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## **Analysis of the Failure of Iran's Economic Development Process in the Transition from Natural State During 1941-1979**

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### **ABSTRACT**

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The institutional economists' view of transition from the Natural State is one of the common theoretical models pointing to the perception of the historical origins of the underdevelopment in different societies. The societies should pass some bottlenecks in order to transition from the natural state (namely coalition or conflict, organization with personal or impersonal relations, and the distribution of productive or unproductive rent) and pass through the Limited Access Order ranges from fragile limited Access Order to Mature Limited Access order toward Open Access Order conditions. The present paper tries to analyze the institutional barriers of economic development in Iran in the framework of Douglas North's views of the natural state during the 1941-1979. The performance of the ruling coalition members is analyzed in each bottleneck of transition from the Natural State. The present research results indicate that the conflict over the power and the exerting of violence from those groups external to the ruling coalition under the shadow of interference by the foreign factors have led to the decentralization of the state power in this period. Under such circumstances, the uncertainty atmosphere overshadowed the political and economic market so that the political and economic super ordinates consider short-term targets. The unproductive rent distribution was therefore formed under the shadow of personal relations so the extractive institutions were produced and disseminated for supporting benefits to a certain group in Iran. This has led to Iran moving toward vicious cycles instead of transitioning from Limited Access Order and moving toward the evolutionary cycles.

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## 1. Introduction

Like many societies, Iran has failed on its path to development. The problem of Iran's lagging behind is rooted in a variety of factors that have been inherited throughout the history. The issue of Iran's lagging behind has occupied the minds of many scholars. The institutional economists' view of transition from the Natural State is one of the common theoretical models pointing to Analysis of the Failure of Iran's Economic Development Process. The viewpoint of Douglas North, the institutional economist and Nobel laureate in economics, on social orders and the transition from natural state is one of the common patterns which can be regarded as a realistic and alternative approach to analyze the economic performance of societies over time, by considering the issue of conflict of interests among stakeholders and their control of violence. He has defined the development process as the way of transition from LAO (most people have limited access to political and economic markets) towards an OAO (people's access to political and economic markets is permitted). He believes that one of the important issues in the process of transition from a NS is the control of violence (North et al., 2006; 2009; 2013).

As a realistic approach, North's theory can be used to explain the obstacles to Iran's economic development. This paper consists of six parts. In the second part, beside explaining North's view of the Natural State, a conceptual model will be presented for the research. In the third part, the Governance Diamond Index is identified for the period under study. Then, in the fourth part, in order to explain Iran's movement among the limited access order spectrums, it will be tried to analyze the performance of each member of the ruling coalition in the bottlenecks of transition from the Natural State using the governance diamond index which identifies the members of the ruling coalition and their rent resources; to this end, the behavior of each member of the ruling coalition will be explained firstly among the limited access spectrum in terms of choosing either the coalition or the conflict; the organization with either personal or impersonal relations will be examined secondly and the distribution of rents will be analyzed thirdly. Finally, in the sixth part, the results of this research will be presented.

## 2. Review of literature

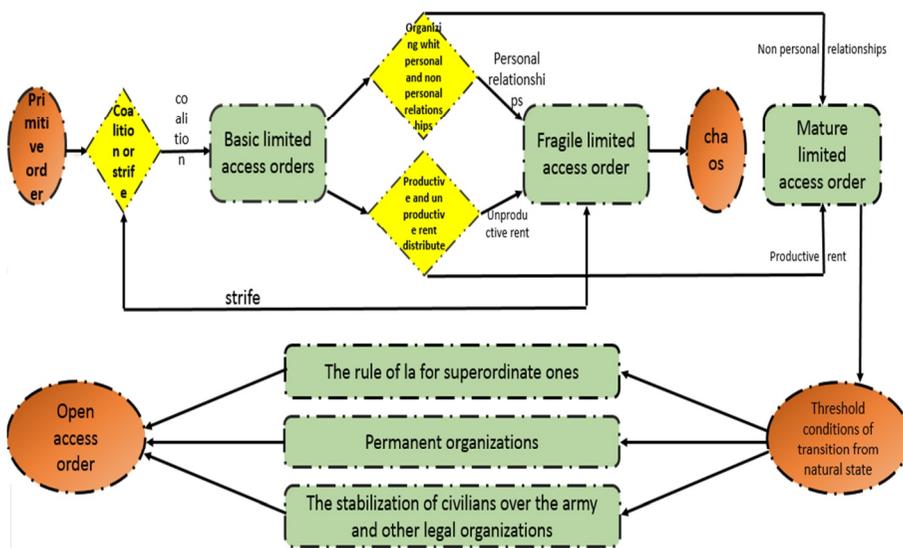


Figure 1. Conceptual Model

North's model proposes three types of order (primitive order (PO), LAO, and OAO). In PO societies, informal institutions are sufficient to sustain expectations and discipline; because personal relations are dominant among members of these communities; with the complexity of the relations, however, the need for a third party, that is a state, is required. For the formation of a NS, there must be a coalition among groups with violence potential; if any of these groups think that they will obtain more benefits in the new structure, they will advance the society towards chaos by disturbing the order and creating conflict. The ruling coalition members must come to the conclusion that their interests in a coalition state are more than a state of conflict, so a NS can be formed. After the formation of a NS, personal relations should be replaced by impersonal relations, and decisions made by organizations should replace individual decisions so that the society moves to a BLAO; If relations remain at a personal level, the distribution of rents will be counterproductive, which will drive the society towards fragility and chaos. If impersonal relations

dominate political and economic affairs; then, with the productive distribution of rents, society moves to a MLAO and organizations outside the ruling coalition, along with organizations within the ruling coalition, will have the right to live permanently, and conditions for moving to OAO will be available. Consisted of the institutionalization of the rule of law for superordinate ones, the permanent livelihoods of organizations in the public and private domains and the stabilization of civilians over the army and other legal organizations, the entry threshold has a capacity for violence. The OAOs are created during the institutionalization of the three threshold conditions of entry, only as a peak or the product of a long, completely inevitable historical process (North et al., 1981; 2006; 2009; 2013).

