

**OIL RENTS AND DEMOCRACY IN IRAN  
1997-2010: RE-VISITING THE RENTIER  
STATE THEORY**

**By**

**YOUHANNA NAJDI**

Thesis submitted in fulfillment of the requirements  
for the degree of  
Doctor of Philosophy

May 2015

## **ACKNOWLEDGEMENTS**

### **In the name of GOD**

This research project would not have been possible without the support of many people. Firstly, I would like to specifically thank my supervisor, Dr. Reevany, who is a good friend and was always willing to help me and give me the best suggestions. His guidance helped me throughout the entire the time of writing this thesis. I would also like to thank my co-supervisor, Dr. Benny, for his advice to improve my thesis.

Besides my supervisor, I would also like to thank my thesis committee, Dr. Azeem, Dr. Zaini, and Prof. Datuk. Qasim for their encouragement, insightful comments and hard questions. My sincere and special gratitude also for Dr. Azeem, for his continuous support of my thesis, as well as his patience, motivation, enthusiasm, and immense knowledge. Also, I would like to express my gratitude to my previous supervisor, Prof. Mohd Azhari Bin Abdul Karim for his patience and providing me with a good atmosphere for conducting research.

I would also like to thank Prof. Solvay Gerke who supported me throughout this entire process. Although officially she was not responsible for my thesis, every time I knocked on the door of her office with many questions, I always left with many new, inspired ideas. Furthermore, I would also like to thank my wife, Dr. Yalda Davoudpour. She was always there cheering me up and stood by me through the good times and bad.

A special thanks to my mother for her endless love and affection, never ceasing even from thousands of kilometres away. Also, the memory of my father has strongly inspired me to further my education, although unfortunately he is not among us now. The author also wishes to express his love and gratitude to his beloved family, my

older sister, and her husband who were always supporting me and encouraging me with their best wishes. Last but not least, many thanks to the CenPRIS and its calm atmosphere.

## TABLE OF CONTENTS

	<b>Page</b>
<b>ACKNOWLEDGEMENTS</b> .....	ii
<b>TABLE OF CONTENTS</b> .....	iv
<b>LIST OF TABLES</b> .....	viii
<b>LIST OF FIGURES</b> .....	ix
<b>LIST OF ABBREVIATIONS</b> .....	xi
<b>LIST OF PUBLICATIONS</b> .....	xiii
<b>ABSTRAK</b> .....	xiv
<b>ABSTRACT</b> .....	xvi
<b>CHAPTER ONE - INTRODUCTION</b>	
1.1. Importance of the Topic .....	1
1.2. Background of the Topic.....	4
1.3. Problem Statement .....	6
1.4. Theoretical Discussion.....	10
1.5. Research Questions.....	12
1.6. Research Objectives.....	13
1.7. Methodology.....	13
1.7.1. Theory and Case Study.....	15
1.7.2. Data Collection.....	17
1.7.3. Data Analysis.....	18
1.8. Research Outline.....	21
<b>CHAPTER TWO - LITERATURE REVIEW AND THEORITICAL FRAMEWORK</b>	
2.1. Introduction.....	23
2.2. Natural Resources and Political Economy; Lessons from Different Countries...24	
2.2.1. Resource Abundance: Blessing or Curse in Terms of Economy?.....24	

2.2.2. Re-Visiting of the Rentier State Theory.....	27
2.3. Rentier State Theory; Difinition and Components.....	30
2.4. The Curse of Natural Resources in Terms of Politics.....	38
2.5. Robert Dahl: From Ideal to Real Democracy .....	45
2.6. Larry Diamond: Civil Society and Accountability .....	47
2.7. Oil Rents in Iran’s Politics and Economy .....	51
2.7.1. Oil Rents and Iran’s Political Economy: Rent-Seeking Activities and MilitaryGroups.....	52
2.7.2. Oil Wealth: Two-Way Road Between Politics and Economy .....	57
2.7.3. Oil Rents in Iran’s Economy: Where is the Curse? .....	61
2.8. Democratization Process in Iran: Obstacles and Shortcomings.....	63
2.9. Summary .....	69

**CHAPTER THREE : IRAN as a RENTIER STATE; HISTORICAL PROCESS  
and ECONOMIC PERSPECTIVE**

3.1. Introduction .....	73
3.2. Historical Process; How Oil Became Governmental Rents? .....	73
3.2.1. The Beginning of an Unfinished Story .....	73
3.2.2. Nationalization of Iran’s Oil Industry .....	76
3.2.3. Cope Against Dr.Mosaddegh and the Fall of the Nationalization Movement .....	78
3.2.4. Oil Rents in the Iranian Government’s Hands .....	79
3.3. New Political Structure; New Political Economy.....	83
3.3.1. Stabishment of the Islamic Republic of Iran.....	83
3.3.2. Constitutional Distribution of Power and the Role of Iran’s Supreme Leader.....	84
3.3.3. Iran’s Political Economy.....	89
3.3.4. Government Institution in Iran’s Energy Sector .....	92

3.3.5. The Share of Oil in Iranian Economy .....	96
3.3.6. Taxation System and the Rentierism .....	103
3.4. Summary .....	108

#### **CHAPTER FOUR : OIL RENTS, DEMOCRACY and MILITARY GROUPS**

4.1. Introduction .....	110
4.2. Reformist Movement and Decline in Oil Revenues .....	111
4.3. Oil and Political Challenges Between Reformists and Conservatives.....	116
4.4. Higher Oil Income and Lower Level of Democracy .....	123
4.5. The Green Movement: Peak of Violence and Oil Prices .....	127
4.6. Social Freedom and Oil Revenue.....	132
4.7. Oil Rents, Democracy and Military Expenditures .....	135
4.7.1. The IRGC: The Transition from Military Force to Political Party .....	136
4.7.2. Oil Revenue and Government Expenditure on the Military Sector .....	143
4.8. Summary .....	147

#### **CHAPTER FIVE : OIL INCOME and GOVERNMENT COMPONENTS**

5.1. Introduction .....	149
5.2. The World Bank and the Four Government Components .....	149
5.3. Rule of Law (RL).....	152
5.3.1. Oil Stabilization Fund (OSF) and Rule of Law .....	153
5.4. Control of Corruption (CC).....	159
5.5. Voice and Accountability (VA) .....	166
5.6. Political Stability and Absence of Violence (PV).....	172
5.7. Summary .....	177

