent's reached to 14 percent and 91 percent in the third program and also 14 percent and 53 percent in the fourth program. In the beginning of the fifth program, the price of oil suddenly increased from 1/9 dollars to 10 dollars and doubled the developmental planning monetary level which, in turn, caused some problems for the country that were called "Dutch Disease". Oil dependence continued after the revolution as well. During the eight-year war of Iran and Iraq, the production system of the country was practically disrupted mostly because of war and also management and ownership crisis and all costs of war were covered by oil incomes. After the war finished and with the beginning of the first five-year program, the added value of oil from interior impure production was in fluctuation between 20 percent and 21/3 percent.

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3. Oil shocks and its effect on macro-level economy

The impact of oil shock on exporter countries is a controversial economic issue. Generally, this impact is likely to be observed in the country expenditure, the economic structure, and also the country behavior in the country. In the oil exporter countries the oil incomes are usually entered into the government budget via treasury. The government, then, is free to act in economic sections which, as a result, cause the private sector to be marginalized. Therefore, the investment costs of government become the same as running costs.

The government predominant investment does not follow the scheduled plan. The investment cost usually goes beyond what is predicted. Thus, an inefficient state management weakens saliently the development outcomes of these investments. Eghbali et al. (1383) showed in their study that in addition to running costs, government investment in the house building section prevents the activity of private sector and its negative impacts are not limited to the year on which the investment has been achieved. Instead, the government will negatively suffer from pertinent cost increases in next years too. Further, since the oil incomes are not related to the performance of economic sectors, an increase in the injection of oil incomes to the government budget causes an increase in the prices. On the other hand, oil price reduction and, as a result, reduction of government oil incomes, affect the country budget considerably.

These problems finally lead to recession and unemployment especially in sectors where unskillful human forces work. As a result, instability extends from economic area to social area. The foreign currency sector (Hallafi et al., 1383) will then put under pressure the budget deficit and payment balance. In this way, inflation that already exists decreases the economic growth. Increase in oil incomes increases the rate of economic growth; however, the impact of this increase is not immediate. In the meantime, its rate is shortcut.

Eghbali et al. (1382) uncovered that a one-percent increase in oil export programs leads to an eight-percent increase after two years. It seems that this is because of population growth and also government growth especially after the revolution. The nature of oil incomes is in a way that local economic sectors have weak after and before relationship with oil incomes. As a result, oil incomes are usually regarded as independent, unprecedented, and unusual incomes for the government. In these conditions, the government expenditure is not provided by tax payer.

To put it another way, people play a trivial role in development costs. The interesting point, however, is that the government sometimes face people resistance and disagreement for some of development plans. However, because people do not pay anything for these costs, the government does not try to agree them either and that is why there has been a kind of discrepancy between people and government in Iran since long ago.

4. The effects of oil incomes in the final period of Pahlavi regime on Iran's economy

At that time, those who had a close relationship with the court and Shah Family started to develop assembly industries in the suburb of big cities using oil incomes. This led to not only making the consumption pattern of society dependent on the foreign, but also making villagers, who were ignored by officials of agriculture sector, immigrate from villages to cities. In addition, the number of commercial and personal banks which belonged to government-dependent investors increased to 36 banks in this era. Receiving loans without regarding the country monetary policies, they established the roots of strategic inflation in economy. The unemployment rate took an increasing trend in this period and imbalance indices showed unsuitable conditions of income distribution. To put it clearly, in this period, the 20 percent portion of population from national income amounted to 36 percent and the portion of 40 percent of society stratums was merely 9/7 percent.

From the other hand, the incomes of oil sale in the Pahlavi epoch changed the country's economy, which was a productive economy based on agriculture, into a consumption economy. Therefore, the consumption nature of the society and excessive dependence on import to meet the needs resulted to more economic dependence of country to foreign, imbalanced economic growth, and also lack of any further development in agriculture that, in turn, enhanced the trend of immigration from villages to cities. As a result, the national economy became uni-product and a strong need for importing agricultural products was felt. Hence, not only oil could not set the stage for veritable wealth production in the country, but propelled the country economy toward bankruptcy and liquidation. In 1979 the direct dependence of the country general budget to oil incomes was over 60 percent.

5. Oil and dependence

The economy that provides its import demands from foreign exchange of various non-oil exports (regardless of being unit-product) is less damaged from fluctuations of global market. The economy of Iran has been largely dependent on oil incomes for varying reasons mainly wrong policy makings for managing the country. Over 80 percent of the country foreign exchange sources and more than 70 percent of the general budget sources are supplied directly or indirectly from oil exports. This, in fact, results to the following unavoidable consequences:

1. The vulnerability of the main income source of country from global market fluctuations
2. being the most important economic variable of country out of control and hence, lack of possibility

to set goals on the key indices of macro-level economy.
3. Having an easy-to-access source for managing the country and thus not having strong willingness to make use of internal capabilities of economy.
4. When excessive dependence on oil is accompanied by government dominance and control, the possibility of creating governments independent from people wishes would increase. In line with this, most of oil exporter countries that have the above-mentioned feature are now managed in a largely non-democratic way.
5. The existence of oil in developing countries has motivated the main powers of global market to extend their dominance over these countries so that they can exploit their cheap energy sources more than ever.