### **3. Methodology**

In this paper, an attempt has been made to analyze the institutional barriers to Iran's economic development in the transition from NS in the second Pahlavi era. Hence, the performance of each member of the ruling coalition in each bottleneck of the transition from NS is first analyzed. To this end, the ruling coalition members should be appointed along with the rent sources which determine their incentive system. Therefore, using the Governance Diamond Index which identifies the members of the ruling coalition and their rent sources, it will be tried to provide an analytical account about some elements (namely formal political institutions, formal economic institutions, main internal super ordinates and rent sources) and the performance of each ruling coalition member in the bottlenecks of the transition from NS conditions will be analyzed to elaborate on the movement of Iran among the LAO spectrums through determining the direction of the institutional matrix and the incentive system. Thus, in the first step, the behavior of each ruling coalition member will be explained through LAO spectrums in terms of choosing between the coalition or the conflict; Then in the second step, the organization will be examined through personal or impersonal relations; and in the third step, the distribution of rents will be analyzed.

## 4. Iran under the shadow of violence

### 4.1. Characteristics of Governance Diamond Index in Iran

In this part of the research, using the Governance Diamond Index, the four elements of the members of the ruling coalition, formal political and economic institutions and rent resources are identified so that an analytical narrative will be presented about these elements from Iran during the second Pahlavi era; Therefore, in order to become more familiar with the ruling coalition, the forces of the ruling coalition and the relations among them are examined in this section in accordance with the issues raised in the Governance Diamond Index.

**Table 1:** the Governance Diamond Index in Iran (the Second Pahlavi era)

<b>Timespan</b>	<b>ruling Coalition (Super ordinates)</b>	<b>Formal Political Institutions</b>	<b>Formal Economic Institutions</b>	<b>Rent Resources</b>
1941-1953	Court, conservative forces (market men, clerics, landlords and landowners)	Constitutional State, parliament with elections in constituencies, prime Minister Appointed by Shah, multiparty Activities especially Tudeh Party activities, fractionism in parliament	Market economy and private sector, lack of protection of property rights, business environment with high transaction costs	Farm lands, oil resources, endowments and Imam's share, import Monopoly, remaining assets of Reza Shah
1953-1978	Court, bureaucrats, industry owners, military forces, business owners under the umbrella of the court, some foreign investors in joint venture	Absolutism, single-party elections, centralized power in the hands of Shah, the appointed parliament	Majority dominance of the state over industry and mining, inclusive price controls, generally unfavorable business environment, public economy	Oil-resource-driven incomes, state expenditures using rents obtained from domestic currency devaluation, budget shortage and foreign aid/ rents obtained from import franchises and industrialization and urbanization, land market traders, rents obtained from purchasing military weapons, Pahlavi Foundation, redistribution obtained from redistribution of Land Ownership and Factory Shares, rents obtained from resource nationalizations

Table 1. presents the elements of internal Super ordinates, formal political and economic institutions alongside rent resources as the Governance Diamond Index during each period. The institutional matrix consisted of formal and informal institutions is directed under the influence of the relation among the ruling coalition members and the incentive system in the society; therefore, this study makes use of the Governance Diamond index to examine the influence of political and economic institutions. The Governance Diamond index elaborates on the incentive structure of the Super ordinates within the framework of rent relations by considering members of the ruling coalition and the rent resources in each period; then, it makes it possible to analyze how the economic and political institutions are formed over the economic performance identifying the incentive structure and the relation among the members of the ruling coalition.

#### **4.2. The ruling coalition**

Iran has experienced Limited Access Order since Reza Shah's inauguration and has progressed steadily across fragile and basic spectra. In the first place, through creating an established condition, Iran moved from a FLAO toward BLAO, but in the extremity of World War II and with the occupation of Iran by the Allied forces and then the deportation of Reza Shah, after a brief period of chaos, it returned to a FLAO. After the 1953 power struggle, through creating an established condition on the political and economic market, the BLAO was established in Iran. At this point, Iran seemed to be on the threshold of entering OAOs, but the main issue is that Iran not only has not moved toward OAOs, but also after experiencing a period of BLAO since the mid-1950's, it returned to FLAO in the mid-1970s, and finally chaos led to the Islamic Revolution. Members of the ruling coalition and social groups that used rent resources and had the potential to create violence in the society are:

**i. Shah and the court**

The court family was considered the largest and most powerful member of the ruling coalition. The royal family consisted of 63 Shapurs (princes) and Shah-Dukht (princesses), cousins and aunts, and uncles. At the head of the Pahlavi dynasty was Mohammad Reza Shah, who was at the forefront of affairs, especially in the years after the 1960's. Shah enjoyed an enormous decision-making power during the BLAO; he was distinct among the economic super ordinates for his countless wealth and pivotal position, and his entourage attributed flatteringly Shah whatever the state did. Shah, in return, rewarded them with his own resources of income (Foran, 2009). The court never disclosed the amount of its real wealth, but Western resources estimate the royal family's wealth at between \$ 5 billion and \$ 20 billion, coming from Iranian agribusinesses and factories. Rent resources of the court were provided through the four resources of oil revenues, the Pahlavi Foundation, Reza Shah's inherited lands, and trading.