#### **CHAPTER SIX : CONCLUSION**

6.1. Conclusion .....	179
-----------------------	-----

6.2. Suggestions for Future Works.....	184
<b>REFERENCES</b> .....	185
<b>APPENDICES</b> .....	221

## LIST OF TABLES

	<b>Page</b>
Table 1.1 Applied variables in existing literatures about	9
Table 3.1 Oil production and direct income of Iran 1926-1932	75
Table 3.2 Iran's Gross Domestic Product (GDP) from 1997 to 2010	102
Table 3.3 Iran's government revenue based on CBI's report	106
Table 5.1 List of some resource funds all over the world after 2000	155
Table 5.2 Brief report on the findings of this chapter	178

## LIST OF FIGURES

		<b>Page</b>
Figure 1.1	Methodological process of this study	14
Figure 2.1	A summary of the rentier state theory and its mechanism	36
Figure 2.2	Corruption and natural resources (all countries)	44
Figure 2.3	The theoretical framework of this study	71
Figure 3.1	Shared petroleum taxation revenues between British and Iranian governments from 1934 to 1949	77
Figure 3.2	Real per capita GDP growth and inflation in Iran	80
Figure 3.3	Distribution of power in the Islamic Republic of Iran based on the Constitution written in 1979	85
Figure 3.4	The actual flow of the Supreme Leader's power in Islamic Republic of Iran	88
Figure 3.5	Governmental entities relative to Iran's oil industry (Explained by the author according to Iran's Constitution 1979)	94
Figure 3.6	Ten richest crude oil reserves in the world	97
Figure 3.7	Top proven world oil reserves	98
Figure 3.8	International oil price between 1997-2010	100
Figure 3.9	Iran's revenue from oil exports between 1997-2010, based on Central Bank of Iran's report	101
Figure 3.10	The share of non-oil gross domestic product and oil gross domestic product in the total Iran's GDP 1997-2010	103
Figure 3.11	Iran's tax revenue in comparison with the world and the European Union	105
Figure 4.1	Iran's Polity IV and Oil Revenues (Milliard <i>Rial</i> )	114
Figure 4.2	Freedom House's scores for Iran and oil revenues (Milliard <i>Rial</i> )	133

Figure 4.3	The IRGC's organizational chart	138
Figure 4.4	Total active military manpower between 1990–2010	144
Figure 4.5	Iran's oil revenue, military expenditure as a percentage of the GDP and military expenditure as a percentage of central government expenditure from 1997 to 2010	145
Figure 5.1	Oil income and Rule of Law in Iran 1997-2010	152
Figure 5.2	Oil income and Control of Corruption in Iran 1997-2010	160
Figure 5.3	Iran's economic freedom in comparison with the world from 1997 to 2010	165
Figure 5.4	Oil income and Voice and Accountability in Iran 1997-2010	167
Figure 5.5	Oil income and Political Stability and Lack of Violence in Iran 1997-2010	173

## LIST OF ABBREVIATIONS

AIOC	Anglo-Iranian Oil Company
BP	British Petroleum
BPOC	British Petroleum Oil Companies
CBI	Central Bank of Iran
CC	Control of Corruption
EF	Economic Freedom
FFYDP	Fourth Five-Year Development Plan
GDP	Gross Domestic Product
GIO	General Inspection Office
IMF	International Monetary Fund
IRGC	Islamic Revolutionary Guard Corps
IRI	Islamic Republic of Iran
MENA	Middle East and North Africa
NATO	North Atlantic Treaty Organization
NIOC	National Iranian Oil Company
OPEC	Organization of the Petroleum Exporting Countries
OSF	Oil Stabilization Fund
PV	Political Stability and Absence of Violence
RL	Rule of Law
SIPRI	Stockholm International Peace Research Institute
SNSC	Supreme National Security Council
TFYDP	Third Five-Year Development Plan

US	United States
VA	Voice & Accountability
WGI	Worldwide Governance Indicator

## LIST OF PUBLICATIONS

- 1- Hassan Gholipour Fereidoun, Usama Zuhair Al-mulali, and **Youhanna Najdi**. (2014). The Interaction between Globalization Indicators and International Tourism Arrivals in the Middle East and North Africa (MENA) Countries. *Anatolia*, 1-10.
- 2- Hassan Gholipour Fereidouni, **Youhanna Najdi**, and Reza Ekhtiari Amiri. (2013). Do Governance Factors Matter for Happiness in the MENA Region?. *International Journal of Social Economics*, 40 (12), 1028-1040.
- 3- **Youhanna Najdi**, and Mohd Azhari Bin Abdul Karim. (2012). The Role of the Islamic Revolutionary Guards Corps (IRGC) and the Future of Democracy in Iran: Will Oil Income Influence the Process?. *Democracy and Security Journal*, 8(1), 72-89.
- 4- Hassan Gholipour Fereidouni, Behzad Foroughi, Reza Tajaddini, **Youhanna Najdi**. (2015). Expenditures on sport facilities and success in Iran: the resource curse hypothesis. *Journal of Policy Modeling*, Accepted for publication.

# **SEWAAN MINYAK DAN DEMOKRASI DI IRAN 1997-2010; PENELITIAN SEMULA TEORI NEGARA PENYEWA**

## **ABSTRAK**

Iran, negara yang kaya dengan sumber tetapi mengalami masalah sistem demokrasi yang amat teruk. Penyelidikan ini bertujuan mengkaji kesan daripada pulangan minyak terhadap demokrasi di Iran, dalam tempoh 1997 – 2010. Justeru, penulis meneliti semula teori kerajaan dan menerapkannya dalam keadaan semasa di Iran untuk menjelaskan bagaimana kekayaan atau kemewahan minyak telah membantutkan atau menghalang proses demokerasi di Iran. Satu penyelidikan kualitatif dijalankan dengan menggunakan pendekatan kajian kes dan analisis konteks. Data sekunder dikumpul daripada laporan rasmi kerajaan Iran dan juga laporan daripada pertubuhan antarabangsa yang boleh dipercayai. Dalam seksyen pertama kajian ini, terbukti bahawa Iran dapat dikategorikan sebagai negara penyewa, berdasarkan definisi teori dan keperluan utamanya. Syer perolehan atau pendapatan minyak dalam ekonomi Iran, peranan marginal daripada sistem percukaian, dan pemilikan industri minyak diketengahkan dalam konteks ini. Sepanjang kajian ini, dikenal pasti bahawa terdapat perkaitan yang negatif di antara pendapatan minyak dan demokrasi di Iran. Dalam kata lain, kejutan harga minyak yang positif atau tinggi menyebabkan terhalangnya proses demokrasi. Sebaliknya, pulangan minyak yang sedikit, mendorong pemulihan atau pembaharuan politik Iran. Keputusan kajian juga menunjukkan bahawa kekayaan minyak mampu membantu kerajaan kekal berkuasa terutamanya disebabkan sokongan jitu daripada pihak IRGC (Islamic Revolutionary Guard Corps), yang merupakan kuasa ketenteraan atau militari utama di Iran. Dapatan ini juga, khususnya, selaras dengan teori negara

