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**Bachelor's Thesis**

**2024**

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**Assessing the Relationship between Theocratic  
Authoritarianism and Economic Institutional Quality  
in Iran**

Bachelor's Thesis

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Study programme: Philosophy, Politics, Economics

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Year of the defence: 2024

## **Declaration**

1. I hereby declare that I have compiled this thesis using the listed literature and resources only.
2. I hereby declare that my thesis has not been used to gain any other academic title.
3. I fully agree to my work being used for study and scientific purposes.

In Prague on  
July 30, 2024

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## References

MONFARED NIK, Aryan. *Assessing the Relationship between Theocratic Authoritarianism and Economic Institutional Quality in Iran*. Praha, 2024. 56 pages. Bachelor's thesis (Bc). Charles University, Faculty of Social Sciences, Institute of Political Studies, Department of Political Science. Supervisor Pelin Musil Ayan, PhD.

**Length of the Thesis:** 70.844 characters with spaces

## **Abstract**

In the latter part of the 20th century, Iran's economy grew exceptionally thanks to fundamental reforms, economic expansion, and oil export. This development was interrupted by the Islamic Revolution of 1979. Shah's secular government was replaced by clerical authoritarianism, resulting in political upheavals for more than 40 years. Institutions have been one of the main areas affected by these changes, and their analysis is crucial to understanding the actual scale of Iran's politics and economics. Based on the established analysis methods, this study aims to analyse the quality of economic institutions in Iran and their relationship with political changes. Different views of political changes are assessed in comparison to thirty other countries from 1975 to 2021. Findings suggest that the Islamic Revolution and subsequent political changes significantly diverged Iran from its expected developmental path, both regionally and internationally. Moreover, among the political changes, the analysis identifies freedom and freedom-related factors as critical indicators of economic institutions' quality. There is a noticeable correlation between the level of freedom in Iran and the quality of its economic institutions.

## **Abstrakt**

Írán byl ve druhé polovině dvacátého století rozvíjející se ekonomikou. Ekonomický růst, strukturální změny a příjmy z ropy pomohly Íránu rozvíjet jeho ekonomiku mimořádným tempem. Islámská revoluce v roce 1979 však nahradila šáhov sekulární režim duchovní autokracií, což vedlo k více než čtyřem desetiletím politických výkyvů. Instituce byly jednou z hlavních oblastí ovlivněných těmito změnami a jejich analýza je zásadní pro pochopení skutečného rozsahu íránské politiky a ekonomiky. Na základě zavedených analytických metod si tato studie klade za cíl analyzovat kvalitu ekonomických institucí v Íránu a jejich vztah k politickým změnám. Různé pohledy na politické změny jsou posuzovány ve srovnání s třiceti dalšími zeměmi od roku 1975 do roku 2021. Zjištění naznačují, že islámská revoluce a následné politické změny výrazně odklonily Írán od jeho očekávané cesty rozvoje, a to jak na regionální, tak mezinárodní úrovni. Navíc analýza identifikuje svobodu a faktory související se svobodou jako kritické ukazatele kvality ekonomických institucí. Mezi mírou svobody v Íránu a kvalitou jeho ekonomických institucí je patrná korelace.

## **Keywords**

Iran, Institutions, Economic Institutions, Institutional Quality, Economic Institutions' Quality, Political Changes, Islamic Revolution, Economic Freedom

## **Klíčová slova**

Írán, Instituce, Ekonomické Instituce, Institucionální Kvalita, Kvalita Ekonomických Institucí, Politické Změny, Islámská Revoluce, Ekonomická Svoboda

## **Title**

The Impact of Political Changes on the Quality of Economic Institutions in Iran: A Comparative Analysis from 1975 to 2021

## **Název práce**

Dopad politických změn na kvalitu ekonomických institucí v Íránu: Srovnávací analýza od roku 1975 do roku 2021

## **Acknowledgement**

I would like to express my gratitude to my family, as their support is always heartwarming. I am thankful to my supervisor, Dr Pelin Aylan Musil, for her kind help. Moreover, I would like to show my gratitude to Dr Salamon and Dr Campos, as being their student was the honour of a lifetime. I dedicate this paper to all young Iranian souls who lost their lives in our struggle for freedom. Woman Life Freedom.