**ii. Landowners and Landlords**

Main landowners have always been regarded as one of the most important members of the power bloc in Iranian history (Ahmad Ashraf, 1995) because of their ownership of the means of production, i.e. land, water, and workers. In the context of FLAO due to post-war conditions, those who benefited from the existing farming system were: landowners, intermediaries, stewards, supervisors, officials, and usurers. They added to their wealth in different ways from buying agricultural products at cheap prices to lending them at high-interest rates or selling products at exorbitant prices and finally by collecting rent. The one who took the most advantages of the exploitation of tribal people and farmers was the great owner. Shah who had usurped many lands during Reza Shah was still Iran's largest owner, but there were other large landowners who each owned hundreds of village. The composition of the large landowners' group after World War II changed more rapidly than before, as Reza Shah occupied many properties. New

business groups, contractors, bureaucrats, and some army officers bought lands more and more. Thus, while the old families, religious groups, and tribal chiefs still owned many lands, the new groups mentioned also owned large lands as well. These groups included reeves and supervisors (Keddie and Richard, 2006).

Along with the clerics, the landowners and market men strengthened their lost power as conservative forces and showed their power by holding different positions in the ruling coalition. During the 1920's to 1950's, landowners and their relatives made up about two-thirds of the members of the parliament. These representatives repeatedly rejected laws on income tax, land tax, rural development, public education, and land reform (Ashraf, 1980; Francis Bostac and Jones, 2014).

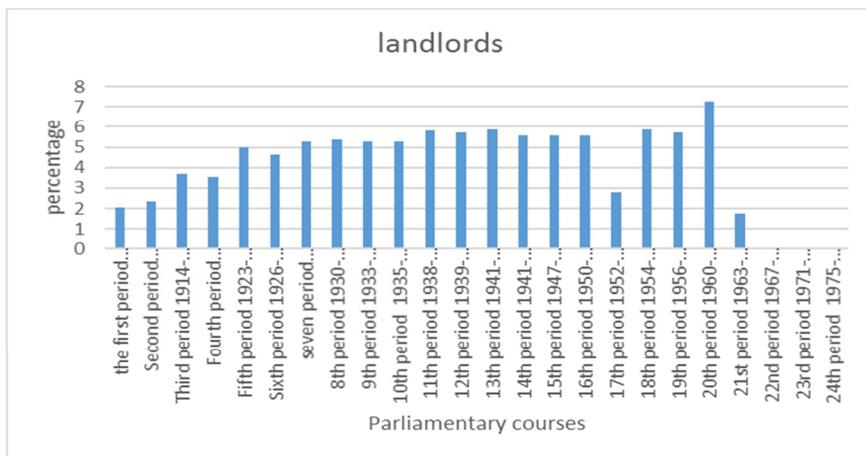
During the Nationalization of the Iranian oil industry, this group stood behind Mossadegh, but after the first few months of Mossadegh's state, the landowners were completely distanced from it because they were frightened from the radicalism of the national movement which put their political and economic position at risk. The country's economic weakness and its resulting reduction in demands not only caused their financial loss indirectly, but more importantly could have resulted in the rise of the Tudeh Party. Mossadegh was destroying the political hegemony they had gained by trying to establish free elections which was not compatible with the natural choice of landowners and their candidates. This is why they joined the Shah's coalition of conservative religious leaders and British and American powers to overthrow Mossadegh (Katouzian, 1981 & 1999).

After the August 19 power struggle and the provision of BLAO, the landowners seized political-economic power for a short period of time. In addition to the village police, they influenced the rulers and other local officials, and they were even able to thwart minor land reforms that were implemented by Qavam os-Saltaneh and Mossadegh, respectively. The landowners were allies of the state until the late 1960s, but oil revenues and US aid increased the Shah's economic and military power, and consequently

his political power to the detriment of landowners. After that, the coalition was completely destroyed by land reform) Keddie & Richard, 2006; Abrahamian, 1982).

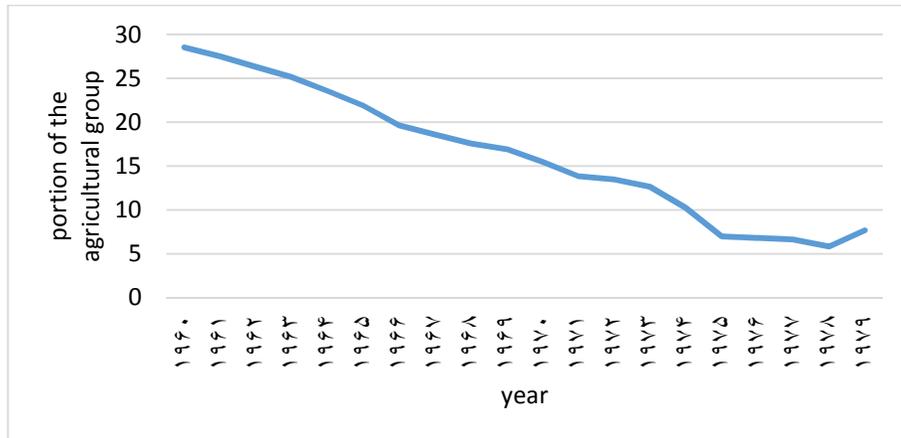
Owing to the discrepancy of land reform policy along with the fact that the state did not need the social classes to be loyal to it, the landowners lost their political influence in legislating and enforcing it, and many of them were shifted in line with new policies (Ashraf & Benoazizi, 1993). Although the landowners lost their political power, their descendants were later able to occupy state positions. It should be noted that a significant number of the new middle-class members were descendants of landowners.

Although they lost their political power in the name of politics and state, members of this class became new capitalists after the White Revolution and land reform by acquiring factories. Then with a variety of kinship, influence, and political mechanisms, they obtained illegal economic, customs, and banking privileges and facilities. Moreover, as a new bourgeoisie, they gained new political power in a new form: the new bourgeoisie's dependence on industry and commerce brought them under state control and into a corrupt support network (Sardarnia, 2007).



