ISLAMIC REPUBLIC OF IRAN
SELECTED ISSUES

This Selected Issues paper on the Islamic Republic of Iran was prepared by a staff team of the International Monetary Fund. It is based on the information available at the time it was completed on March 7, 2018.

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International Monetary Fund
Washington, D.C.
ISLAMIC REPUBLIC OF IRAN

SELECTED ISSUES

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DEVELOPING THE DOMESTIC GOVERNMENT SECURITIES MARKET IN IRAN:

- The authorities have intensified efforts to develop a domestic government securities market. The Debt Management Office (DMO) is fully staffed with front-mid-back office functions. An electronic issuance system and effective custody and settlement systems are in place.

- A public debt law that identifies the Ministry of Economy and Finance’s (MOEF) role as the sole issuer of government securities and requires the preparation and publication of a medium-term debt management strategy, annual borrowing program, and publication of debt and asset data would enhance transparency and provide investors greater assurance about the government’s capacity to repay debt and ultimately lower borrowing costs.

- A pre-announced issuance calendar, streamlining the number and type of securities issued, and competitive auctions would provide greater clarity and increase liquidity in the market.

- A market based monetary framework would make it less risky and cheaper for investors to warehouse securities on sale and to fund trading portfolios, and provide much needed liquidity to the securities market.

- As the market develops, the authorities should move to a primary dealer system to aid diversification of the investor base and foster deeper markets.

A. Current Structure

1. The Iranian government is seeking to develop the domestic bond market under the Sixth National Development Plan (NDP). It established the DMO in 2015 which compiled data on the government’s arrears, and increased the size and pace of issuance of government securities to clear arrears and finance the budget deficit. The on-going audit of arrears has revealed government arrears of about 30 percent of GDP which brought the debt-to-GDP ratio to near 50 percent in 2016/17. The audit shows that the central government’s (CG) arrears are owed to banks, private contractors, and social security institutions.

1Prepared by Selim Cakir and Tohid Atashbar (Senior Researcher at Majlis Research Center of Iran).
2. **The deficit and gross funding needs of the CG are set to rise as securitization of arrears and financial sector reform advance.** The CG interest bill is expected to reach 4.8 percent of GDP by 2019/20 reflecting both bonds issued for bank recapitalization and securitization of arrears. The CG’s gross financing need is projected to rise from 4.5 percent of GDP in 2017/18 to about 15 percent of GDP in 2019/20 (IMF Country Report No.18/xx, Appendix II, Public DSA).

3. **Faster development of the government securities market would help overcome Iran’s limited access to international capital markets and lower its recourse to monetary financing of the budget.** A mature securities market could offer a wide range of instruments to fund the government deficit. It would provide a benchmark yield curve, and reduce the need for direct and inflationary monetary financing of fiscal deficits. It can also strengthen the transmission and implementation of monetary policy.

**B. Government Securities Issuances in Iran**

4. **Following the establishment of the DMO,** government securities issuance has gained pace. The first government Sukuk issuance in the form of Al-ljara (rent) was in 2015 and Morabaha (cost-plus) Sukuk in 2016. These securities carry maturities of two to five years and their return/profit is set around 20 percent. The Planning and Budget Organization (PBO) provides the guarantee for repayment through budget resources. The government has issued Participation Papers (Musharakah) since 1997 to finance projects and procure raw materials.

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3 The DMO is a Center reporting to the Minister of Economic Affairs and Finance. The Minister has delegated day-to-day management to the Treasurer General, to whom the Head of DMO reports. DMO has 45 staff and back-mid-front office functions are in place.
5. **Islamic Treasury Bills (ITBs) comprise the largest share in government securities issued.** The MOEF started to issue ITBs in 2015 to clear the government’s arrears to its contractors. ITBs are zero-coupon securities, sold at a discount from face value. The contractors sell the ITBs they receive from the government at the bond market established in Iran Fara Bourse (IFB). ITBs carry maturities of 4 months, 6 months or 1-year. The average maturity of borrowing has declined as issuance of ITBs gained pace. The government also issues settlement papers for off-setting tax obligations and expenditure arrears between the government and contractors. To date, the government has issued ITBs that cover 4.6 percent of total stock of arrears.

6. **Iran’s Law on Issuance of Participation Papers (1997), Law on Facilitating Competitive Production and Improvement of Financial System (LFCPIFS, 2015), and annual budget laws provide the legal basis for government securities issuances.** The issuance of securities is done under the supervision of a Sharia committee which is a high-rank board in the Securities and Exchanges Organization (SEO).

<table>
<thead>
<tr>
<th>Types of Bonds</th>
<th>Legal Basis</th>
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</thead>
<tbody>
<tr>
<td>Participation Papers (Musharakah)</td>
<td>1997 Law on Issuance of Participation Papers</td>
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<td>Morabaha Sukuk</td>
<td>LFCPIFS</td>
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<td>Al-Ijara Sukuk</td>
<td>LFCPIFS and Annual Budget Laws</td>
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<td>Settlement Papers</td>
<td>LFCPIFS and Annual Budget Laws</td>
</tr>
<tr>
<td>Islamic Treasury Bills</td>
<td>Annual Budget Laws</td>
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</tbody>
</table>

7. **While the bulk of the securities are issued by the MOEF, line ministries issue securities as well.** For example, the Ministry of Agriculture issued ITBs to settle its debt to farmers from wheat purchases and the Ministry of Welfare and Social Security issued ITBs to settle its debt to health insurance companies, both in 2015/16.