6. Oil budget and oil economy

In the third program of development, one of the main considerations in the annual budgets was to equip the government income sources to achieve economic goals without oil. However, during these programs, not only the portion of oil incomes in the economy did not decreased, but this portion increased remarkably. To clarify this, the portion of oil sale from the whole sources of government that was 46/71 percent in 1378 amounted to 58/88, 58/68, 73/50, and 70/70 percent's in the next four years respectively. While according the purposes of the third program, the portion of oil sale should take a descending trend and reached 89/44 percent in the final year of the program (1383), in this year in spite of a relative reduction of oil portion in the whole sources, the value of this source increased by 9/2 percent whose main reason was the increase of daily oil exports (400000 barrels), increase of each barrel of oil (about 10 percent), and also increase of foreign currency (for 4/7 percent). Thus, it can be claimed that the annual budgets during the third program did not match the intended goals. Besides, during all years of this program no reduction was observed in the over 80 percent portion of oil in the country exports. In contrast, the value of oil exports increased from 17 billion and 89 million dollars in 1379 to 28 billion and 823 million dollars in 1383. In the fourth program of development, the issue of less dependence of budget on oil incomes and other natural resources was taken into consideration more seriously. In the first part of clause number two of the fourth program, the government was obliged to increase the portion of supplied costs incomes from non-oil sources in a way that all costs of government was completely supplied from tax and other non-oil incomes by the end of the fourth program. But, the performance of government in annual budgets especially in the first years of this program shows a clear deviance from this policy. In keeping with this, in budgets of 1384 and 1385 and given the first amendments, the portion of oil incomes amounted to 79/4 and 62/1 percent's respectively.

Moreover, in the fourth program of development, the government foreign exchange incomes were approved to be 15 billion and 235 million dollars in 1384. But in practice, with an almost 30 billion dollars increase, it reached 44 billion and 619 million dollars. In 1385, the use of oil exports foreign exchange incomes along with non-stop withdrawal of foreign exchange saving account practically increased the dependence of government on oil so much that it went beyond 45 billion dollars; while in this program the foreign exchange incomes in 1385 was predicted to be 15 billion and 597 million dollars. Therefore, the difference between the predicted amount and the actual performance showed a 204 percent of lack of anticipated purpose achievement. In 1385, the incomes obtained from selling crude oil reached 129 thousands and 426 billion rials and the use of foreign exchange saving account reached 142 thousands and 817 billion rials, which, in turn, played the most salient role in this unplanned growth.

7. The deviation of budget in 1386

The contradiction of 1385 budget with the fourth program and the 20-year perspective document, lack of regarding the substances and enactments of 1385 budget rules and offering four amendments as an unprecedented act in the history of country budget, excessive use of oil dollars, and also the outgrow of government (opposite to the general policies of article 44 of constitution) all caused the 1386 budget bill to be compiled seemingly in a contractionary way.

In the 1386 budget, the tax incomes increased by 4/18 percent and other incomes by 22/2 percent. In all, the non-oil incomes increased by about 18/3 percent. In addition, the total consumption of budget foreign exchange dropped from 29 billion and 192 million dollars in 1385 to 29 billion and 55 million and 860 thousand dollars which showed a total reduction of 29/2 percent. Additionally, the ratio of non-oil incomes to the total sum of budget raised from 37/2 percent in 1385 to 44/7 percent in 1386. Finally, it was predicted in 1386 to reach the reduction of oil incomes in the total sum of the general budget from 58/3 percent in 1385 to 9/42 percent in 1386.

Even if the 1386 budget achieves its intended goals successfully, there would still be remarkable deviations from the fourth program. As an example of deviation, that of foreign exchange incomes obtained from oil sale from the determined purpose of 16 billion and 221 million dollars in the fourth program to 29 billion and 742 million dollars can be mentioned.