**Figures 2:** Percentage of landowners in parliament

**Source:** Islamic Revolution Document Center



**Figures 3:** Share of agricultural production from GDP

**Source:** Central Bank of Iran

Figures 2 and 3 illustrate the process of changes in landlords and landowners on the political and economic market. According to Figure 2, the share of agricultural products in GDP has declined after the oil shock. As per this figure, it is clear that landowners and landlords were unable to increase their economic power during this period, and their power on the economic market was declining after the oil shock. Figure 2 shows the share of landlords and landowners from MPs. According to this figure, landlords and landowners included a large proportion of the representatives during this period from the thirteenth to the twentieth parliaments, and because of the emergence of the Mossadegh state and the decline of their power, this share declined only in the seventeenth round; however, with landlords and landowners exiting the ruling coalition after the 20th parliament, and the replacement of oil revenues with agricultural land amounting to the maintenance and creation of the political and economic power, the MPs' share for the landlords and landowners had fallen sharply. These figures show that landlords and landowners lost their power on both the political and economic markets during the mid-Pahlavi era.

### **iii. Businessmen and Market Men**

In the era of FLAO, i.e. after Reza Shah's removal from power, the market men joined the clerics as a conservative force. Because of the market men's functioning on the political and economic markets in Iran, there was a profound relationship between them and the clergy class, enabling the market's financial resources to extend their religious movements and to go beyond their traditional borders (Motallebi, 2008).

The market at the Second Pahlavi era consisted of three groups: businessmen and beneficiaries who were the smallest, yet the most affluent and powerful group; the shopkeepers were the most organized group on the market, each of which had their own trade union; and the third group were salespeople and sales assistants including street vendors, marketers, etc. (Milani, 2018).

During the Nationalization of the Iranian oil industry, the guild chiefs formed a community of merchants, tradesmen, and craftsmen to support the nationalization of the oil industry.

During the Mossadegh era, the market men and the national bourgeoisie grew, and as a result, offered him their support. As the national bourgeoisie and the market men were becoming stronger, the power bloc composed of the dependent bourgeoisie, the masters, the commanders of the army and the court, suffered a major setback (Ahmad Ashraf, 1971).

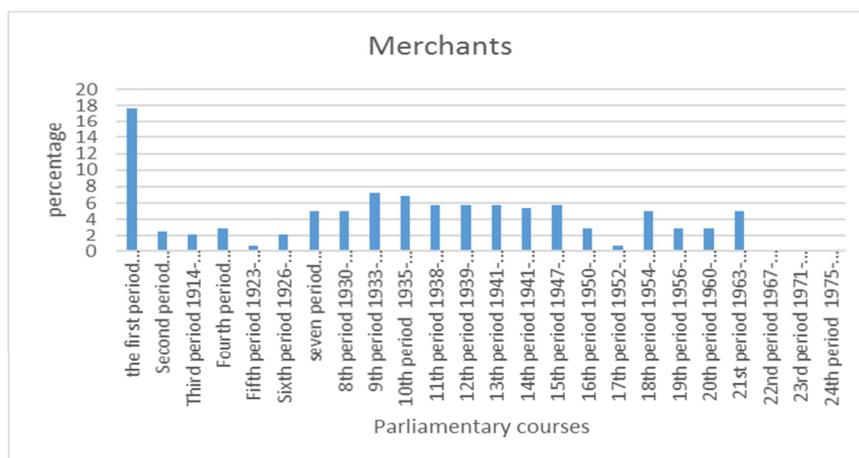
The growth of the market men and the national bourgeoisie reached its peak during Mossadegh's era (1951-1953). Mossadegh's policy was to reduce the Shah's power, strengthen the market men and the national bourgeoisie, and end Iran's dependence on foreign capital (Mazdak, 1982). Iran's economic sanctions following the nationalization of the oil industry helped Mossadegh state pursue this policy more boldly. An import substitution was created to reduce Iran's dependence on foreign products and to resist economic sanctions. Mossadegh's policies resolved the court, the dependent bourgeoisie, the influential lords and clergy, while benefiting the national bourgeoisie and the market men. Not surprisingly, the latter

supported him by heart, while the power bloc opposed him. Supported by Britain and the United States, the power bloc eventually toppled Mossadegh. Mossadegh's fall was a major blow to the national bourgeoisie and the market men, but the dependent bourgeoisie and the owners became more powerful following the coup d'etat. Mossadegh's fall reversed the situation. The power bloc appeared stronger than the past, and the national bourgeoisie and market men were in trouble (Amjad, 1989).

After the 1953 power struggle, due to relative independence the market had gained in BLAO, it could still hold half of the country's handicrafts, two-thirds of retail trade, and three-quarters of wholesale trade. In the years of economic prosperity, the group gained a lot of power, but under the policies of the state, the market gradually fell out of the power bloc, so that despite benefiting from economic growth, it became a staunch opposition to the ruling coalition (Motallebi, 2008).

During Amir-Abbas Hoveyda's premiership, industrial modernization and social transformation changed the class structure. Market forces and social layers faced economic reforms, and state support for the industrial and manufacturing sectors faced many bottlenecks and constraints. As a result, the market and market men gradually became dependent on the rentier state and the world economy. Although the market men made great profits during the period of capitalist development by having significant resources in private sector credit, the state tried to act with political and financial decisions and actions to erode their resistance and opposition. The state was pressuring all investment opportunities and prosecuting or imprisoning any businessman, shopkeeper, and producer who had violated the approved rate by setting prices for goods. The creation of banks and new shopping malls as well as the expansion of Koorosh big chain stores were other causes making market men dissatisfied with the state. As the villagers massively migrated to the cities, many of them became competitors of the urban shopkeepers, and started working as shopkeepers (ibid).

Figure 4 indicates the market men' power on the political market. According to this figure, it seems that the market men did not have much power in the parliament. Their power has also diminished on the political market during Mossadegh's state; they have also lost their power on the political market after the twentieth parliament.