penyewa, yang menegaskan tentang pentingnya kumpulan militari dalam negara penyewa. Di samping itu, penulis juga menganalisis kesan negatif daripada pulangan minyak kerana ia dikaitkan dengan tiga indikator atau petunjuk kerajaan, iaitu Kedaulatan Undang-undang, Kawalan Rasuah dan ketidakstabilan politik dan kekurangan jenayah. Sementara itu, ditemui juga bahawa Suara dan Akauntabiliti tidak mempunyai kaitan dengan kekayaan minyak Iran. Sebagai kesimpulan, dapat dirumuskan bahawa, berdasarkan teori negara penyewa, kekayaan minyak mampu meningkatkan peranan militari dan kumpulan para-militari di Iran, dalam tempoh 1997 - 2010, yang mempunyai pengaruh negatif terhadap proses demokrasi, kawalan rasuah, dan kedaulatan undang-undang.

# **OIL RENTS AND DEMOCRACY IN IRAN 1997-2010; RE-VISITING THE RENTIER STATE THEORY**

## **ABSTRACT**

Iran is a resource-rich country that severely suffers from a lack of democracy. The purpose of the present research is to study the effect of oil revenues on democracy in Iran from 1997 to 2010. In order to do so, the author re-visited the rentier state theory and applied it to Iran's present condition to explain how oil wealth has hindered the democratization process in Iran. A qualitative research was conducted using the case study approach and content analysis. The secondary data was collected from official reports of the Iranian government as well as from reports of reliable international organizations. In the first section of this study it is evidenced that Iran can be categorized as a rentier state, based on the definition of the theory and its vital requirements. The share of oil income in Iran's economy, marginal role of taxation system, and government ownership of the oil industry were highlighted in this context. Throughout the study, it was identified that there is a negative relationship between oil income and democracy in Iran. In other words, positive oil price shocks hindered the democratization process, while less oil revenue led to political reforms. The results of the study also demonstrated that oil wealth has helped the government to stay in the power largely due to the major support of the Islamic Revolutionary Guard Corps (IRGC), which is the main military power in the country. This finding, in particular, was in the line with the rentier state theory which emphasized the importance of military groups in rentier states. The author also analyzed the negative effects of oil revenue as it pertained to three government indicators including the Rule of Law, Control of Corruption and Political Instability

and Lack of Violence; Whereas, Voice and Accountability were found to have no relationship to oil wealth in Iran. Finally, it was concluded that, according to the rentier state theory, oil wealth caused an increase the role of military and Paramilitary groups in Iran from 1997 to 2010 which had a negative influence on the country's democratization process, control of corruption, and rule of law.

## **CHAPTER ONE**

### **INTRODUCTION**

#### **1.1. Importance of the Topic**

Democracy, as one of the most important concepts in political science remarkably has attracted the attention of scholars, particularly since World War II. Existing literature has considered democracy from various perspectives. For example, the main elements of democratic governments such as political and civil freedom, rule of law, equality, quality of institutions, political competition, free and fair election as well as fair judiciary system have extensively been discussed in several studies (See for example Dahl, 1971; Huntington, 1991; Diamond, 2002; Howard and Roessler, 2006, Gerring et al., 2012; Woodberry, 2012; Gassebner et al., 2013).

In spite of various viewpoints about democracy, current scholars are most concerned with finding obstacles that may hinder or challenge transition to democracy. Particularly, their research highlights the relationship between natural resources and a country's quality of government.

Since the late 1980s, a sizable body of scholarly literature has argued that an abundance of natural resources increases the possibility of poor economic performance (Sachs and Warner, 1995; Papyrakis and Gerlagh, 2004; Stijns, 2005), civil war (Collier and Hoeffler, 1998; 2005; Fearon, 2004; Ross, 2004) and contributes to low levels of democracy (Ross, 1999; Bulte and Damania, 2005; Cuaresma et al., 2011). Indeed, by using both empirical and theoretical approaches, these researchers illustrated that natural resources is a curse rather than a blessing.

Thus, studies about resource-rich countries such as Iran became an interesting topic for researchers in both political and economic fields all over the world. Iran is a member of the Organization of the Petroleum Exporting Countries (OPEC)<sup>1</sup> and the third richest country after Venezuela and Saudi Arabia (OPEC, 2001), as it has around 154 billion barrels of proven crude oil reserves. It is worth noting that the first major oil field in Iran was discovered at the south of the country in Masjid Soleiman city in 1908 and since that time, historically, oil has played a crucial role in Iran's politics and economy. Another major factor that contributed to Iran and other oil-exporting countries successes in the oil business is the European Industrial Revolution, which led to an international demand for oil, which soon became known as "Black Gold". This major turning point in history led to the necessity of oil, not only for Iran and oil-exporting countries but also for the rest of the world.

In examining the sociopolitical impact of oil, some key issues such as oil incomes and government spending should also be taken into account. The importance of oil income has been emphasized by Iran's new government which came into being after the Islamic Revolution in 1979. This critical event led the government shifting from strong relationships with western countries into concepts of self-dependence and self-sufficiency both in politics and economics. By a short glance on Iran's government, it can be distinguished that as the only country with Shi'ism religion in the world, its political structure clearly relies on the oil sector and hence, this issue makes it a special case in terms of politics and political economy.

