



## **Report on Wilton Park Conference WPS04/17**

### **IRAN : FUTURE PROSPECTS**

**Monday 22 – Wednesday 25 November 2005**

#### **Political and social landscape**

1. It is twenty-five years since revolution created the unique state that is the Islamic Republic of Iran. Nowhere else in the world do religious clerics have as much power. In recent years, the political landscape has been characterised by a constant struggle between the conservative clerical establishment versus modernising reformists. The success of reformist candidates in parliamentary elections in 2000 brought new hope to many Iranians, and outside observers, that the grip of the clerics would at last be loosened. With President Khatami elected to a second term in 2001, Iran could look forward to internal reform and better relations with the wider world.

2. Such optimism was sorely challenged in the parliamentary elections of 2004 which many see as a turning point in the reform process. The conservatives are once again in the majority, helped to power by the disqualification of many liberal candidates. Some describe this as a silent coup d'état by the conservatives but others tend to the opinion that it was a vote of no-confidence in the reformists, rather than a ringing endorsement of a return to the right. Many blame the situation on President Khatami's reluctance to recognise and stand up to the challenges to his reforms from deeply entrenched conservative elements in the government and judiciary. Not content with winning the parliamentary elections, the conservatives have firmly set their sights on regaining the Presidency in 2005. Does this mean that the window for reform has now been closed for the foreseeable future?

3. To many, Iran demonstrates a highly factionalised, bifurcated political system that is little short of organised chaos. It is not at all clear where the real heart of power and decision-making lies. Elements of democracy do exist but when challenged from within or without the 'system' reacts in an aggressive manner. Liberals argue that the very large proportion of young people who make up the population are impatient for a new leader who can effectively navigate such a system, advancing reform and improving Iran's relations with the outside world without provoking a backlash from the clerics and other conservatives. Some suggest

that Iran could develop along the lines that China has adopted – a relatively open economy with close ties to the US and Europe but which retains its authoritarian instincts. The China model appears to prove that western style democracy is not the *sine qua non* of economic growth. Can Iran prosper economically and socially as what may be termed an authoritarian oligarchy?

4. A closer examination of the 2004 elections seems to indicate that there was a deliberate offensive by the conservatives against a free media, and reformist intellectuals and youth organisations. Such a policy has served to create tension and frustration among many who had previously been loyal to the regime, but it seems as though the conservatives are happy to accept this as the price of victory.

5. Political analysts point out that this new breed of conservatives encompasses a broad spectrum of interests. It is over-simplistic to portray Iranian politics as a simple battle of the conservatives versus reformists. The divisions within each camp are as great as those between them. This is evidenced by events such as the appointment of the first non-clerical Speaker of Parliament which is a significant signal that even the conservatives realise that they have to appeal to the broad majority of the electorate.

6. It is generally agreed that there is little appetite among the majority of ordinary Iranians for another revolution. Stability is vastly preferred to the prospect of further social upheaval but politicians ignore at their peril the democratic aspirations of a growing class of young, well-educated Iranians who are markedly less accepting of the dictates of the clerics than their parents. Recent studies have shown that Iranian society is less religious than it was; indeed there is a growing anticlericalism. Significant numbers of young Iranians now define their identity by nationality rather than by religion. Could this be the beginning of the de-linking of religion and politics in Iran, with Islam restricted to the sphere of ethics and family life, rather than the central tenet of the Iranian state? Many would say that the state has deliberately impeded the development of independent political activism, resulting in a lack of suitable institutions and experience for taking forward the reform and democratisation of Iranian society, though a reformist civic society/NGO sector exists. Given these factors, a gradual democratisation, rather than the overnight transformation that some external commentators seem to believe desirable and possible, appears to offer the best and most realistic hope for the future.

## Foreign policy

7. It can be claimed that the convoluted power structure in Iran means that foreign policy is directly related to domestic issues, with everything driven by external events rather than discourse or any planned strategy. Since the revolution the Iranian leadership has had little dialogue with the rest of world (nor, in fairness, has the international community done much to engage it). Cynics argue that the clerics have traditionally revelled in the management of crises, real or fabricated, as the basis of their government, since such events divert public attention away from economic issues on which their performance has been distinctly lacking.