**Figures 4:** Percentage of Merchants in parliament

**Source:** Islamic Revolution Document Center

#### iv. Clerics

Clerics have always been the focus of the ruling coalition because of their social status in the society. When a class is politically or socially empowered in a society, it attracts the attention of stakeholders. The cleric class was no exception. In order to maintain its social and political standing, the clergy should also obtain and maintain financial resources, so that an analysis of the financial resources of clerics can describe or predict some of their actions and reactions. Endowments and Imam's share as the largest resources of clerics' income during this period were threatened and triggered by clerics' reaction (Kamali, 2018).

Clerics, as one of the conservative groups in FLAO, regained their power and played a significant role in the nationalization of the oil industry, but ideological discords between Mossadegh and clerical leaders as well as no realization of clerics' financial resources caused them stop supporting Mossadegh.

After the power struggle on August 19, 1953, in particular the June 1963 incident, conservative forces, especially the clergy, withdrew from the power bloc following the increase in the Shah's power. During this period, the clergy organization was consisted of four distinct groups:

- Non-political scholars
- B. Court scholars
- C. The moderate opposition clerics who did not seek the overthrow of the state but wanted the implementation of the constitution and especially the principle of balance or the supervision of the 5 mujtahids over the approvals of the National Assembly.
- d. Revolutionary clerics (Muzaffar, 2008: 247).

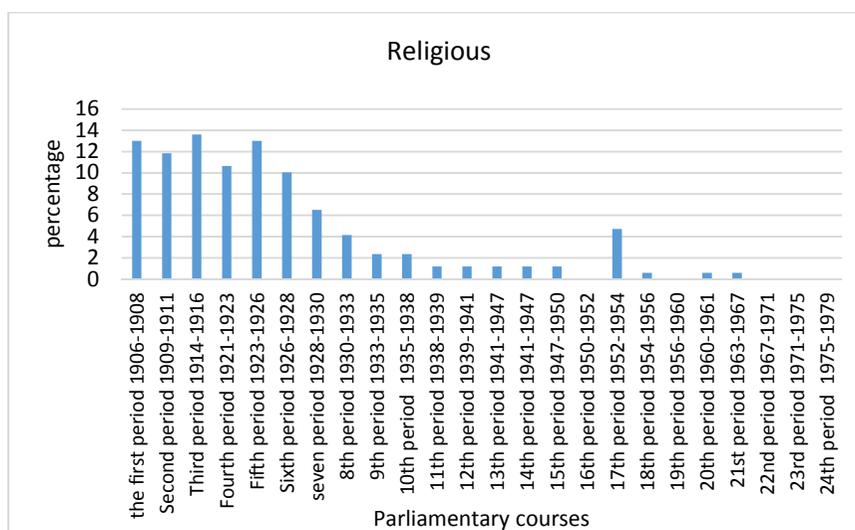
During the BLAO, the economic boom of the 1960s helped religious organizations because it allowed high-income market men to finance the expansion of schools and seminaries, but clerics were among the groups who lost their rent resources due to the other function of Mohammad Reza's monarchy, i.e. the promotion of popularity of royal ideology with an archaist tendency, the prevalence of secularism along with the white revolution and modernity. This led to clashes between the clerics and the Shah.

After the growth of oil revenues, the quality, financial independence and political power of the state increased compared to the wealthy classes and religious institutions. The growth in state bureaucracy made the demand and supply of Western-style education increase, which became the most important channel for accessing high-ranking state officials and the interplay of these changes with other material and ideological factors pushed the religion and the religious community to the margins of socio-political structure (Katozian, 1987). During this period, considering the archaism

ideology, secularization of the society, and modernism, the state undermined the power of the clergy directly and indirectly, portraying the king as a progressive leader and calling the clergy the guardians of the Middle Ages: The state established the imperial calendar in 2535 Instead of the lunar and solar Hijri calendars. The state had also sent The army to the villages to teach the true Islam to the peasants, Closed the printing house of religious books, took over the endowment administration, dissolved religious student organizations, passed the new family rights law and raised the age of marriage and in marital matters, it gave women more rights which were not in line with conventional Islamic laws. In addition, the state subjected the opposition clergy to direct attacks, arresting, deporting, and torturing dissidents. The bill of state-provincial associations had already been approved and had caused the dissatisfaction of the clergy (Foran, 2009: 500). The Amuzegar state's austerity plan also led to the cessation of secret payments made to some scholars from a secret fund, leading to the loss of support for the ruling coalition by some scholars and even their placement in the queues of regime opponents (Milani, 2001).

The important point in this period was the existence of a powerful religious system which secretly operated against the ruling coalition. Just as SAVAK was busy eradicating the mass and frontal organizations (and after a while the guerrillas), Ayatollah Khomeini and his supporters quietly, and without attracting much attention, laid the foundations of a powerful nationwide network and they eventually could defeat the ruling coalition (Milani, 2013: 368).

Figure 5 shows the power of the clergy on the political market. During this period, it seems that they did not have much power in the parliament except for a brief period under Mossadegh's state.



**Figures 5:** Percentage of Clerics in parliament

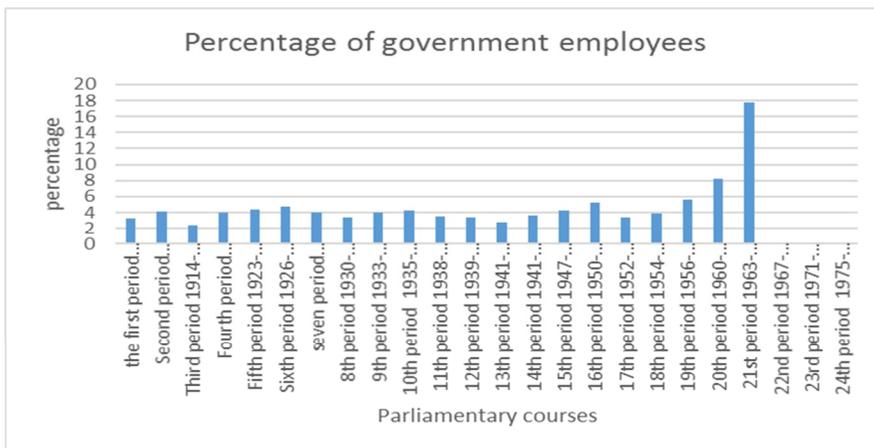
**Source:** Islamic Revolution Document Center

