

# Oil price drop undermines stability of Iranian regime

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With the price of oil plummeting on world markets, the Iranian government of President Mahmoud Ahmadinejad is confronting a financial crisis that will inevitably bring it into sharp conflict with substantial sections of the population.

The collapse in oil prices from a high of \$US147 a barrel in July to less than \$65 in trading mid-week is blowing a massive hole in the state budget, 50 percent of which is derived from oil revenues. Oil prices have continued to fall despite an agreement on October 24 by the Organisation of Petroleum Exporting Countries (OPEC) to slash production by 1.5 million barrels.

The projected Iranian budget of \$307 billion for the year to March 2009 will have to be financed by a deficit. Estimates of how much the Iranian state will have to borrow range from \$7 billion to as high as \$50 billion.

Under conditions of continuing turmoil on world financial markets and the freezing up of credit, it is unclear how such a deficit will be financed. Few major international institutions will risk lending to Iran, as it is subjected to economic sanctions designed by the US to punish the regime over its nuclear programs. The operations of major Iranian banks and firms have been curtailed and, in some cases, their assets frozen.

Iran's foreign currency reserves are believed to amount to \$100 billion. If they are drawn upon to finance a budget deficit, they will rapidly be exhausted, especially if the country also begins to run trade deficits.

The sharp decline in oil revenues coincides with rapidly

rising imports and a decline in non-oil exports, particularly agricultural goods. Drought has devastated this year's pistachio crop—the main export apart from oil and a commodity upon which hundreds of thousands of rural Iranians depend upon for their livelihoods.

Ahmadinejad faces the prospect of having to carry out drastic cutbacks to social spending and/or higher taxation, under conditions where there is already mass disaffection with the regime. Even by official estimates, 14 million live in poverty. Unemployment is at least 15 percent and may be as high as 30 percent. Inflation is out of control, with prices rising by an average of 25 percent per year. Food prices have gone up by 40 percent this year alone. A speculative property market has sent house prices and rents soaring.

In this political climate, Ahmadinejad's introduction of a 3 percent consumption tax in late September provoked outrage among the bazaaris—the small business owners and traders who have been one of the most reliable bases of support for the Islamist regime since it took power. For the first time since the 1979 overthrow of the Shah, the bazaaris declared an indefinite strike on October 8, shutting down market places in Tehran and other major cities.

The government caved in the following day and announced that it was suspending the introduction of the proposed tax. The bazaaris nevertheless continued their strike for six days in Tehran, demanding that Ahmadinejad cancel, rather than just suspend, the new tax. According to the BBC, large numbers of police have been deployed into the main bazaars to intimidate the business owners.

The next policy looming as a trigger for social conflict is the government's plan to abolish subsidies which keep down the price of petroleum products and cost of water. Under a rationing system that has been in place for over a year, Iranian consumers can purchase 100 litres of petrol each month at a price of just 10 US cents per litre. The Iranian state has to import close to 40 percent of the country's fuel at world prices as it does not have sufficient refining capacity to process domestic production.

The subsidies had been scheduled to end by 2011. During the transitional period, Ahmadinejad promised that all middle and low income households would receive a cash payment of between \$44 and \$70 per person as compensation. The populist gesture was widely viewed as a cynical attempt to buy voter support for his re-election in next June's presidential election. The budget crisis means that the petrol subsidies will most likely have to be cut sooner and the cash handouts will have to be cancelled.

Desperate to boost the price of gas exports, the Iranian government announced this month that it had held talks with Russia and Qatar over the possibility of forming a natural gas producers' equivalent of OPEC.

Iran possesses the world's second largest reserves of gas and is strategically positioned to supply energy markets in Europe and Asia. The reality, though, is that Iran has to import as much gas as it exports. As is the case with petroleum products, it does not have the processing capacity and pipeline networks to meet its own domestic demand. Iran's gas sector needs tens of billions of dollars in investment, which has not materialised due to the sanctions regime and concerns over the prospect of a war with either Israel or the US.

Iran would therefore gain little financial benefit from an OPEC-style gas cartel that forced up prices. The collapse in oil revenues has even provoked concerns that the country will face gas shortages this winter as the government may not be able to afford the necessary volume of gas imports.

Recriminations against Ahmadinejad, who took office

in 2005, are on the rise within the Iranian establishment. His administration is being condemned for failing to slash the budget earlier and to save additional revenue from oil exports while prices were high. The savings in Iran's "future fund" may amount to as little as \$7 billion, compared with Russia's \$157 billion. Ahmadinejad has been using the extra revenue to finance public works programs and subsidies.

A campaign to discredit Ahmadinejad or pressure him into leaving office appears to be underway. Last week, the parliament accepted an impeachment motion against Ahmadinejad's interior minister and close ally, Ali Kordon, on charges of "dishonesty". Kordon incorrectly claimed to hold a degree from Oxford University when Ahmadinejad offered him a cabinet position in August. The vote to remove him will take place on November 4.

Over the weekend, the Iranian media gave considerable attention to claims that the president had missed several engagements because he was in poor health. The extent of the rumours compelled Ahmadinejad's aides to publicly announce that he may have recently been suffering from "exhaustion", caused by long working hours, but was not ill.

To this point, Ahmadinejad has not come in for open criticism from the clerical elite, headed by Ayatollah Ali Khamenei, which holds most of the real levers of power in Iran. The clergy's stance indicates that the economic dilemmas that have emerged make the entire regime vulnerable to social discontent, not simply Ahmadinejad and the current government.



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