Therefore, with regard to the importance of the topic, two issues can be considered. First of all, this study aims to uncover the impact of political economy on

---

<sup>1</sup> The Organization of the Petroleum Exporting Countries (OPEC) created on September 10–14, 1960 during the Baghdad Conference, by Iran, Iraq, Kuwait, Saudi Arabia and Venezuela. OPEC tries to secure stable and fair prices for petroleum producers. (See [http://www.opec.org/opec\\_web/en/about\\_us/24.htm](http://www.opec.org/opec_web/en/about_us/24.htm)) [Accessed 15 January 2015]

democracy in Iran, specifically focusing on the effects of oil income fluctuations. It should take into account that based on estimations of some international organizations like the International Energy Agency (IEA), demands for oil will be around 175 million barrels per day by 2030. This situation means that for oil-exporting countries like Islamic Republic of Iran, the clear and hidden impacts of natural resource revenues are a kind of durable question not only for today, but also for the future.

Secondly, this study focuses on the time period between 1997-2010, which includes the two main recent democratic movements of the Iranian people. The first of which happened during the seventh Presidential election on 23 May 1997 (2<sup>nd</sup> *Khordad* month in Persian calendar); the second democratic event was the “Green Movement” which originated from the tenth Presidential election in June 2009. Interestingly, Iran’s economy experienced both negative and positive oil price shocks throughout the period of this study between 1997 and 2010, and for this reason, research about the impact of oil incomes on democracy in this period may cover the effects of both ups and downs of oil revenue on levels of democracy in Iran.

The central argument of this thesis is the relationship between oil incomes as an external rents and democracy in Iran throughout the time period between 1997 to 2010. While economists have considered the effect of oil revenue on Iran’s democracy through the lenses of economic theories such “Dutch Disease” and “Resource Curse” examining the political impacts of oil wealth on political field needs a theory that is related to politics, not economics. Along this line, the main theory in the field of political economy and natural resources is the “rentier state” which can be briefly summarized as describing those countries with windfall oil rents

that do not feel the need to incorporate taxation systems which leads to long-lasting problems such as weak institutions, corruption, and low level of rule of law, accountability and mismanagements. Gradually, these conditions deteriorate government components and democratization.

By using the rentier state theory, this study analyzes Iran, one of the most resource-rich countries in the world, in order to find out the role that oil rents plays as an obstacle to democratization in this country; moreover, how the current Iranian government uses these revenues to stay in power despite its weak institutions.

## **1.2. Background of the Topic**

In the contemporary history of Iran before the period of this study, two democratic revolutions led to two major revolutions; the first of which was the Constitutional Revolution from 1905 to 1907 under the leadership of political elites and intellectuals to modernize the *Qajar* dynasty and limit the authority of the monarchy. The movement also emphasized that the rule of law and establishment of the fair and modern judiciary system needed to be based on the Western model. The revolution finally led to the establishment of the Iranian parliament and the first Constitution in 1907 (Faghfoory, 1987; Najmabadi, 1996).

The second democratic movement was the Islamic Revolution in 1979 under the leadership of Ayatollah Ruhollah Khomeini (1902-1982). Although Mohammad Reza Shah (1919-1980), the last king of the Pahlavi dynasty, had increased the availability of education, expanded industry, modernized the military sector, improved economic structures and provided better infrastructure, as some researchers have mentioned, he did not pay enough attention to political reform and the

democratic demands of the Iranian people (Keddie, 1998; Nasr, 2000; Kamali, 2007; Schayegh, 2010).

Nonetheless, in political fields during the 1960s and 1970s, Mohammad Reza Shah expanded the role of the Iranian government's internal security system, the National Intelligence and Security Organization, to suppress opposition groups and dissident political activists like clergymen, university students and intellectuals. In response to this measure, the Islamic revolution and its leaders strongly emphasized political concepts like independence, equality and freedom during political rallies and public demonstrations. As a result, the Iranian people's desire for a better quality of government and higher levels of democracy shifted public favor to the leadership of Ayatollah Khomeini.

In the contemporary history of Iran, for the first time, oil and politics became inextricably linked to each other in 1951 when Iran's oil industry was nationalized during the Pahlavi Dynasty under the leadership of Iran's Prime Minister Dr. Mohammad Mosaddegh (1882-1967). The government controlled all operations related to Iran's oil industry, including exploration, development and exploitation (See for example Ramazani, 1962, Abrahamian, 1982). Following the fall of the Pahlavi Dynasty and establishment the Islamic Republic, the new government became the official owner of all natural resources, according to Article 44 of Iran's Constitution 1979. In addition, coming to the power of reformist and conservative groups have not changed this condition.

In reality, although nationalization of Iran's oil industry in 1951 prevented other countries from interfering with Iran's oil sector, it also made Iran's government the official owner of all of Iran's oil resources. This condition is still in place today in the Islamic Republic and continues to affect the Iranian people. Consequently, as

Acemoglu et al. (2004) argued, the nationalization of oil industry not only makes the government the richest organization in the country but also provides a vast amount of autonomy for the government to implement laws over the people and taxation mechanism. Robinson et al. (2006) have broadly explained that when this situation happens, the main results of this condition in terms of the government are low level of accountability, weakness of political institutions and lack of a taxation system.

These results are clearly evidenced in Iran's political and economic history. After the nationalization movement in Iran in 1951, the GDP per capita growth rate increased to 8% per year from 1963 to 1976 (Esfahani and Pesaran, 2008) and guaranteed the autocrat power of Pahlavi Dynasty until the Islamic Revolution in 1979 (Farzanegan and Schneider, 2009). This trend has continued until present day in the Islamic Republic where the government is still the official the owner of energy industries while the country continues to suffer from low levels of democracy and freedom.

### **1.3. Problem Statement**

For many years, people debated that the possession of a sizable natural resource endowment is a major advantage for rapid development in different areas for resource-rich countries (Viner, 1953; Lewis, 1955; Higgins, 1968). Before the 1980s, several studies argued that natural resources would enable developing countries in transitioning from underdevelopment to industrialization situation (Rostow, 1961). Some of these researchers put forward similar arguments, finding that a natural resource endowment would facilitate an industrial development by providing investible funds (Balassa, 1980; Krueger, 1980).