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4 By November 2017, the MOEF issued Rial 50,000 billion (3.4 percent of GDP) of settlement papers.
Development of an Efficient Government Securities Market in Iran

8. **Macroeconomic and financial stability will be critical to build an efficient government securities market in Iran.** Lack of access to international markets and a paucity of institutional investors could hamper the development of an efficient market. Volatility in growth and inflation, strong liquidity growth, and lack of a market-based monetary policy, will have to be addressed to build investor confidence.

9. **Some basic pillars will have to put in place to develop an efficient and liquid primary and secondary government securities market:** (i) a solid legal framework; (ii) a clear and transparent debt management and execution strategy that provides clarity and predictability; (iii) well-functioning systems for trading, clearing, custody, payment, and settlement; (iv) a well-designed market-based monetary policy; (v) non-distortionary taxation of financial instruments; (vi) efficient and market-based sales methods, and; (vii) a diverse investor base, i.e., a combination of banks and institutional investors, both domestic and international.

Legal Framework

10. **The borrowing authority for government should be issued solely to the MOEF.** This would strengthen control over debt, provide clarity to market participants, reduce the cost of borrowing for the government and improve treasury management.\(^6\) A public debt law identifying the MOEF as the sole issuer of government debt and setting out the necessary governance, audit, reporting and accountability processes would provide potential investors greater legal clarity and improve transparency. The law should require the government to develop and publish a debt management strategy, prepare an annual report on its debt management activities, and report on its debt and asset position. This would make the government’s objectives clearer to investors and provide the data necessary for investors to assess and be assured of the government’s capacity to repay its debt obligations in a timely manner. The MOEF is preparing a draft public debt law and has requested IMF TA assistance.\(^7\)

Debt Management Strategy

11. **A sound debt management strategy (DMS) is key to the sustainable and efficient management of public debt.** A DMS is a plan for the evolution of the public debt portfolio that operationalizes the debt management objectives given the constraints, and specifically the government’s preferences with regard to cost-risk trade-offs.\(^8\) The currency composition of the

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6 See Awadzi (2015)
8 See the World Bank, International Monetary Fund (2009).
public debt portfolio is also a channel through which external shocks can impact the fiscus. For example, in Argentina, Brazil, Indonesia and Russia exchange rate depreciation led to a sudden rise in public debt. In other cases, the realization of large off-budget arrears and or contingent liabilities led to steep jumps in government debt. In other countries increased reliance on short-term debt came at cost of increased vulnerability to rollover risk when debt came due. Such experiences highlight the importance of developing effective debt management strategies to mitigate such risks.

12. **The authorities should develop a DMS and make it public to help build investor trust and ultimately lower borrowing costs.** Although the annual budget laws provide a ceiling for types of securities to be issued, there is no pre-announced issuance calendar, debt statistics are not published, and the objectives of debt management are not clearly defined nor publicly disclosed. A DMS that defines the scope of debt management with an emphasis on the preferred risk profile of the debt portfolio would aid debt market development. The strategy could review the instruments available for issue, set targets for the pace of securitization of arrears, a minimum average maturity/duration for debt and maximum share of short-term to long-term debt, currency composition, and interest rate structure (fixed vs floating). A strategy proposal prepared by the DMO should be discussed with the CBI and the PBO to ensure greater coordination between monetary and fiscal policies. Once approved, the strategy should be made public and reviewed at least annually.

13. **The DMS could be operationalized through an annual borrowing program.** The program should present information on the government’s annual financing requirement and strategy to meet this need through domestic and external capital markets. The annual borrowing program would provide information on the types of securities to be issued and their timing. As the market develops, the program can include information on buybacks and exchanges.

14. **As part of its annual borrowing and debt program the authorities need to develop a clear strategy to securitize the remaining arrears.** The plan would communicate to stakeholders the government’s plan, timetable, and criteria for the liquidation of arrears, thereby providing private contractors greater certainty about payment prospects and assure contractors all that selection of creditors to be paid is determined according to clearly understood criteria.

**Settlement and Clearing System**

15. **Iran has a well-functioning securities settlement infrastructure.** The accounts for the securities are automated, the custody arrangements for the recording of securities ownership remain under the IFB, and the settlement system allows for T+1 settlement with delivery versus payment arrangement. Electronic platforms work to lower the cost, eliminate delays in trading and settlement and help protect against theft or forgery. IFB provides efficient and low-risk settlement facilities. From the market supervision perspective, the current system provides comprehensive,

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9 See Jaramillo, Mulas-Granados, Kimani (2017).
timely, and reliable information on holders of government securities and on trading developments. It also allows the government to introduce an efficient tax system on securities, if the government chooses to introduce one. The IFB also acts as the central depository. The depository facility at IFB has the ability settle forward trading and repurchase agreements as two successive spot deals. The market is supervised by SEO.

Money Market

16. **An active liquid money market greatly assists the development of a well-functioning government securities market.** A well-functioning money market supports the securities market by increasing the liquidity of bonds. It makes it less risky and cheaper to warehouse securities on sale to investors and to fund trading portfolios of bonds.