8. Globalisation is perhaps the unstoppable force that is now forcing the government to face the harsh political and economic realities head-on. The recent nuclear negotiations between Iran and France, Germany and the United Kingdom (EU3) have also been very significant in this respect – forcing Iran to take a ‘normal’ role in the international community. The fact that these negotiations are being undertaken on the Iranian side by what have been termed ‘modernising internationalists’, or pragmatists, is seen as a very positive sign, helping to de-link national interests from the established clerical order and defuse radical sentiment. Iran manifestly does not want to be viewed by the rest of the world as part of an extremist ideological fringe sympathising with groups such as al-Qaeda.

9. Modernisers insist that a change in Iran’s foreign policy orientation is essential if economic reform is to be achieved. Many are generally optimistic that Iran is moving in the right direction, albeit slowly. The gradual shift of power to an outward looking, internationalist elite for whom economic development is the basis for security, and away from populist revolutionaries driven by Islamic ideology and fixated on the security and military apparatus of the state, is a reason for optimism.

10. Iran’s relationship with the United States is the key element in foreign and security policy. Whether Iran likes it or not, the Middle East has become an American landscape. Iran cannot aspire to share influence with the US in the region, in Afghanistan for example, without the tacit support and approval of Washington, but has delayed dealing with the fundamental problems in the relationship for as long as possible. This highlights a certain paradox - Iran wants to be both a normal state and remain a revolutionary state at the same time. Pragmatists believe that building good Iran-US relations will involve a very slow process of give and take on both sides. For example, even among Iranian liberals, some see continued US support for Iranian groups in exile that have rapid regime change as an implicit or implied objective, rather than gradual democratisation driven from within Iran, as a serious

obstacle to improved relations. As a further complicating factor Iran is also deeply suspicious of what it perceives as undue Israeli influence on US foreign policy towards the region.

11. From the US perspective, Iran is perceived as a self-confident nation that would see little interest in brokering a grand deal with the United States over the sharing of influence in the region. US interests towards Iran centre primarily on the nuclear weapons issue, with, perhaps surprisingly, terrorism and economic issues Iran's relations with Iraq and Afghanistan much further down the list of priorities.

12. The other non-regional power with significant interest in Iran is the European Union. Given the EU's preference for 'soft' power instruments as compared to the United States, most vividly seen in attitudes towards Iraq, some question whether the West as a single entity can form a common foreign policy towards Iran, or indeed if such is desirable. Others maintain that the US and the EU have a common interest in a stable and secure Iran and are united on the substantive policy issues, even if they may have differing views on how to achieve them.

### **Regional security dimension**

13. Iran can legitimately claim to have the potential to fulfil a regional leadership role given its size and strategic position at the heart of the region. Its traditional rival in the region, Iraq, is currently preoccupied by its domestic situation. Yet the aftermath of the US-led invasion of Iraq has very direct ramifications for Iran, since the nature of the emerging Iraqi regime will shape the regional security landscape for some time. The consensus is that Iran has nothing to gain politically from interfering in internal affairs of Iraq, or even worse becoming involved again in direct military confrontation, even though a number of territorial issues remain unresolved. The emergence of a strong, pro-western Iraqi Government is not judged to pose any particular threat to Iran. The worst-case scenario for Iran would actually be the disintegration of Iraq. A federal state would almost certainly stir up separatist sentiments among Iranian Kurds, and an unstable Iraq would be fertile ground for infiltration by al-Qaeda and other terrorist groups. Iran has as much to fear from such groups as anyone else and has shown evidence that it can be effective in the war against terror. However given its major economic challenges, Iran certainly cannot afford to make its defence and security a top spending priority.

14. In respect to the Israel-Palestine problem, Iran faces something of a dilemma since its ideological and national interests are not necessarily the same. To some extent the Islamic Republic has a moral and constitutional obligation to come to the assistance of the

Palestinian people and it is clear that there is great public sympathy among the Iranian people for their plight. However Iran has many domestic and foreign worries of its own and is hesitant to get too embroiled in this very intricate problem. From the Western point of view, Iran's position on the Middle East Peace Plan has been most unwelcome with unhelpful rhetoric (partly in response to domestic consumption?) and support for rejectionist groups, unacceptable to the West. Ultimately Iran wants to have its views factored into the debate. In the current climate, Iran is unlikely to support any US – brokered peace agreement. Should this develop in the future into a more multilateral initiative, with substantially increased EU involvement for example, this may be more palatable to the Iranian regime.

### **Nuclear issues**

15. Given the above analysis, one has to ask why, despite unconvincing denials to the contrary, Iran is seeking to become a nuclear power. Some think that it is directly related to the psyche of the regime, which, as mentioned previously, prefers to operate in a crisis environment as if in permanent 'war mode'. It can then proudly claim that any attack on it would be defended "by all possible means". To an outside audience this may sound like foolish and dangerous posturing, but it is an undeniable fact that many Iranians of all political persuasions support the development of a nuclear programme for reasons of national security and pride.