However, since the late 1980s, several scholars have challenged these viewpoints, arguing that reliance on natural resource exports has undeniable disadvantages. In fact, their main assertion was that natural resource abundance is strongly associated with negative social, economic and political results, including civil war and internal conflicts, poor economic performance, as well as a low levels of democracy (Gelb and Associates, 1988; Leite and Weidmann, 1999; Wantchekon, 1999; Sarraf and Jiwani, 2001; Davis et al., 2003).

In this framework, while Iran is a resource-rich country, the religious extremist regime in Iran and several human crises have raised concerns about the political condition of the country since the inception of the Islamic Republic in 1979. From a political perspective, reports from international organizations and recent democratic movements in Iran have clearly revealed that the country strongly suffers from the low level of democracy and human rights crises (Freedom House 2011; 2012; Marshall and Jagers, 2002). More importantly, two recent democratic movements - one in 1997 and another in 2009- revealed that the Iranian people have pursued democracy, not only for the purpose of instating a better quality of government, but also to solve different economic and political problems, such as unemployment, poverty, gender inequality as well as an alarmingly high rate of drugs (Karbassian, 2000; Amuzegar, 2004; 2005; Ilias, 2008; Karimi, 2008; Esfahani and Pesaran, 2009; Safdari et al., 2011).

Thus, researchers have paid attention to the roots of the lack of democracy in the Islamic Republic of Iran from a variety of perspectives; for instance, the structural challenge between tradition and modernity (Bashiriyyeh, 2002), the lack of civil society (Saeia, 2007), rent-seeking behavior of Iranian military groups (Alfoneh, 2008), as well as the governmental narrative from the political role of

religion (Karimi, 2012). Moreover, Kurman (1999), Gasiorowski (2002) and Keddie (2003) clearly emphasized the political challenges among Iranian political groups, particularly conservatives and reformists, as one of the main causes of political crisis in the country. None of these aforementioned studies acknowledged the role of oil in Iran's political power. In addition, there is a very limited amount of research regarding the influence of oil income on Iran's politics and economy, specifically in terms of its effect on political structure. However, some researchers have illustrated the relationship among the fluctuation of oil revenues and both negative and positive oil price shocks on economic growth, government expenditure and factionalism in Iran (Farzanegan et al., 2001; Bjorvatn and Selvik 2007; Esfahani et al., 2013).

However, most existing studies about the effect of oil revenues on Iran's political field are outdated and focused on the pre-Islamic era, like Mahdavy (1970); they are not comprehensive and just cover limited elements like Amuzagar (2008), Zahirinejad (2010) and Najdi and Azhari (2012), or did not pay enough attention to the role of oil like Hen-Tov and Gonzalez (2011), Hen-Tov (2006) and Kamrava (2007). Table 1.1 briefly shows that there is still a gap in the literature about the impact of oil revenues on the level of democracy in Iran because no research has yet been conducted.

As can be found from table 1.1 researchers, particularly economists, have broadly estimated the impact of oil price volatility on Iran's economic field while political scientists have neglected its effect on both the level of democracy and the main indicators of the government (like Rule of Law, Control of Corruption, Voice and Accountability, Political Stability and Lack of Violence) which shows whether the government is democratic or not.

**Table 1.1.** Applied variables in existing literatures about (Created by the author of this thesis)

Reference	Economic Growth and GDP	Government expenditure	Factionalism	Unemployment	Foreign policy	Housing investment	Inflation
Bjorvatn & Selvik (2007)							
Amuzegar (2008)							
Esfahani & Pesaran (2008)							
Maleki (2009)							
Farzanegan & Markwardt (2009)							
Farzanegan & Schneider (2009)							
Arman & Aghajari (2009)							
Moradi (2009)							
Gholipour Fereidouni (2010)							
Zahirinejad (2010)							
Mehrara & Dehkarsalari (2011)							
Farzanegan et al. (2011)							
Farzanegan (2011)							
Mehrara et al. (2011)							
Safdari et al. (2011)							
Dizaji (2012)							
Mehrabadi et al. (2012)							
Esfahani et al. (2013)							
Garkaz et al. (2012)							

Therefore, it is necessary to concentrate on this problem more comprehensively by using new data from both the government and international organizations, especially because of the recent changes in Iran's government. By applying new statistics and theory, this study aims to uncover the relationship between oil revenue and the level of democracy in Iran; moreover, it strives to illuminate how the windfall revenue from oil exports has enabled the Islamic government to remain in power, despite its weak institutions.

#### **1.4. Theoretical Discussion**

There are some political economy theories that have explained the effects of natural resources on economic and political performance of governments. For instance, "Dutch Disease" is defined as a condition whereby a windfall profit from a natural resource price shock dramatically increases the real exchange rate, which negatively affects manufacturing and the tradable sector which also leads to high inflation in the non-tradable sector of resource-rich countries (Bruno and Sachs, 1982; Corden, 1984).<sup>2</sup>

Although the concept of "Dutch disease" was first coined in Netherlands following the discovery of gas reserves at the beginning of 1960s, it is still one of the most important theories contemporaneously, and many scholars have identified this problem in other countries (See for example Sachs and Warner, 1995; Gylfason, 2001a; Hausmann and Rigobon, 2002; Fielding, 2007; Beine et al., 2012).

The "resource curse" is another famous theory which emphasizes the paradox that oil-dependent countries tend to have lower economic growth in comparison with

---

<sup>2</sup> Some scholars have discussed that Dutch Disease can be traced to foreign exchange inflows in the form of international aid or loans, see for example: Adam and Bevan (2003), Nkusu (2004) and Rajan and Subramanian (2005).

other countries that do not possess this natural resource. The theory hypothesizes that the mismanagement of huge revenues from natural resources and a deep reliance on these incomes makes the government incredibly vulnerable to the volatility of oil income. The “resource curse” theory has been applied in analyses of many different countries; it is commonly understood and expected among economists that possession of natural resources is a “curse” for developing countries rather than a “blessing” (See for instance Wheeler, 1984; Gelb and Associates, 1988; Auty 2004; Ross, 2012; Wenar, 2013; Holden, 2013; Torres et al, 2013).

While these theories are necessary for understanding the influence of natural resources, both are constructed from the economic perspective rather than the political perspective. For this reason, this study aims to apply the “rentier state” theory which asserts the relationship between external rents, such as oil and gas revenues, and the political performance, particularly democracy. Indeed, this thesis will visit the rentier state theory in Iran as a case study while also investigating the volatility of this rent on the main elements of the government. In doing so, firstly, this study will broadly discuss whether or not the rentier state theory is compatible with Iran; secondly, this study will analyze the effects of oil rent on democracy in Iran.