17. **A market-based monetary policy framework would improve the effectiveness of monetary policy and aid the development of the money and the securities markets.** (see IMF Country Paper No. 17/63). Replacing the directed credit target and interest rate caps with a market-based framework that sees the CBI policy rate consistent with the CBI’s inflation target and the funding of healthy banks at the CBI’s policy rate against collateral would help foster a deeper money market. The sizable offset operation proposed in the 2018/19 budget, under which government debt to contractors will be offset against the outstanding debt of banks to the CBI, could provide the CBI securities that would enable it to conduct open market operations. Therefore, it is essential that the government securitizes its debt to the CBI with tradable securities bearing market interest rates. In addition, the securitization of government’s arrears and the recapitalization of financial system through issuance of government bonds would provide the financial institutions with high quality collateral to access the CBI’s liquidity facilities. These, in turn, would provide the securities market with much needed liquidity for its development.

Taxation

18. **Taxation of government securities has significant implications for market development.** Taxation of capital gains and income from securities affects consumption-saving and investment decisions and the demand for financial assets and investment.

19. **The return on financial instruments, including earnings from government securities, are exempt from capital gains and income tax in Iran.** While the current system achieves tax neutrality and should help the development of financial markets, as financial markets deepen, the government should consider taxation of financial instruments to protect and improve the revenue base. Any new taxes, nevertheless, should ensure tax neutrality through equalizing effective tax rates across various financial instruments.
Issuance Techniques for Government Securities and Diversifying the Investor Base

20. **The DMO should consider using competitive price auctions as its main distribution channel for selling government securities.** Currently, state banks conduct sukuk sales on behalf of the government in the IFB securities market. The price of the securities is fixed and the state banks collect bids for amounts. The process can last for a week, on occasion, to reach the intended sales amount. A syndication of banks issues the securities, the banks receive a fee but they do not underwrite the sales. The securities remain on sale with fixed prices for a period. While this methodology could be appropriate for relatively small and infrequent issuances, the government will need to borrow from the markets more frequently and in bigger amounts to fund its deficit and competitive price bidding auctions could better meet its cost objectives.

21. **In the medium-term, the authorities could consider reopening previously issued securities to build benchmark issues to enhance market liquidity.** This would reduce the liquidity risk premia in the yields of government securities. To avoid refinancing risks with building benchmark issues, spreading the maturity profile across the yield curve, buybacks, exchanges, or switches of older issues with new issues can be used.

22. **Currently the investor base in government securities is not very diversified.** According to the IFB, about 80 percent of the bonds are held by Asset Management Companies that are owned by local banks. Banks hold only a small portion of bonds in their own balance sheets. Foreign ownership is about 10 percent, and the remainder is held by individuals and corporates. The implementation of the pension reform (see IMF Country Paper 18/xx, Box 3) could make pension funds important investors in the government securities markets in the medium-term.

23. **In the medium-term, introducing a network of primary dealers or market makers could help diversify the investor base and foster deeper and more liquid markets.** The incentives and obligations as well as eligibility criteria to become a primary dealer need to be clearly defined and disclosed. While it is premature for Iran to consider a primary dealer system, following restructuring of the financial system and adopting a market-based monetary framework, the authorities could consider introducing a primary dealer system.

24. **To ensure investor diversity and sustained demand at treasury auctions, the authorities could target inclusion in the international bond indices in the long-run.** This would require (i) local bonds to be traded on an international clearing house; (ii) a certain size for a single bond issuance in local currency; (iii) existence of primary dealers to ensure liquidity and consistent bid/ask spreads; (iv) market liquidity to reach certain level of transaction volume.
References


EXPANDING IRAN’S NON-OIL EXPORTS

- Natural resources dominate Iran’s exports but account only for a small share of Iran’s GDP.
- Iran needs to expand and intensify its trade with more partners to grow non-oil exports.
- Improving Iran’s export competitiveness, attracting more foreign direct investments, removing barriers to trade and developing bilateral and multilateral trade agreements would aid Iran in reaching its targets for the development of the non-oil export sector.

A. Current Status of Non-Oil Exports

1. The comparatively low share of oil exports to GDP reflects Iran’s relatively large and diversified economy. Natural resources dominate Iran’s exports representing almost 53 percent of total exports but account only for 12.3 percent of Iran’s GDP. Iran exports more products than the average of MENA countries but many of its products are closely related to the oil sector (such as plastic and rubber products).

2. Iran’s overall level of non-oil exports as a share of GDP and the degree to which it trades with other countries is low. Non-oil exports represent only 11 percent of GDP, in line with other oil exporting countries (who on average export 10.4 percent of GDP) but are low compared to upper middle-income (who on average export 24.2 percent of GDP), reflecting the legacy of import substitution, a reliance on domestic markets, and the impact of sanctions. Iran trades with relatively few countries. Iran exports its non-oil exports mainly to the largest economies in Asia (colored in red in the tree map below), with 37 percent of its non-oil exports going to China. Exports to Europe (colored in purple)—which represent a non-oil market 40 percent larger than the Asian one—remain subdued.

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1 Prepared by Magali Pinat.
3. **Iran needs to expand and intensify its trade with more partners if it is to increase non-oil exports and achieve the Sixth Development Plan target of growing non-oil exports to 15 percent of GDP by 2020.** Examining Iran’s main exports in three broad goods categories highlights the opportunities for Iranian non-oil exports:

- **Polyethylene** (top export of plastic and rubber category, representing 11.6 percent of Iran’s non-oil exports). Iran mainly exports this good to China (84 percent) and Turkey (10 percent). However, the large European market—which imported US$ 9.5 billion of polyethylene in 2015 and accounted for 35 percent of the global market — is largely underexploited.