#### v. Bureaucrats

During the BLAO, the bureaucrats had access to rent resources as they were another power pillar. At the top of the pyramid of the state bureaucracy were the prime ministers, deputy ministers, advisers, and chief executives, who achieved high rents and privileges in the industrial and commercial sectors. Distributing parts of the oil revenues and rents to senior officials and ministers, the Shah made them great capitalists. Other high-ranked and lower-ranked employees and the lower benefited from economic corruption in smaller sizes and lower sums. Partnering with the state officials in economic corruption, the state system significantly undermined their critical power, turning them into a mere yes-men. Fear of power, flattery, insecurity, personal abuse, and similar traits were among the characteristics of the employees and superordinates of the Second Pahlavi era (Sardarnia, 2007). In appointed states, state and embassy positions and jobs were given to officials via paying large bribes; these jobs could be given to those who were never specialized in the assigned affairs. The influence of wealth and power

holders on statesmen and ministers had reached a point where it could even make Iran's economy face a crisis. In the 1960s and the first five years of the 1970's, The employee class did not oppose the state because of the benefits of economic growth and other rewards they were entitled to. During the economic boom, the number of middle-class wage-earner members increased from 3 million to 6 million individuals. Because of the economic boom and the shortage of labor, women's role was highlighted in this class especially in the education system. The state system greatly reduced the ability to question and criticize the state's plans and opposition to these groups by making them financially dependent on the superordinates and turning them into yes-men and supporters. However, due to increased repression, lack of participation and economic crisis, employees eventually joined the opposition (Azghandi, 2009).

Figure 6 indicates the share of bureaucrats in parliament. During this period, the share of this group of the ruling coalition members has been increasing, and the share has increased dramatically since the change in ruling coalition members and the replacement of conservative forces by technocrats.



**Figure 6:** Percentage of bureaucrats in parliament

**Source:** Islamic Revolution Document Center

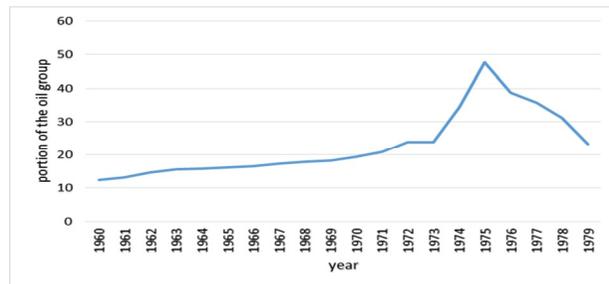
**vi. Industry owners and investors**

During this period, the state, the private sector, and foreign investment were the three arms of industrial development. The major areas of domestic investment were the light, construction, and banking industries. Local investors in the Shah's era demanded a range of landowners, prominent and old urban families, old industry owners, market traders, and senior officers (Foran, 2009). At the heart of the modern capitalist and bourgeoisie class of the capitalist and industrial bourgeoisie, which resulted from the modernization, creation, and expansion, were 300 families, of which 70 families accounted for more than 17% of modern industry, and a significant proportion of them were relatives and family members of Mohammad Reza Shah. In order to accelerate their wealth and obtain amenities, these families began to partner the Pahlavi family in the stocks of their corporations and units (ibid). To make the bourgeoisie permanently dependent on himself, the Shah used the strategy of issuing commercial and production licenses and setting up special agencies for foreign companies (Sardarnia, 2007).

The Shah's state established banks such as the Omran Bank, Tose'e Bank, and Bank of Industry and Mine along with other banks to assist the state's affiliated private sector. During the third development plan (1972-1988), private investment received 46% of its resources from the state with foreign resources. In the Shah's privatization program, the Pahlavi family was at peak of the power pyramid, and superordinates and senior officials, deputy ministers, general managers, and military commanders were in next ranks (ibid). The emergence of the ruling coalition into manufacturing relations led to the move toward rentier relations because the costs which should be involved in upgrading technology and manufacturing relations were spent on rentier relations. The contribution of this stratum of the ruling coalition to production relations and creating short-term economic security through political solutions and political relations caused that industrialization in Iran be merely a decorated model of global industrialization.

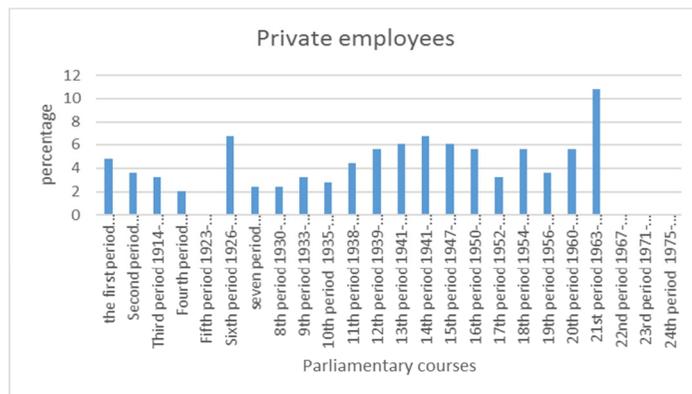
Foreign investors could derive their profits from Iran. Foreign investment was not very significant except for the oil industry, but the sale of foreign goods and foreign personnel were much more significant (Keddie, 2006). The traditional Iranian bourgeoisie had also accumulated enormous wealth in the process of industrialization of Iran. In early 1972, the traditional petty bourgeoisie and its disciples made up more than a quarter of the urban workforce (Ashraf, 1995). The conversion of productive relations into rent relations and the lack of rule-of-law, and consequently the systematic corruption among ruling coalition members along with limited political and economic space, led to the outflow of capital from investors and the ruling coalition abroad.