The present study will focus on the rentier state theory to describe the relationship between oil rents and democracy in Iran from 1997 to 2010. Using the rentier state theory will help the author of this study to evaluate the effect of oil in Iran’s political field more comprehensively and from a variety of perspectives such as democracy, freedom, control of corruption, voice and accountability, rule of law as well as the role of military groups.

Viewed from the political economy perspective, although the rentier state theory is more compatible to study about natural resource and democratization, interestingly the existing literature about Iran shows that scholars have not pay attention to this viewpoint. Therefore, this study will try to fill this gap in existing literature by applying the rentier state theory to analyze the main characteristics and elements of Iran's government in terms of its political economy.

Additionally, among different definitions of democracy and its required elements, this study will concentrate on the factors which have been addressed by Robert Dahl (1976) and Lary Diamond and Leonardo Morlino (2004). They have emphasized similar components required to create democratic structures such as free, competitive and fair elections, rule of law, quality of institutions, broader standards of good governance including transparency, accountability, as well as lack of corruption.

Although political scientists have identified other main and marginal factors necessary for democracy, this study will investigate the level of democracy and quality of government in Iran based on Dahl (1976), Diamond and Leonardo Morlino (2004).

### **1.5. Research Questions**

This study aims to apply the rentier state theory to understand the connection between oil wealth and democracy in Iran from 1997 to 2010. Briefly, the theory emphasizes that in rentier states, rents come from abroad and the economy of these countries strongly depends on rents. Moreover, each rentier state's government has control over these rents.

Therefore, according to the rentier state theory, the main questions of this study can be framed as follows:

1. What are the characteristics of a rentier state that can be found in Iran?
2. What is the effect of oil rents on democracy in Iran from 1997 to 2010?
3. What is the effect of oil rents on government components (including Rule of Law, Voice and Accountability, Control of Corruption as well as Political Stability and Lack of Violence) in Iran from 1997 to 2010?

### **1.6. Research Objectives**

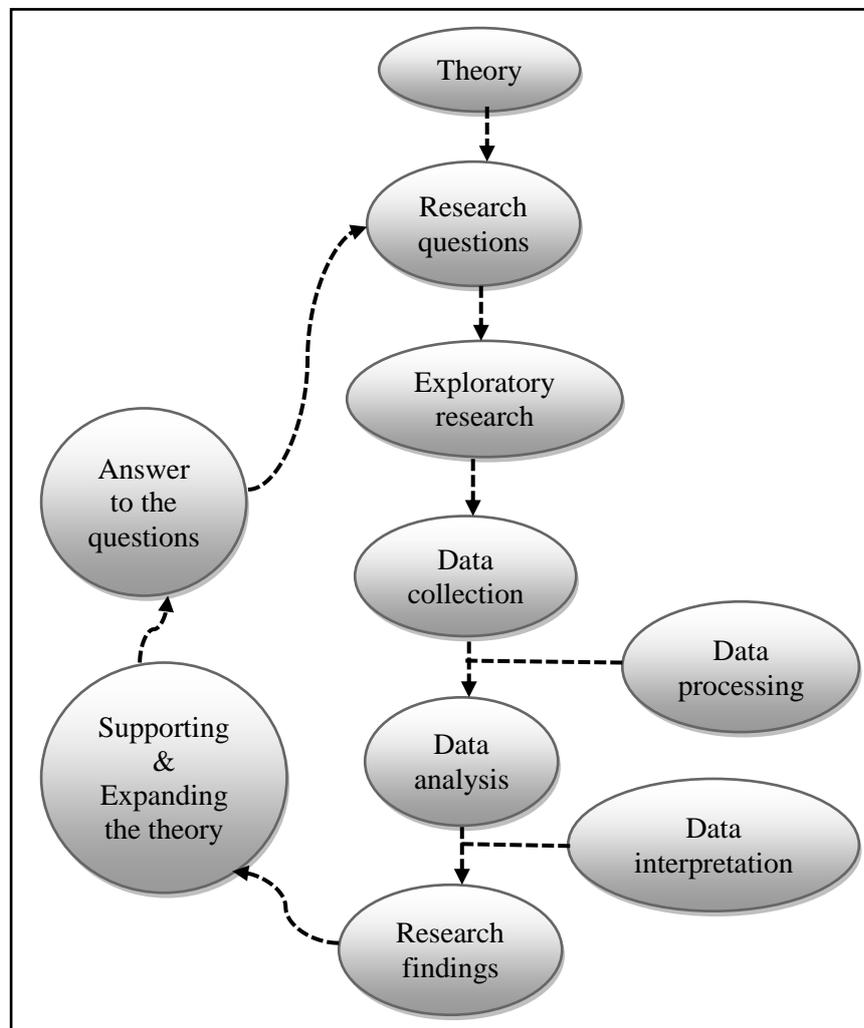
By using the rentier state theory, the main objective of this study is to investigate the effects of oil revenues in regard to the level of Iran's democracy and in terms of the four major elements of the government: rule of law, voice and accountability, political stability and absence of violence, as well as control of corruption in Iran between 1997 to 2010. Therefore, the objectives of this study are:

1. To describe the mechanism that makes Iran's government a rentier state.
2. To investigate the impact of oil revenue on democracy in Iran.
3. To understand why the Iranian government is able to avoid democracy and deactivate democratic movements.
4. To find out the origins of the close relationship between Iran's core of the power and military groups.

### **1.7. Methodology**

This thesis uses qualitative research methods which seek to deal with realities of social science rather than artificially constructed data in quantitative analysis (Manheim et al., 2002: 137; Gummesson, 2005). For instance, Morrow et al. (2001:

582-583) have emphasized that the qualitative method is an ideal tool when conducting multicultural research more so than in other fields of social science. The present study is a qualitative research in the field of political economy. It employs the specific case study (Iran) with time boundaries (1997-2010). The purpose of the research is to find reliable data and information that may show the effects of oil in the democratization process in Iran, specifically from 1977 to 2010. The full description of the research process has been more fully recounted in figure 1.1.