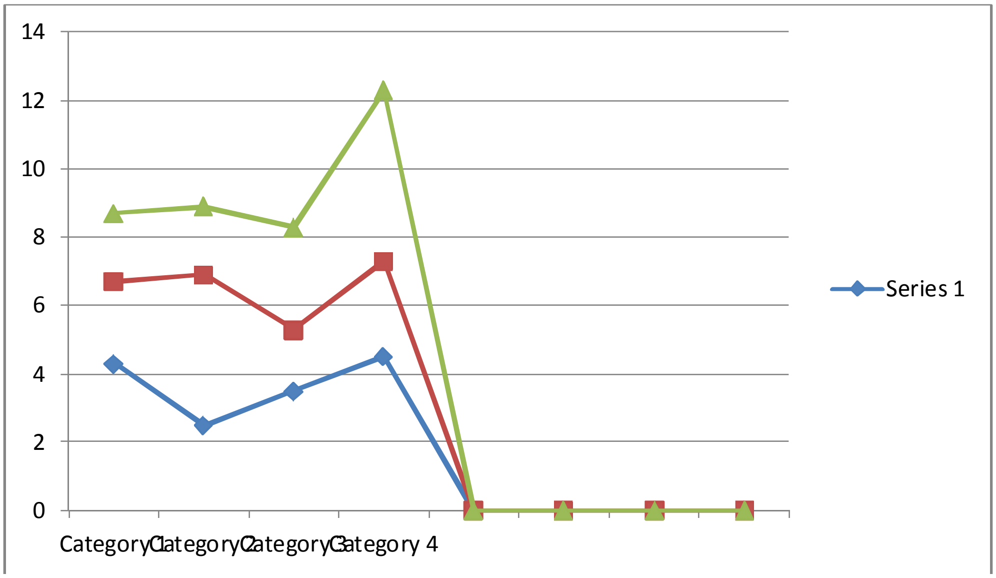

Fig. 1: Oil Portion from Total Governmental Sources (extracted from the research unit of "Iran Economy" quarterly from formal data and statistics)

8. The outcomes of oil reduction on Iran economy

The validity and correctness of budget-related decisions directly hinges on the correctness of made estimations and predictions. Accordingly, it is crucial to take into consideration the probable dangers which might affect these estimations while examining the budget. One of these estimations is related to the oil price. Oil price is one of the factors that have always affected the budget of country in the past decades and especially the recent years. Generally, the determined figure for the oil in the budget is directly pertinent to the extent of country's dependence on the oil exports and thus, any increase or decrease in the global price of oil directly influences the performance or lack of performance of economic and developmental projects. It also goes without saying that the as the determined figure for the oil price in the budget is lower (as it is the case in the 1386 budget), any increase in the global price of oil leads to an increase in the surplus of oil incomes.

However, the point that budget is compiled with a low price of oil does not necessarily imply a decrease in the dependence of budget on oil. In our country, which based on law the surplus of foreign exchange resources are saved, the rejection of imbalance between resources and budget consumption, which is due to low determination of oil price, eventually results to illegal exploitation of the resources. To put it another way, in the ratified budget the dependence on the oil seemingly drops, however, indiscipline in its performance along with the increase of expenditures from government estimations leads to the emptiness of foreign exchange saving box which, in turn, increases the budget dependence on oil. In other words, not only the oil incomes of the current year is consumed in this year, but the oil incomes of the preceding years are also consumed in the same year.

9. Oil rent

Although there is no agreement among economists over the definition of oil rent, it is usually defined as the difference between the market prices of oil and the costs of oil production. Discovering and extracting oil in large quantities, the issue of oil rent was prioritized. It is, in fact, the primary factor in the incomes of government and government injects to any favored section or group of society or even any sector of governmental or non-governmental economy. As a result, investment in other economic sections becomes unsecured in that the independent variable of oil (oil incomes) affects the economic sections.

10. Discussion and conclusion

The development periods of business activities incorporate the improvement of affluence and slowing the business activities. Recession and stagnancy are in the nature of capitalism systems. Therefore, it is common that generally a set of modifications and changes in the process of commercial activities in the world and especially in Iran happen.

The economic data of industrial countries in the district of Euro, U.S.A, and Canada signify that these communities have entered a recession period from that time the fall of global markets on august 2007 and also the issue of non-basic loans commenced. Factors such as financial crisis, banks and financial bankruptcies, drops in companies' income level, drops in global interest rates, and also considerable drop of commodities imply this fact that investors avoid highly risky investments and economy is in recession status.

Lack of assurance to investment, slowing of economic growth, and reduction of demand has strongly influenced the price of energy and it has indirectly affected Iran economy. In such conditions, Dollar and Yen, as less productive foreign currency, has attracted the attention of international financial institutions and hence, it is anticipated that Dollar continues its increase compared with other currencies. This reinforcement and increase of Dollar, reduction of oil incomes, and recession in different industries, have raised the probability of more weakening of Rial against U.S Dollar. Furthermore, oil incomes, which supply a remarkable volume of government imports and exports, are strongly affected by this oil price as an external variable. Instability in these incomes causes very negative outcomes on Iran economy. The interesting point is that the impact of this instability, whether due to increase or decrease of oil price, would bear negative impact on the country economy in the long run.

Therefore, the best strategy in this situation is to stabilize the incomes. One of the measures that have been taken by government since 1379 is to the foreign exchange saving account. This measure can be effective only when it leads to stability in economy especially in the production section. Oil has never helped the governments to become larger. As long as we do not replace the oil sale as a kind of investment with other investment goods (infrastructures) and spend oil incomes only for daily needs, oil will be like a disaster for the country economy and caused us to miss opportunities by staying in ignorance and negligence. Taking into consideration the following strategies might control, to some extent, the negative outcomes of oil price reduction: 1) prediction of real oil price in the annual budget of country 2) composing contractionary budgets 3) appropriate monetary policies to control inflation and liquidity 4) acceleration in performing the policies of article 44 especially special attention to agriculture sector, and 5) reducing the dependence of budget on oil.

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