16. The recent E3/EU negotiations with Iran and its agreement to suspend its uranium enrichment programme are seen as a valuable mutual confidence-building exercise, notwithstanding lingering doubts about Iran's sincerity to keep to its side of the deal. The European Union and the United States share the view that a nuclear-armed Iran is an untenable proposition. Such a capability would be a destabilising influence in the region and, significantly, could impact adversely on the nuclear aspirations of certain other states. Nothing will satisfy the E3/EU except Iran's full compliance with the Non-Proliferation Treaty and International Atomic Energy Authority (IAEA) obligations and demands for inspections. In response to Iran's protestations that it only requires a nuclear capability to meet its domestic energy needs, experts argue that imports of nuclear fuel from Russia negate the need for Iran to have its own production capability. However some sympathise with Iran's unease about overdependence on Russian goodwill in this respect.

17. The United States unsurprisingly sees this in a very different light. For them, the proliferation of Weapons of Mass Destruction (WMD), and their possible use by terrorists against the US or US interests, is currently seen as the greatest single threat to its security. The fact that it is convinced that Iran is clandestinely developing such weapons colours its

whole relationship with the country at the present time. One body of opinion believes that the US should instigate a more proactive dialogue with Iran to try to resolve this issue and should outline a proper strategy with benchmarks and targets rather than continuing to pursue its current piecemeal approach.

18. The E3/EU negotiations are held up as evidence that Iran is willing to negotiate provided it is engaged as an equal partner. The United States should perhaps use this as a model for direct negotiation, though arguably they may be quite happy to let the EU do the spade work involved. A much more hawkish view is that the US does not have any faith in the E3 negotiations and that direct military action needs to be taken to neutralise Iran's nuclear capability. Many argue that such action, or even just the threat of it, would be extremely unwise as it would give credence to the claims of terrorist groups and secure them a whole new generation of recruits. Most believe that the United States would provoke a serious and deadly confrontation with the Islamic world if it acted against Iran in this manner, as well as alienating whatever support it now has from the EU. Most feel that even the US would consider this too high a price to pay.

19. Israel's perceived determination to prevent Iran achieving nuclear capacity is yet another factor to be considered in this debate. From the Iranian point of view, it cannot understand what are viewed as the double standards shown by the US and the EU. For many in Iran the nuclear defence option is becoming more attractive and more logical. Is it perhaps unwise for Iran to rely on the NPT to ensure its long-term security? Is there a solution to this impasse? Internationalists feel that economic cooperation is the best way to forge stability in the region. While Iran has only limited economic resources it would be folly to concentrate so much on the development of its offensive nuclear weapons capability. Non-proliferation and the continuation of a civilian nuclear programme underpinned with foreign assistance would seem to be the most attractive option for both Iran and the wider international community.

## **Economy**

20. Although the prevailing regime in Iran appears to be more concerned with ideological rather than economic matters, Iran's economic performance in recent years is judged by some to have improved. Much of this can be attributed to the steep increase in global oil prices, but Iran has also been a major beneficiary of the phenomenon that saw, post 9/11, regional capital becoming more concentrated in the region rather than being invested in the US or Europe. The current \$2000+ per capita GDP figure for Iran is now back to pre-revolution levels. However, inflation, the large budget deficit and un- and under-employment

are all causes for concern. Due to lack of opportunities many professionals are employed in relatively menial jobs, a major waste of a valuable economic resource. Iran is faced with a 'chicken and egg' dilemma. What comes first – economic development or political reform? Many argue that without political reform, progress in other areas is virtually impossible.

21. There do exist, however, possible engines for change. An important factor is the demographic profile of Iran – 70% of the population is under the age of 30. This abundance of human resources makes heavy demands on the job market, a fact that even the most conservative elements in the government realise must be addressed. Such pressures have forced the government to act, for example through reforms of the education system to make school leavers better equipped for the world of work. Unfortunately the system is still producing many new graduates who are unable to find suitable jobs. Unlikely to accept their fate with resignation, and with the realisation that poor economic performance is a result of bad management rather than external factors, some predict that this is the very cohort of young people who will eventually demand and create a new outward - looking Iran, open to foreign investment and better economic opportunities for its young population. The increasing entry of women into the labour force must also be counted as a significant factor in this equation.