**Figure 1.1.** Methodological process of this study

As can be seen in this figure, after choosing the theory, the author has collected and analyzed data in order to answer research questions, and uncover the effect of oil revenues on democracy in Iran. Data collection, data analysis, theory and case study of this research will be broadly defined in the following sections.

### **1.7.1. Theory and Case Study**

Using theory is a common tool in qualitative research. Yin (1993) has emphasized that a given theory may help the author to increase the validity of his or her study if the theory is formulated clearly. In this regard, the formulation strongly depends on the relationship between case study and variables of the research. As Walsham (1995) has presented, theory has at least three different applications in qualitative research: to show the design and collection of data, to illustrate the best approach when interpreting results, and last but not least, to support the relationship between the case study and the presented argument.

Indeed, while scholars in quantitative studies test theories at the beginning of research (Bryman and Bell, 2007), applying of a theory can be addressed as a vital feature of qualitative research which affects the whole of study (Gummesson, 2005). Furthermore, Finn (2000:14) has noted that using theory not only increases the value and validity of research but also it is intensively necessary to present analysis and interpretation as well as to modify the previous works, which are relevant to the study.

Therefore, this study aims to analyze the current research questions from the perspective of the rentier state theory, which is one of the most valuable theories in political economic research. Although the rentier state theory has been used to visit some resource-rich countries, it has not yet been applied to Iran's economy after the

Islamic revolution, which is one of the richest countries in terms of natural resources, particularly that of oil and gas. This study uses the rentier state theory to not only describe whether the theory applies to Iran as a case study, but also it helps the author to illustrate the effects of oil incomes on Iran's political economy more comprehensively.

As aforementioned, the Islamic Republic of Iran is the case study of this research. "Case study" is broadly accepted as a research strategy in social science. Several scholars have methodologically emphasized on the importance of case study research, which has remarkably increased its popularity (Ragin and Becker, 1992; Thomas, 2011; and Creswell, 2013; Merriam, 2014). Yin (2004) has emphasized that the significance of employing the case study method in research is its ability to examine a specific case within its real-life context. More recently, Creswell (2013: 97) has also pointed out the benefits of the case study approach in that it clearly explores a real-life, contemporary-bounded system over time through the use of in-depth data collection that utilize multiple sources of evidence and statistics.

Generally, a given case study provides the major vehicle for investigation in the interpretive tradition (Walsham, 1993: 14); it also helps one to discover the roots of specific problems, not only for the purpose of the case study, but also to reveal how these problems might apply to other countries and regions (Lee, 1989; Galliers, 1991) and makes a comprehensive strategy to assess and interpret social phenomena (Montealegre, 1995). Furthermore, the case study strategy helps to expand existing theories (Eisenhardt, 1989) because of its particularly insightful focus on the details of a process in specific context (Hartley, 2004). All of these advantages have led to the growing confidence in the case study strategy, particularly in qualitative research studies (Hatrley, 2004: 323).

Importantly, as Yin (1994: 7) has noted, the type of research questions used in a study is the first and most important element to consider when deciding which research strategy to apply. He also has added that case study research questions typically seeks to answer “Who,” “What,” “Where,” “How,” as well as “Why,” of their studies (See also Townes and Shavelson, 2002: 106). The present study has analyzed the questions of “What” and “How” in regard to Iran’s political economy, and thus, the case study strategy can be addressed as method of this thesis. Yin (1994: 13) has divided case study researches into two groups. The first one is an “empirical inquiry” and the second is a “case study inquiry.” The present study is a case study inquiry, which relies on multiple sources of data and utilizes theoretical frameworks to organize data collection and analysis. In other words, a theoretical framework improves consistency and the credibility of a case study, particularly in qualitative research.

Briefly, Iran is the case study of this thesis and the rentier state theory has been used as its theoretical framework. Setting boundaries for the case, the study also covers Iran’s political economy between 1997 to 2010 because this time period includes two major recent democratic movements, both of which possess positive and negative international oil price shocks which, in turn, illustrate the relationship between oil wealth and democracy in Iran.

### **1.7.2. Data Collection**

There are multiple ways to collect data in qualitative research, for instance, archival records, interviews, direct observation as well as documentary reviews. Yin (1994: 83) has identified six sources for collecting data in case study research: documents, direct observation, participant-observation, archival records, physical

artifacts, and interviews. Among them, the present thesis has applied documentation and interviews. In fact, the major strength of case study data collection is that it gathers and applies several different sources of data to get more convincing and accurate results.

The present study has used secondary data, which uses sources such as official reports from Iran's government, annual reports of reliable international organizations (e.g. the World Bank, Freedom House, Polity IV and Organization of the Petroleum Exporting Countries called "OPEC"), and interviews with ten political scientists and political economists. In essence, statistics regarding Iran's economy and the role of oil in this country are obtained from Iran's government official reports; meanwhile, data about the level of democracy, freedom and quality of Iran's government have been collected from the Freedom House, World Bank, and Marshall and Jagers's Polity IV project. Using both the governmental and international reports helps researchers understand the study from more comprehensive viewpoint and to compare data to a range of time periods (Hussey & Hussey, 1997, Bryman & Bell 2007).

Additionally, data has been gathered for the purpose of this study from multiple literature sources as well, including books and articles as well as credible websites. Moreover, some documents and interviews written and conducted in the Persian language have been translated to the English language. All political scientist and economist interviewees were selected because of their expertise and relevant publications in connection with the topic of this study. Interviews with these researchers were conducted through email and Skype; all interviewees answered in the English language. The author of this thesis has tried to access the official statistics reported by the Iranian government but the government does not publish

any official data about the relevant factors. For instance, no data about the government's revenue from taxation and also expenditure on military sector have been reported by Central Bank of Iran. Therefore, in order to study about these matters, the author of this study has referred to the statistics of the reliable international organizations such as the World Bank, Heritage Foundation as well as International Monetary Fund.

### **1.7.3. Data Analysis**

Data analysis is a mechanism whereby a researcher organizes the materials that he or she has seen, heard, learned and read; moreover, it is a process that links data and theory and link the study to previous works (Glesne, 1999: 130). According to Lecompte and Schensul (1999), data analysis is a kind of mechanism that can be used to reduce complicated data and statistics into an attractive, new and clear story.