- **Car parts** (top export of the transportation category, representing 0.1 percent of Iran non-oil exports). Iran mainly exports car parts to a small set of countries in Europe, namely Turkey (72 percent), France (24 percent), and Russia (3 percent).

- **Pistachios** (top export of the vegetable category, representing 5.9 percent of Iran non-oil exports). Iran exports pistachios to a large share of world buyers.
Figure 1. Exploring New Markets: Where Do and Can Iran Exports Go? 3 examples (share of product exported, 2015)

**Plastic and Rubber: Polyethylene**

*Countries importing Polyethylene* (total of USD 27.6 billion)

*Countries importing Polyethylene from Iran* (USD 1.6 billion)

**Transportation: Car Parts**

*Countries importing car parts* (total of USD 9.6 billion)

*Countries importing car parts from Iran* (USD 15.3 million)

**Vegetables: Pistachios, Fresh or Dry**

*Countries importing pistachios* (total of USD 2.5 billion)

*Countries importing pistachios from Iran* (USD 793 million)

Source: WITS/Comtrade and Staff calculations
**B. Policies to diversify and grow non-oil exports**

4. **Improving Iran’s export competitiveness will be key for non-oil exports to grow and diversify.** Reforms to unify the exchange rate must be accompanied by deep structural reforms to improve competitiveness and raise non-oil exports. Iran’s Global Competitiveness Index rank—which improved seven notches to 69th—continues to be constrained by problems of access to finance, bureaucracy and policy uncertainty. The export sector is small. Some 250 companies account for 60 percent of total goods exports.

5. **Attracting more Foreign Direct Investment (FDI) would help the exporting private sector to develop and increase its technological know-how.** Currently, FDI net inflows represent only 0.02 percent of GDP, below the level observed in other MENA countries (2 percent of GDP). Human-capital intensive exports are below emerging and developing countries average. To tackle technological obsolescence, knowledge transfer via FDIs could help Iran develop human-capital intensive exports and create high skill jobs.

6. **Iran could also lower its administrative barriers to trade.** It takes 25 days to clear exports, the longest in non-conflict MENA countries reflecting weak infrastructure (in particular air transport but also roads and ports), red tape and high tariffs. The proposed amendments to the Customs Law should help improve trade processing time. Domestic import tariffs averaged 20.9 percent in 2016 and restrictions on service trade (the fourth highest in the world) to protect inefficient enterprises.

7. **Bilateral and multilateral trade agreements could help expand market access for Iranian firms.** The tariffs applied to Iran’s exports by its trading partners averaged 8.9 percent in 2014 (compared to an average of 2.9 percent applied to all other countries). Developing bilateral agreements, notably with the European Union (EU), could benefit Iran non-oil exporters.¹

¹ Iran has 12 FTA/PTA agreements (Afghanistan, Bangladesh, Belarus, Bosnia-Herzegovina, Cuba, Lebanon, Pakistan, Sri Lanka, Syria, Tunisia, Turkey, and Uzbekistan).
References


FOSTERING INCENTIVES FOR WOMEN TO WORK TO PROMOTE LONG-TERM GROWTH IN IRAN

- Iran’s highly educated women are an untapped source of growth and productivity.
- A broad range of policies could enhance female participation in the labor market, including education campaigns to reduce discrimination against women, strengthening legal rights for women, and subsidizing affordable child care for lower income women.
- Simulations suggest that reducing the gender pay gap by half has the potential to boost GDP by up to 26 percent. Policies that reduce the costs for women to work outside the home could boost GDP by about 9 percent.

A. Introduction

1. Iran has made tremendous strides in eliminating gender gaps in education and health indicators. For about a decade now, there has been virtually no gap between male and female enrollment in primary and secondary education. The gender gap in tertiary education enrollment is small and, in some fields of studies such as engineering and science, women are now in the majority (IMF, 2016a). Years of schooling attained by women have expanded by 40 percent within in one generation (World Bank, 2016a) to reach an average of 9 years. The fertility rate in Iran has fallen sharply in the last 30 years and has been below two children per woman since the 2000s, and on par with the average of advanced economies. Life expectancy at birth for women is higher than men by 2 years (76.7 versus 74.5 years).

1/ Missing data for 1990.

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1 Prepared by Vivian Malta (SPR) and Magali Pinat (MCD). The authors wish to thank Marina Mendes Tavares (SPR) for valuable inputs and guidance.
2. **Despite these laudable achievements, female participation in the labor force is low.** Female labor force participation (FLFP) was 16.2 percent in 2016, lower than countries with similar income per capita, including within the MENAP region. Some 83.8 percent of all females over the age of 10 are inactive and out of the labor force—the fourth highest rate in the world—3.2 percent of women were unemployed, and only 13 percent were working. Women represent 13.3 percent of legislators, senior officials and managers and hold 3.1 percent of seats in the parliament. Iran has two Vice Presidents who are women.