22. There is also a change in the country's political, business and social elite. Unlike the situation in Eastern Europe following the fall of the Soviet Union, a private sector culture already existed in Iran. Some see the emergence of a new state 'technocracy' – a second generation of Islamic revolution managers, neither bureaucrats nor ideologues, who are open-minded, educated, and helped by new technologies like the internet. Civil society organisations are on the increase as is the growth of an urbanised and educated population.

23. Could the economic take-off of Islamic countries like Malaysia hold the key to Iran's future success? The regime is beginning to recognise the need for investment and interaction with rest of world. Aspirations to World Trade Organisation (WTO) membership could be an impetus to reform, though there is still a profound element of the regime's psyche that yearns for economic self-sufficiency. This, and the failure to normalise relations with the United States, could still prove to be a real impediment to realisation of this goal.

24. It is clear that the Government of Iran is facing serious difficulties in meeting these formidable challenges. It has traditionally been heavily dependent on oil and gas revenues and has had little incentive to diversify the economy. The public sector has been the backbone for growth and employment but has now reached its limit. Iran's demographic 'time-bomb' means

that unemployment could soon rise to over 20%. Some economists predict that it will need a GDP growth rate of 7.5% simply to remain at current levels. Iran is an undertaxed economy, with tax revenues only accounting for 3-4% GDP tax revenues. There are disproportionate subsidies on food, oil products and petrol. The government's privatisation programme is to many rather half-hearted with several debt/equity swaps with quasi-governmental bodies masquerading as true privatisation. There is a severe lack of efficiency in public services which need huge investment in training and restructuring and, not least of all, there is significant financial and administrative corruption.

25. The Government has declared an anti-corruption campaign. Despite the fears of some that the campaign is being used by the extreme right to target new government technocrats, the consensus is that it is a signal to potential future wrongdoers and not a witch hunt to catch past offenders, some of whom are so well-connected politically as to be untouchable. The influence of the Foundations (bonyads) is hard to quantify. Arguably the most influential are now restructured and more accountable and, importantly, taxed. However this crackdown might have precipitated the emergence of more regionally based groups whose organisational and financial structures may be more difficult to penetrate.

26. Discussion of the economy cannot preclude the impact of the new Majles (Parliament). Although it is dominated by conservatives its members cannot be said to be unified in their approach to the economy. There is a broad right-wing mercantilist tradition that favours the continuation of Iran as a trading nation rather than the development of indigenous industry. Neo-conservatives favour a Russian model based on a small group of trusted oligarchs controlling all major economic activity. The impact of this fragmentation sends out conflicting and confusing signals. If the Islamic Republic of Iran is based primarily on a security concept, it is understandable that it wants to follow a statist approach and wants economic activity to remain the preserve of a small, approved elite. Many feel that there is still a fundamental lack of understanding that its main role should be to provide a stable and enabling environment within which economy can grow. However there is a general consensus that this confusion about the role of government will eventually subside. The regime is already talking about a knowledge-based, fast growth economy and the 4<sup>th</sup> Five Year Plan will be broadly pro-business.

27. The future of the energy sector deserves special mention. The Government has ambitious plans for the sector but, some would say, has not yet formulated the strategy for their achievement. A big question is where to concentrate future investment. Most forecasters think the most likely concentration will be on gas-intensive industries. Foreign investment will



be crucial but investors will undoubtedly be looking for stability and predictability. In this regard, Iran's relative attractiveness will be closely compared to a number of other countries in the Middle East and Central Asia. Iran is however a sophisticated player in the field and knows it can counter possible lack of interest by western investors by turning towards the fast growing economies of India and China. These are seen as good alternatives even if the technology capabilities they have to offer may not quite be 'state of the art'. China is in particular an increasingly popular trade partner for Iran, not least because security and political sensitivities are less intrusive than they are in dealings with the West.

28. Iran's economic relations with the European Union are not as advanced as they might be because of nuclear issues, but there is still a considerable amount of foreign direct investment (FDI) from the EU in the oil supply industries in particular. The United States' Iran-Libya Sanctions Act (ILSA) does not have as much impact on the economy as might be imagined, except in high-tech areas or for example in civil aviation where it is difficult to obtain spare parts for aircraft. Multinational companies stress that they cannot afford to ignore ILSA, and the repercussions that infringements might have on their other business, but despite constraints many still manage to be actively involved in energy sector.