In the wake of the economic crisis and the subsequent high inflation, state policies led industry owners and market men to join the opposition group. By threatening the industry owners, the state set a minimum wage and, in many cases, forced them to accept the workers' request for raising wages. These policies were regarded as a kind of an unjustified state intervention in the marketplace and met with fierce opposition from the industry owners. In order to control inflation, the state implemented a price stabilization and anti-overcharging plan. The Battle of Inflation Reduction began in 1975 with a one-month deadline from the state for the private sector to voluntarily reduce prices and the rents (Milani, 2018). Prices were stabilized and the army did not act, but this time the cure was worse than the pain itself, and sent a large number of businessmen to the Shah's growing opposition (Milani, 2008).



**Figure 7:** share of oil in GDP

**Source:** Central Bank of Iran



**Figure 8:** Percentage of private employs in parliament

**Source:** Islamic Revolution Document Center

Figure 7 indicates the share of oil in GDP. According to this figure, the share of oil in GDP has increased sharply after the oil shock.

Figure 8 indicates the share of private sector representatives in parliament. This share has changed less during this period than other members of the ruling coalition.

### 5. Iran with natural state

In this research, Iran's transition from the NS during the Second Pahlavi era was analyzed and the following results are obtained:

**i. Coalition or Conflict**

In the first phase, following Reza Shah's resignation from power and the World War II, conservative forces sought to restore their power in a FLAO. The young king saw his legitimacy for power in association with those groups; therefore, clerics, market men, and landowners formed the ruling coalition alongside the court (Abrahamian, 1982). With the expansion of the ruling coalition and the growing influence of the Allies in Iran, the ruling coalition, and especially the court, was unable to expand and stabilize its power, and it could at any time be removed for external or internal reasons (Milani, 2011).

During this period, Mohammad Reza Shah's power depended primarily on the military and, to a lesser extent, on conservative and monarchist factions and the press (Foran, 2009). The king, who had come to power based on an agreement with foreign agents and some domestic forces to form a coalition instead of a conflict, experienced a chaotic atmosphere in the country for a variety of reasons such as war, famine and drought. When the surrounding circumstances calmed down, the power-seeking groups dominated FLAO over the society, which was due to the political openness and intense interference of foreign agents in the country. It made grounds for the creation of violence in Iran.

Following the collusion of some conservative forces in the course of the nationalization of the oil industry and the fall of the Mossadegh state, Mohammad Reza Shah, aiming at implementing reforms, gradually replaced young technocrats with the conservative forces with the help of oil revenues, foreign aid, and provision of grounds for BLAO. After the June 1963 incident, the conservative forces either left the ruling coalition and joined the opposition outside the ruling coalition, or like landlords, changed their nature and tried to be part of the ruling coalition in the new structure (Milani, 2008).

After the 1953 power struggle and the provision of grounds for BLAO, bureaucrats and industry owners formed the ruling coalition alongside the court. During this period, the king was able to revive his power with the help

of the United States, oil revenues, and military forces. A return to his father's era, King's rule over affairs was exacerbated under the influence of oil revenues. The increase in oil revenues made the Shah no longer have to form a coalition. Therefore, he became unrivaled on the political market by making all the ruling coalition members and social groups dependent on himself. He also suppressed the groups who were left out of the ruling coalition and caused violence from time to time. Eventually, the decline in oil revenues which had empowered the ruling coalition, in particular the king greatly, left the king alone against the middle class and conservative forces. In fact, Shah had no coalition anymore to support the Pahlavi dynasty. The limited rationality and high temporal preference rates among the ruling coalition members prevented them from finding out that the coalition was more profitable in the present situation, so they opted for conflicts rather than the coalition so as to gain more in the new structure.

#### **ii. Organization with Personal and Impersonal Relations**

In the second phase, until the 1953 power struggle, conditions for impersonal relations were not provided and little effort made by the Mossadegh state to do so did not obtain any result due to the chaos and FLAO. Moving toward the formation of impersonal relations can cause groups which have fallen out of the ruling coalition to gradually enter the realm of power in a process of creative destruction rather than creating violence. In this period, however, the ruling coalition had access to a huge rent resource and did not allow such a process to form. Backed by this wealth, the leadership of the ruling coalition made all affairs become focused on him and, given the power he had gained, he paved the way for the promotion of flattery and hypocrisy of his subordinates and, hence all affairs end to the king himself. The king had full control over the bureaucratic and military structures. The Shah intervened in all matters despite calling himself an irresponsible official (as cited in Dehbashi, 2014 & Nasr, 2000). The reports were given directly to the Shah by the chiefs, leading to uncoordinated, top-down orders from the

top (Katouzian, 2012). For flattery, the Shah's entourage avoided reporting realities and giving him feedbacks of the society, causing the country's fundamental decisions be made while the king highly neglected the affairs. The flattery led to efficient managers being dismissed and all the success be attributed to the Shah. The Shah took advantage of all the improvements and achievements, and ultimately was considered responsible for all failures and disappointments (Milani, 2011). Under the conditions of NS, maintaining post-crisis conditions depends heavily on the personality of the leaders. During this period, like other times the country was in crisis, the king did not perform well and could not prevent the collapse of the ruling coalition. In times of crisis, the king was always hesitant, meanwhile he sought the origin of the crisis not in domestic factors but in foreign conspiracies; hence, his solutions to the crisis were more focused on those plots (ibid). For the sake of establishing his power, the king caused division among the country's political superordinates, leading to costly rivalries among them, a disagreement among them under critical circumstances and they even tried to destroy each other under such conditions. The lack of consensus among the superordinates prevented unified decisions during this period, causing hasty decisions made late in this period to in turn prevent the country from surviving the financial crisis which gradually turned into a political one. As a result, the ruling coalition was overthrown (Majidi, 2012; Katouzian, 1981).