3. **Once in the labor force, women in Iran are also more likely to be unemployed.** In 2016, the female unemployment rate of 18.9 percent was twice as high as males. Although the average male and female unemployment rates are broadly in line with the MENAP region average, the female unemployment rate exceeds the emerging market average (EM) of 11 percent. Furthermore, a woman in Iran is likely to remain unemployed longer. While 30 percent of men remain unemployed for less than 3 months (versus only 11 percent of women), almost 48 percent of women remain unemployed for more than 19 months (versus only 28 percent of men).

4. **Iran’s highly educated female population represents an untapped source growth and productivity gains.** Increasing FLFP can significantly boost GDP, productivity, tax collections and alleviate the expected burden of aging (see IMF, 2016b). Section B presents several factors contributing to the low rate of FLFP in Iran. Section C analyzes the macroeconomic impact of reforms to reduce gender gaps in the labor market using an overlapping generations model. It examines the macroeconomic impact of three reforms: reducing the gender wage gap, reducing the obstacles for women to join the labor force, and subsidizing childcare costs to low- and mid-income female workers in the formal sector.
B. Why is Female Labor Force Participation Low in Iran?

5. The low level of job creation in Iran, especially in the private sector, has limited women's opportunities to find work. One of the main determinants for women to enter the labor force is the availability of job opportunities. Due to the reliance of the Iranian economy on oil and the importance of the state-owned sector, each percentage point of non-oil GDP growth increases employment by just 0.2 percentage points. Although 614,000 jobs were created in Iran in 2017, the majority were in the agriculture and lower-skill service sectors and did not match the skill-set of Iran's highly educated female college graduates.

6. The rate of FLFP in Iran is also underestimated due to the high prevalence of informal employment and underreporting of part-time work. The authorities estimate that the informal economy comprised 36.5 percent of total GDP in 2016. Informal employment is relatively high amongst women in Iran, including amongst high-skilled women (in contrast to international experience), who for social and economic reasons underreport work. The CBI reports that that part-time employment represented 5 percent of the 5 million total female jobs reported in the Labor Force Survey in 2016, but this estimate is likely understated.

7. Gender-based legal restrictions may also deter women from participating in the labor force. International studies have found that gender-based legal restrictions are correlated with low FLFP (World Bank 2016b, Gonzales, C., and others, 2015). The World Bank’s Women, Business, and the Law: 2016 study found that Iran had 23 gender-based legal restrictions on women’s employment and entrepreneurship, the third highest number in the world. For example, married women need to obtain their husband’s permission to start a business (Civil Code Art. 1117), to apply for a passport and can be required to ask permission to get a job (although typically not used). Income tax deductions are granted only to the husband (Direct Tax Act Art. 101). On the plus side, wage equality is explicitly guaranteed for women (Labor Code Art. 38). While job advertisements and hiring processes can exclude women, the authorities report that they have removed gender-caps in the civil service recruitment rounds for several ministries.

<table>
<thead>
<tr>
<th>Gender-based legal restrictions, 2016</th>
<th>DZA</th>
<th>BHR</th>
<th>IRN</th>
<th>IRQ</th>
<th>KWT</th>
<th>OMN</th>
<th>QAT</th>
<th>SAU</th>
<th>SYR</th>
<th>UAE</th>
<th>YMN</th>
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<tr>
<td>Apply for a passport</td>
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<td>Be head of household</td>
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<td>Choose where to live</td>
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<td>Confer citizenship to children</td>
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<td>Get a job without permission</td>
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<td>Travel outside the home</td>
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<td>Travel outside the country</td>
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8. **The fact that women often earn less than men may also have created disincentives for women to join the labor force.** Although many countries across the world have equal pay legislation, all continue to have gaps in the salaries earned between men and women that cannot be explained by observable individual and job characteristics (the so-called “unexplained wage gap”). The lack of individual level data on wage earnings in the Iranian household survey has precluded an accurate estimate of the level of the wage gap between men and women in Iran. However, based on a survey conducted by the World Economic Forum, the pay premium between men and women for similar work is estimated to have been 42 percent in 2017, placing Iran 99th out of the 131 countries surveyed.

9. **Personal and family responsibilities have also deterred women from seeking formal employment.** In a 2015 labor force survey, conducted by the Statistical Center of Iran, 72 percent of Iranian women replied they were not looking for a job because of personal and family responsibilities, compared to only 2 percent for men.

C. **Policies to Encourage Greater Female Participation in the Labor Force in Iran**

10. **This section studies the impacts of three reforms that could help to narrow gender gaps in the Iranian labor market.** Using a dynamic general equilibrium model with heterogeneous agents and overlapping generations, we examine the impact on long-term real GDP, male and female wages, formality, productivity and government revenue collections of three policies. The first
policy simulation estimates the impact of a reduction in the “unexplained” wage gap between women and men. The second, reduces the cost to families of having women working outside the home. The third introduces a childcare subsidy payment to low-and middle-income formal female workers.

11. The model is calibrated using Iran’s macro and micro statistics. The general equilibrium model replicates key features of the Iranian economy, such as taxes, cash-transfer programs, pension systems, mean and variance of the income distribution, education spending, size of the informal sector, share of part-time labor, and female labor force participation.

12. The framework allows males’ and females’ decisions to differ across the income distribution. Agents differ from each other in terms of age, gender and the initial endowment each receives at birth. These differences generate distinct incentives and choices for agents to work throughout the life cycle. The model also features endogenous human capital formation.