### **Governance**

29. The process of government in Iran is very opaque. It is not at all clear how decisions are really made. That said, the current period of relative stability that Iran is experiencing is virtually unknown in history. The Islamic Republic has been truly institutionalised and very few inside or outside of Iran would give the possibility of regime change in the near future much credence. The regime is by no means democratic but most agree that there is no shortcut to democracy and that it cannot be imposed from outside.

30. The relatively frequent holding of elections does not mean to say that democracy is established in Iran. The Guardian Council's disqualification of large numbers of potential candidates in the last election represents a serious flaw in the system with many talented people arbitrarily excluded from government on spurious grounds. Ordinary Iranians are hungry for personal freedom and try to live their lives without reference to the Government. There is wide discontent with the ruling regime but the opposition has been unable to produce a credible leadership through which it can be channelled.

31. Some fault the Iranian constitution for not explicitly determining the legitimate source of power. This has led to lingering confusion and a dilemma of security and legitimacy. A regime that feels itself surrounded by hostile US power has become very insecure and uses this

'threat' as an excuse to suppress dissent. Many people fear that the more threatened Iran feels, the more dangerous it will become. This is perhaps a clear signal to the international community that cooperation and dialogue with the regime are likely to be far more productive than the threats and haranguing that have characterised so much of the recent past.

### **Human rights, women and youth**

32. The protection of human rights in Iran, dating from the period of the Shah, has always been highly politicised. In recent years it has been adversely affected by the stalemate between conservatives and reformists. International pressure alone does not have impact; it needs to coalesce with domestic developments. Some consider the long-term pattern of human rights violations, such as arbitrary arrests and the use of torture in detention, is unchanged although the scale may vary. In such circumstances, recent efforts at dialogue with the Iranian authorities, for example by EU governments, are seen as ineffectual. Others believe that engagement can only be assessed over the long-term, by engaging a broad range of institutions and at various levels of authority. Gaining greater publicity in Iran of human rights dialogues may also increase impact, and furnish support to indigenous human rights groups.

33. Women's political participation has gradually increased since the revolution, despite the heavy legacy of historical and cultural traditions. Reformist women parliamentarians were highly focussed and persistent in recent years and brought many improvements to women's legal status, for example in divorce and child custody. Even in rural areas, women regularly attend higher-level education. More needs to be done, however, in changing school textbooks, providing quotas for women in all stages of the electoral system, increasing opportunities for women in the labour market and institutionalising the changes which have occurred. Whether such developments can continue under a conservative parliament is an open question, although some argue the import of women's solidarity and gradualist approach should not be underestimated.

34. Social values are changing – social and sexual mores of young people are widely different from that of their parents. Problems associated with the West – delinquency, drug addiction, sexually transmitted diseases - are increasingly prevalent in Iran too. Increasing exposure to western culture, films and pop music through the internet and the influence of the Iranian diaspora give young Iranians a different outlook on life. The regime must deal with their disenchantment and disillusionment. Student groups are not well organised though. This is still largely a phenomenon of the urban middle class. The rural working class is still very traditional, emphasising the fact that Iran is hardly a homogenous society.

## **Conclusion**

35. The regime of the Islamic Republic of Iran has legitimacy in the sense that there is currently no clear alternative. Nuclear issues are bound up with this – even moderates think it is legitimate to have means to protect the nation. The future is nationalism – a sense of pride in the nation rather than Islamic identity. The regime has to accept social and political diversity as a benefit and not a threat.

36. What are the possible responses from the West? An active policy of pursuing regime change, or complete isolation, have largely been dismissed as not viable. The former option would simply give the regime an excuse to continue nuclear proliferation.

37. The best prospect thus lies with conditional engagement – gradually building up areas of cooperation built on common interests. Such an approach will not make dramatic headlines but is generally agreed to be the most sustainable option in the long term. On the nuclear issue a common western policy following lines of the EU/E3 would be major prize. Will the US go along with such an approach? History shows that a divided West will not succeed. If the West could speak with one voice it could greatly help Iran's ability to save face and know where it stood – one interlocutor rather than several at present. The benefit to Iran would be to avoid referral to the Security Council as a pariah state. Both sides need to find agreement on the thorniest problem of all, the definition of guarantees. Currently the West envisages a complete suspension of the uranium enrichment programme. Iran still wants to retain the full cycle capability. Can both sides agree objective guarantees that Iran's nuclear programme is only for peaceful purposes? By showing good faith and confidence in the negotiations on this issue all parties - the European Union, the United States, and most of all, Iran - will surely benefit.

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