As researchers have discussed, there are different approaches to analyzing data. For instance, Merriam (1998) has identified at least four models: constant comparative method, narrative analysis, ethnographic analysis and phenomenological analysis. Bernard (2000: 443) also has suggested multiple types of data analysis such as cross-cultural analysis, discourse analysis, hermeneutics or interpretive analysis, grounded theory analysis, narrative and performance analysis as well as content analysis.

The present study uses content analysis as one of the most applicable approaches in the social science, particularly in political science. As Krippendorff (1980: 18) has indicated, content analysis is a kind of research technique wherein the researcher makes replicable and valid inferences from texts due to the contexts of

their use. Indeed, it is a scientific tool which can increase a researcher's knowledge of specific phenomena and provides new insights.

Moreover, content analysis allows the researcher to process data and texts that are informative, reliable, meaningful and representational to others (Krippendorff, 1980: 41). Thus, this mechanism can remarkably incorporate large volumes of data, particularly with case study and theoretical framework. Using content analysis, the present research aims to achieve some targets such as to link statistics to the rentier state theory, to survey existing literature reviews, to find the gap and useful source of data, to highlight the relationship between variables and theory which are applied in the research, and to categorize all data, events, interviews and documents throughout the study.

In fact, in conducting a content analysis, the researcher discovers which documents are related to each section of the study and how to interpret them. Additionally, as Wesley (2010) has explained, in employing content analysis, scholars have more opportunities to use statistics, figures, tables and even matrixes, which are applied in the present study.

Briefly summarized from methodological perspective, the present study uses the qualitative research approach that incorporates the case study focus as well as content analysis. The data used is considered to be "secondary data," which has been collected from official reports of Iran's government, annual reports of reliable international organizations, credible websites and documents. Furthermore, the author of this study conducted interviews with ten political scientists and political economists to gain valuable expert opinions and insights. (See the list of interviewees in APPENDIX A and equation of the answers in APPENDIX B).

## **1.8. Research Outline**

The dissertation is organized as follows. Chapter two is comprised of the Literature Review and Theoretical Framework. Chapter two explains the rentier state theory and shows how the previous works have applied this theory to investigate the effects of oil revenue on political field. The chapter also aims to show how previous scholars have revisited the rentier state theory in different countries and regions and what did they find in their researches? The chapter, additionally, illustrates the main elements of the rentier state theory which will be applied in the present study.

Furthermore, most important studies related to the topic of this thesis have been mentioned in chapter two and then, the main similarities and differences among them have been highlighted. Finally, the chapter tries to show the gap in the existing literature that scholars have not considered to the effects of oil wealth on democracy in Iran, in particular, by revisiting the rentier state theory. Therefore, the present study tries to fill in this gap in the literature.

Chapter three explains how and why Iran's government is the owner of oil and oil revenues. In doing so, this thesis focuses on Iran's Constitution 1979 and the mechanisms that put mass amounts of oil sector wealth in the hands of the government.

Chapter four is divided into two sections. The first section discusses the relationship between oil income and the level of democracy. In fact, this section tries to show if there is any correlation between the volatility of oil revenues and democracy in Iran from 1997 to 2010? In the second section, the author argues the close relationship and strategic ties between Iran's core of the power and its military groups, based on the rentier state theory which has been defined in chapter two. In fact, this argument reveals that oil incomes provide common interests for these two

sides and this condition has helped the government of Islamic Republic of Iran to survive for a long time despite fundamental problems in politics and economy.

Chapter five evaluates the relationship between the fluctuation of oil incomes and the four main elements of Iran's government: voice and accountability, rule of law, control of corruption, and stability and absence of violence from 1997 to 2010. Finally, chapter six provides the conclusion, discusses the main findings of this study, and suggests new questions and points of interest for future study and inquiry.

## CHAPTER TWO

### LITERATURE REVIEW AND THEORITICAL FRAMEWORK

#### 2.1. Introduction

This chapter aims to review the most recent and important previous researches about the effects of natural resource, particularly oil, on the political economy of Iran and rest of the world. In doing so, the re-visiting the resource curse and rentier state theories for different countries will be discussed and then, the thesis will solely concentrate on Iran, as it is the case study of this dissertation.

Firstly, this chapter defines the rentier state theory and then shows how the previous research had applied this theory to different countries and regions. In the next section, the focus of the chapter is on the existing literature about the effects of oil in Iranian politics and economy. Scholars have broadly considered the correlation between natural resources and economic variables in Iranian economy; however, they did not pay enough attention to the significant role of oil wealth in the democratization process in the country. Hence, the author of this study will describe how scholars have hitherto neglected the relationship between oil wealth and democracy in Iran.

Therefore, the target of this chapter is to understand what researchers have found in the past about the correlation between natural resources and levels of democracy, not only in the case of Iran, but also for regions around the world. Moreover, the theoretical framework provides a clear guideline of the present thesis. Finally, by the conclusion of this chapter, it is expected that the gap between previous research and literatures will have been bridged to the present by the current theoretical framework of this study.

## **2.2. Natural Resources and Political Economy; Lessons from Different Countries**

### **2.2.1. Resource Abundance: Blessing or Curse in Terms of Economy?**

The abundance and availability of natural resources in connection with politics and economy has broadly attracted the attentions of scholars for decades. Although economic historians have traditionally discussed how natural resources have endowed great benefits on a nation (Wrigley, 1988), there is now a paradoxical, yet common wisdom among economists that possession of these natural resources for developing countries is actually a curse, rather than a blessing (Lal and Myint, 1998; Auty, 2001a).

Generally, there are three main theories about the effects of natural resources on politics and economy in resource-rich countries. The first one, “Dutch disease,” comes from the Netherlands in the 1960s when the positive shock in the price of natural resources led to high inflation in non-tradable sectors and also economic depression, particularly in the manufacturing sectors of this country. Since that time, several studies have re-examined the Dutch disease theory in different resource-rich countries to find out whether these countries have been similarly affected by Dutch disease or not (Usui, 1997; Hjort, 2006; Égert, 2012; Dülger et al., 2013; Hasanov, 2013; Van der Ploeg and Venables, 2013; Apergis et al., 2014; Benkhodja, 2014).

The second theory, the “resource curse,” argues that countries that have abundant natural resources experience lower economic growth and poorer economic performance in comparison with other countries that do not have these rents. Briefly, the resource curse says that natural resources, in fact, provide windfall cash for the rich countries as a result of it, the people’s tendency to effort, creativity and