13. The main sources for gender inequality in the model are the disutility a family experiences when a woman works outside the home and the wage gap between women and men. In the model, husbands and wives decide how much their families should consume, how much labor to supply to the formal and informal sectors, and how much to invest in their children’s education (human capital). Wives and husbands weigh different factors when making decisions to participate in the labor market. Husbands always work, and the only decision regarding males’ labor is how much time they should allocate between the formal and informal sectors, given their human capital and their household’s constraints. Wives, however, not always work. When a woman supplies labor, the family incurs a utility cost related to the difficulty of coordinating multiple household activities, such as home production and rearing children. This allows for low female labor force participation. Also, the model proxies gender discrimination in formal and informal labor markets in an unexplained gender wage gap (after controlling for factors such as type of job, education, age). These two sources of gender inequality create different outcomes for men and women in terms of labor force participation, number of hours worked (part-time or full time), formal versus informal jobs, and earnings. The full description of the model, its calibration and data sources can be found in Malta, Mendes Tavares and Pinat (2018).

Reducing the Gender Wage Gap

14. Reducing the ‘unexplained’ wage gap between women and men has the potential to double female labor force participation rate over the long-term. If the “unexplained” wage gap of 40 percent in the formal and informal labor markets is reduced by half, the number of women in the labor force doubles to 80 percent, as both higher and lower skilled females increase their supply of labor in response to more attractive wages. In equilibrium, the average wage of a female working in the formal sector increases by 23 percent (and by 36 percent in the informal sector). The inclusion of more females in the labor force lifts their income, boosting demand for consumption of both formal and informal goods. Formal firms hire more males and females. The males joining these firms have lower skills, since the higher-skilled male workers were already employed in the formal sector. Thus, average earnings of males in the formal sector falls by 10 percent.
15. **Reducing the unexplained wage gap also boosts the size of economy and government tax collections.** The expansion of FLFP increase female incomes, pushing the demand for goods and services up, and thus spurring firms’ production. This virtuous cycle helps the level of real GDP to grow by 26 percent in contrast to the scenario of no change in policy. Government’s total revenues grow 22 percent (from 15 to 18 percent of GDP) due to the higher collections of consumption taxes, labor taxes (due to higher number of workers in the formal sector) and corporate taxes (given the boost in the formal production).

16. **Even in the case where the wage-gap between women and men is more moderate, a narrowing of this gap can still produce economic gains.** Given the fact that Iran’s equal pay laws and its large share of public sector employment limit the possibility for wage discrimination, an alternative calibration where the unexplained wage gap in the economy is reduced from 20 percent to 10 percent is simulated. The reduction in the gender pay gap boosts real GDP by 2.6 percent and total revenue collections by 2 percent (from 15.1 to 15.4 percent of GDP). Women’s average earnings in the formal and informal sectors rise by 13 percent, reflecting both the lower pay gap and the extra incentives to pursue more education, which in turn improves females’ productivity and earning potential in the labor market.

**Reducing the costs/obstacles for women to participate in the labor market**

17. **Lowering the costs for women to join the labor force can also enhance long-term growth.** As noted above, 72 percent of Iranian women did not look for a job because of personal and family responsibilities. In our model, we capture this as a cost in the family’s utility function when a woman works outside the home. However, national education campaigns that limit gender bias and encourage women who wish to pursue careers outside the home can over time reduce the cost and stigma for women who wish to work. Such policies are captured in our model as a drop in the disutility cost, which in turn translates into an increase in FLFP participation by 10 percentage points. This increase in FLFP boosts real GDP by 8.7 percent in the long-run and increases government revenues by 6.8 percent.

18. **The rise in FLFP boosts both female and male earnings.** This reform encourages highly educated women (usually richer) to join the labor force, as their absolute returns from work are higher. The higher competition among skilled workers in the formal sector induces investment in human capital which in turn boosts workers’ productivity, leading to higher salaries for both men and women. Average earnings rise by 13 percent for women and 4 percent for men. Specifically, human capital of the formal economy increases because families invest more in education given the return in the form of higher earning capacity, more high-skilled women opt to join the labor force, and the increase in formal labor force participation also raises human capital formation through learning-by-doing, meaning, they get more skilled while working.
Subsidizing childcare costs to low- and mid-income formal female workers

19. Providing targeted subsidies for childcare costs to low- and middle-income mothers can boost female employment in the formal sector. We simulate the effects of a targeted childcare subsidy to mothers from the bottom 70 percent of the income distribution working in the formal sector. The subsidy is proportional to the number of hours worked in a formal job, and at its maximum it is equivalent in value to the universal cash transfer for a woman working full time. Such a reform generates a 40 percent increase in FLFP in the formal sector. However, there is a partial crowding-out effect, as older females can leave the labor market due to competition in that sector. In net terms, women work 10 percent more hours. While the framework assumes all men always work, they also benefit from this reform as their average earnings increase by 2 percent because the reform induces households to spend more on education, such that, at the steady-state, both men and women are more educated, increasing their expected earnings.

20. The childcare program boosts the economy and government revenues. The childcare subsidy reform increases the level of long-term real GDP by 2 percent. Government revenues increase by 3.2 percent due to higher income and labor tax payments collected from women working in the formal sector and offsets the expected cost of the child-care subsidy program (0.7 percent of GDP). Income inequality as measured by the Gini coefficient falls, since the reform targets women from lower deciles of the income distribution.