### **iii. Rent Distribution**

As society moves to the FLAO end of a continuum, the creation of a sustainable corporate rent will gradually give way to a more personal and less sustainable rent. The oil shock of this period made the Shah's power astonishing; hence, he took control of everything. Under these circumstances, rent distribution shifted to personal rather than an organized and impersonal one, leading the society to move toward FLAO rather than MLAG. In the post-Mossadegh era, rent-seeking groups included the court

family, bureaucrats, employees, urban class, especially workers, military men, market men, some clerics, opposition leaders and industry owners.

In all BLAOs, the shift in global prices, which alter shared rent resources, will either force or allow the dominant coalition members to restructure their communities. The increase in oil revenues expanded the scope of the ruling coalition, and young technocrats took advantage of more rent resources alongside the military men. The enlargement of the state because of the increase in its oil revenues added to the number of its affiliates. A new middle-class including employees as the major part of the middle-class, the educated, managers, technicians, self-employed business owners such as juris-consults, physicians and engineers, joined the ruling coalition. But later, after the oil crisis and the decline in oil revenues, these middle-class groups no longer supported the state (Katoozian, 1981; Azghandi, 2009).

Guided by the state, the rentier economy, the land reform and the modernization plan in the 1960s and 1970s provided significant new resources and opportunities for nouveau riches to gain economic privileges, wealth, dignity, and power. On the one hand, the Shah made the structure of political power highly monopolistic and concentrated, and on the other hand, by pursuing and implementing economic plans, he expanded socio-economic groups and interests. In the industrialization process, the state expanded its authority over economy as an important lever to consolidate its personal foundations. The state-controlled investment in heavy, infrastructure, and oil and gas industries. In the rentier and greatly state economy structure, economic modernization created a private, state-dependent sector. Modernization created new resources of power, wealth, rent and increasing facilities which became a major route of economic corruption and more wealth accumulation (Sardarnia, 2007; Katouzian, 2012).

Given the existence of LAO in Iran, it was expected that after the decline in oil revenues and the critical conditions in the country, the dominant coalition dynamics would focus on old or new rents which would make cooperation last and limit violence. These dynamics were also expected to

create new rents for this purpose, but disappointment of the ruling coalition about the future of the country prevented the creation of new rents in this period. A sharp state budget deficit would not allow the ruling coalition to distribute oil resources. The king also believed that he would survive the crisis aided by foreign agents. Many market men and industry owners were also from religious minorities, and because of the lack of social security, the maintenance of existing atmosphere was risky for them, so they preferred to take their capital out of the country. Foreign investors were also able to export their capital, so they did not try to maintain or improve the existing conditions. The middle-class, and above all the bureaucrats, made attempts to exploit these rent resources in a more open political atmosphere and felt that the king would return to his former position after the financial crisis. Given the resulting conditions, the clerics, too, saw their interest in overthrowing the Pahlavi state, and eventually came in line with other opposition groups despite their ideological differences. Moreover, Marxist slogans did not allow the workers to interact. The lack of rent resources made the Shah no longer being able to keep his supporters in the ruling coalition, and eventually, he was left alone with popular protests, and even parts of the ruling coalition joined them in order to be able to benefit from more abundant rent resources in forming a new regime. Taken together, these factors led the country to move to a FLAO and finally chaos rather than threshold conditions and move towards a MLAO.

## **6. Conclusion**

According to North's theory of the Natural State, Iran experienced a period of chaos and then a FLAO from 1941 to 1953, and after the 1953 power struggle, the conditions of BLAO were established in the country. But as the country was expected to meet the threshold of transition from NS, it eventually moved to fragility and collapse. To answer the question of why the country moved towards FLAO, an analytical narrative about elements such as superordinates, formal political and economic institutions, and rent

resources was presented in the form of the Governance Diamond Index. In the early Second Pahlavi reign, conservative forces (landowners, market men, and clerics) formed the ruling coalition alongside the court; but after the 1953 power struggle, the Shah removed conservative forces from the ruling coalition with the support of the increase in oil revenues, foreign aid, and military forces. Under the shadow of young technocrats in state positions, he made all affairs rely on himself so that the rent resources were distributed unproductively. Power struggle during this period did not allow for power concentration and therefore the production and survival of inclusive institutions. Due to the uncertainty, which was mostly influenced by the strategic position of the country and imposed on the country by foreign agents, investors Pursued their short-term economic goals due to hopelessness about the future of the country and lack of belief in long-term goals. In fact, the strategic position of Iran caused the political and military goals to dominate the economic goals, and this was considered by both foreign agents and the domestic political superordinates to make Iran a place for temporary economic investments by the superordinates. Production relations were also affected by rent relations, and investors dominated by rent relations could continue their activities. In the period after the power struggle in 1953, despite the concentration of power, the ruling coalition itself produced extractive institutions using the repression instruments on the political and economic markets instead of making grounds for the creation of inclusive institutions. Increasing state interference in production relations led to the dominance of rent relations on this market, and finally, with the creation and continuation of extractive institutions and the failure to meet the threshold conditions of transition from the NS, the country moved toward Vicious Cycles.

Lack of the rule of law for superordinates, domination of personal relationships and the non-formation of permanent organizations, military men's control over political and economic affairs, unproductive rent distribution, imbalance in political and economic development, emergence

of oil resources, conservative forces going out of the ruling coalition, existence of hereditary institutions, advent of young technocrats into the political market, the Shah's dominance over all affairs, uncertainty about the country's future, domination of political goals over economic activities, the military men's interference in economy, large numbers of foreign investors, experience of the financial crisis of 1959, conflicts between public expectations and state performance, limited rationality and high time preference rates between superordinates and social groups survived NS during this period and eventually movement toward FLAO.

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SG data analysis and writing, MR conceptualizing the idea, AS conceptualizing the idea, MM conceptualizing the idea. All authors read and approved the final manuscript.

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There is none.

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