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Impact of Policies to Support Higher Female Labor Force Employment: Changes of various variables (in percentage points) for each policy

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2 Around 450,000 2015 Iranian Rials per month.
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In recent years, significant efforts have been made in upgrading the legislative and institutional anti-money laundering and combating the financing of terrorism (AML/CFT) framework.

Iran is party to the United Nations Convention Against Corruption (UNCAC). Further progress is needed to bring into domestic law and implement the convention.

Combatting corruption, money laundering (ML), and terrorism financing (TF) can enhance the integrity of the financial sector, facilitate broader connections to the global banking system and ultimately safeguard resources that can support inclusive economic growth.

A. Introduction

1. **ML and TF hamper access to global financial markets and correspondent banking relationships which can negatively impact financial stability and the business environment.** In addition, financial sector fraud, “Ponzi schemes” and bank insolvencies could undermine public confidence in the financial system, or could risk a deterioration in access to international financial markets.2

2. **Corruption can undermine the state’s ability to deliver sustainable inclusive economic growth.** When government functions are impaired, it can adversely affect economic performance, including macroeconomic and stability, and deter investment.3 It fosters public distrust in government and weakens the state’s capacity to perform its core functions.4

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1 Prepared by Chady El-Khoury (Legal Department).


3 International Monetary Fund Staff Discussion Note, 2016, “Corruption: Costs and Mitigating Strategies,” SDN/16/05, May.

3. The authorities are conscious of the risks and potential implications\(^5\) emanating from financial crimes and have initiated reforms to strengthen the anti-corruption and AML/CFT frameworks. With World Bank assistance, the authorities launched earlier this year a domestic interagency National Risk Assessment (NRA) exercise to improve their understanding of money laundering, associated crimes (e.g., drug trafficking, corruption) and terrorism financing risks. The results of the exercise—expected later this year—will shed more light on those risks and could improve risk based policy design and implementation.

**B. Progress against ML/TF and corruption**

4. Effective AML/CFT and anti-corruption frameworks protect the integrity of the financial system and the broader economy. The prospect of detection, conviction and punishment dissuades ML/TF crimes. An effective anti-corruption strategy could bolster investor confidence, and support sustainable economic growth. Greater transparency, backed by strong and effective institutions, can help minimize opportunities for corruption.

**AML/CFT efforts**

5. Iran initiated AML reforms in 2008. The first pillars of the framework were established by the adoption of the AML law (2008) and its by-law (from 2010) that criminalized ML, set-up the AML coordination body—the AML high council composed of several ministries—and the Financial Intelligence Unit (FIU), and put in place preventive measures for financial institutions and certain non-financial businesses and professions. In 2010, the FIU was operationalized, and the Central Bank of Iran (CBI) initiated its AML supervision of financial institutions.

6. Since June 2016, significant improvements have been made to the AML/CFT legal and institutional framework. Iran adopted a CFT law in 2016. Given that Iran provided a high-level political commitment to reform the framework by agreeing on an action plan with the FATF, the FATF decided to suspend the counter-measures\(^6\) in June 2016. Since then, Iran has established a cash declaration regime at the border, and has also introduced to parliament draft amendments to its AML and CFT laws to bring them in line with international standards. In recent months, Iran ratified the United Nations Convention against Transnational Organized Crime (UNTOC), and the CBI approved preventive measures such as customer due diligence and beneficial ownership to be implemented by financial institutions. In its recent February 2018 statement\(^7\), FATF gave the

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\(^6\) FATF’s call for counter-measures comprised, among others, enhanced due diligence on the quality of respondent institution’s AML/CFT controls; restrictions on opening of correspondent accounts; and not allowing Iranian banks to open subsidiaries in foreign jurisdictions.

authorities until June 2018 to fully complete the action plan (see section C on remaining items under the plan) that was due on January 31, 2018.

Anti-Corruption reform

7. Iran ratified the UNCAC in April 2009. The UN assessed Iran’s compliance with certain aspects of the UNCAC and its report was published in June 2014. The report focused on legislative review and did not evaluate effective implementation.

8. Iran has made some progress in aligning its legal and institutional framework to the UNCAC. Many corruption offences have been criminalized (e.g., bribery, embezzlement, and trading in influence). Legal liability of legal persons has been introduced. Provisions for the seizing and confiscation of proceeds of crime (including non-conviction based confiscation) have also been introduced. Furthermore, several institutions have been authorized to prevent and combat corruption, notably the General Headquarters for Combating Economic Corruption, the Ministry of Intelligence, the Supreme Audit Court, the Secretariat of the General Headquarters for Promoting Integrity in the Administrative System and Combating Corruption, the Judiciary, including the General Inspection Organization (GIO), the General and Revolutionary Prosecutor’s Office, the Judicial Complex for Economic Affairs.

9. Efforts now need to address remaining gaps and make the framework operational and effective. The definitions of bribery, trading in influence, abuse of functions, illicit enrichment, and obstruction of justice offenses should be brought fully in-line with the UNCAC. The by-laws to ensure protection of witnesses, experts and victims of corruption should be put in place. Furthermore, the system of declaration of assets of senior public officials has to be brought into line with international best practices. An independent anti-corruption agency could support the design and implementation of an anti-corruption strategy.

C. Options to Reduce the Risks of ML/TF and Corruption

AML/CFT priorities

10. An effective AML/CFT framework will help counter financial crimes and facilitate Iran’s re-integration into the international financial and trade system. It is critical that Iran swiftly adopt and publish—before the FATF June 2018 Plenary Meeting—a comprehensive legislative and regulatory framework in-line with the FATF action plan that was agreed with the Iranian authorities. According to the FATF, Iran should fully address its remaining action items by:

8 Chapters III (criminalization and law enforcement) and IV (international cooperation) of the convention.
10 Articles 15, 16, 18, and 21 of the Penal Code.
establishing a broader range of penalties for ML violations,

- ensuring adequate legislation and procedures to provide for confiscation of property of corresponding value,

- ensuring an adequate and enforceable customer due diligence regime,

- ensuring that financial institutions verify that wire transfers contain complete originator and beneficiary information,

- demonstrating how authorities are identifying and sanctioning unlicensed money/value transfer service providers,

- ensuring the full independence of the FIU and requiring the submission of suspicious transaction reports for attempted transactions,

- ratifying and implementing the UNTOC and the 1999 UN International Convention for the Suppression of the Financing of Terrorism\(^\text{12}\) and clarifying Iran’s capability to provide mutual legal assistance,

- adequately criminalizing terrorist financing, including by removing the exemption for designated groups “attempting to end foreign occupation, colonialism and racism”, and

- identifying and freezing terrorist assets in line with the relevant United Nations Security Council Resolutions (UNSCRs).

11. **Improving the effectiveness of the AML/CFT framework should continue.** Conducting a National Risk Assessment on ML/TF will improve the authorities understanding of risks, enhance risk-based policy design and implementation, and improve the allocation of resources. Other priorities include:

- **Enhancing the AML/CFT risk based supervision of banks and other financial institutions and imposing corrective actions when relevant.** Licensing and fit and proper requirements should be enhanced to prevent criminals from owning and/or controlling financial institutions. Effective supervision will reduce the risk of financial abuse in the financial sector, and enhance the detection and prevention of ML, proceeds of fraud and corruption, and TF activities. Ultimately, this will improve compliance and enhance the relationship and bolster trust between Iranian banks and their correspondent banks.

\(^{12}\) The convention adopted in December 1999 was ratified by 188 countries: https://treaties.un.org/Pages/ViewDetails.aspx?src=IND&mtdsg_no=XVIII-11&chapter=18&lang=en
• **Improving the compliance of financial institutions—particularly banks—in identifying beneficial owners and domestic politically exposed persons (PEPs).** Financial Institutions should be required to adequately apply preventive measures commensurate with their risks. This will require—among others—issuing CBI guidance to assist banks in implementing these requirements, focusing CBI inspections on these areas, and improving the capacity of banks’ internal controls and compliance systems. Those measures will allow banks to detect and report suspicious activities including those related to proceeds of corrupt public officials and misuse of legal entities, and reassure correspondent banks that they will not deal with prohibited individuals and entities that are under economic sanctions.

• **Developing mechanisms to ensure the transparency and timely availability of accurate beneficial ownership information of legal entities established in Iran.** A public registry for beneficial ownership is one approach that would enhance transparency about the ownership of corporations. Timely access—including by correspondent banks—to adequate, accurate, and current information of all types of entities established in Iran—could enhance access to the global financial system.

**Enhancing the anti-corruption framework**

12. **While there are multiple laws in place that criminalize various forms of corruption in both the public and private sectors, the legal framework may not be adequate to always permit effective pursuit of corruption.** In line with the recommendations of the UNCAC Peer Review Executive Summary, the legislative framework should be upgraded to properly criminalize bribery, illicit enrichment and other corruption offenses. Other priority reforms include:

• **Enhancing the system of declaration of assets of senior public officials in line with international best practices.** Financial declaration (or disclosure) systems are a recognized tool in the fight against corruption and in promoting transparency. A comprehensive asset declaration regime should include the following characteristics: (i) targeted to senior public officials, their family members and close associates, and assets beneficially owned, (ii) transparent and requires publication of asset declarations, and (iii) provisions for dissuasive measures or sanctions for noncompliance (e.g., criminal offense for intentionally declaring false information or not declaring).

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13 Domestic PEPs are individuals who are or have been entrusted domestically with prominent public functions, for example Heads of State or of government, senior politicians, senior government, judicial or military officials, senior executives of state owned corporations, important political party officials. The definition of PEPs is not intended to cover middle ranking or more junior individuals in the foregoing categories.


• **Establishing an independent anti-corruption agency** with law enforcement powers to focus on implementing a holistic strategy to fight corruption, and prioritizing and pursuing corruption cases. Prosecution and adjudication of corruption cases should be autonomous and protected from interference.

• **Building synergies between the AML and anti-corruption frameworks.** Domestic coordination should allow the two systems to operate in tandem. Concerned agencies should coordinate and cooperate to tackle corruption and its proceeds. For instance, the FIU which receives suspicious reports related to PEPs could enhance its ML disseminations to anti-corruption agencies investigating proceeds of corrupt officials. And vice versa, agencies in charge of an anti-corruption agency could share information with the FIU to trigger money laundering analysis by “following the money” generated from corruption, identifying perpetrators of corruption (and their associates), and tracing their assets domestically and abroad.
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