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## **Introduction**

Iran experienced a dramatic political transition in 1979 with the Islamic Revolution, which abolished the pro-western and secular Shah's regime and drastically changed the nation's political structure and institutions. The political changes and the theocratic regime founded after the Islamic Revolution shaped Iran's economy. The impact of this revolution on the quality of economic institutions is one of the numerous effects that need further investigation. This thesis aims to investigate the impact of the political changes caused by the political change on the quality of Iran's economic institutions during the timeframe of 1975 to 2021.

Institutions, as a matter of study, have become a focal point of academic research in recent years. Their influence over final results has been extensively investigated, and the institutional role in changes is now widely accepted in academia and is a topic of ongoing research. Considering institutions' crucial role in economic performance, the following inquiry serves as the basis for this study: From 1975 to 2021, how did Iran's political changes affect the quality of its economic institutions? This question is essential to comprehending Iran's economic development path and to derive conclusions about the connection between political changes and institutional quality. The hypothesis posits that Iran's political turmoil and subsequent Islamic regime have resulted in a decline in the quality of its economic institutions. This differs from the trends seen in other nations that have undergone different political paths.

The study uses a mixed-methods approach incorporating quantitative and qualitative methods to investigate this question. The Fraser Institute's Economic Freedom of the World Index is one of the leading data sources and is considered as an indicator of the quality of economic institutions. It offers a thorough assessment of institutional quality across various aspects. In addition, measures of political regimes and political institutions alongside the level of freedom are used to explore the results of political changes from different views. Analytical tools such as non-linear statistical correlations and interaction models are utilised to determine how political issues affect economic institutions. Political changes caused by the Islamic Revolution and the events following it have decreased the level of freedom in Iran, and this decrease in freedom is highly related to the depreciation of the quality of economic institutions.

The thesis is organised into four chapters. In order to lay the theoretical groundwork for the investigation, the first chapter examines pertinent literature on institutions and

the effects of political power on economic outcomes. Iran's political and economic situation is briefly reviewed historically, and background information is provided for analysis. The second chapter explains the research methodology, including the different concepts and the respective data sources, in addition to the analytical methods employed in the study. The empirical data are presented in the third chapter, and the results for each analysed factor in the context of comparative analysis are explored. The final chapter discusses the outcome of the research with a view to the political changes in Iran in the last four decades. A review of the main conclusions, implications for future study and policy, and suggestions for more studies on the subject are included in the conclusion part.

This thesis intends to contribute to a greater understanding of how political regimes affect institutional quality and economic development by examining the relationship between political changes and economic institutions in Iran. The study's findings can benefit policymakers, academics, and international organisations working on institutional reforms and economic stability in transitioning countries.

# **1. Theoretical Framework**

The fall of the Berlin Wall in 1989 started a wave of changes that renewed the face of politics for many people, more specifically, the ones located under the previous communist domain of the Soviet Union and its allies. Enthusiasm towards the West and liberal democracy pictured a prosperous future after years of hardship. However, in a few years, it became clear that not all candidates would pass the transition period successfully. Which raised the question, why? Scholars examined different theories focusing on various factors involved in Central and Eastern Europe and now-liberated post-Soviet republics. The transition engineers and scholars implemented different methods in each country, from fast price liberalisation and free elections to exchanging the soviet titles with democratic titles of the same individuals in other countries. A missing point in the initial elaboration was to foresee the effect of each decision as there was not sufficient experience with previous transitions to democracy in a short time for many countries.

However, a byproduct of this new field of study was the emergence of a new focus within economics and institutions. One of the first measurements in many countries was to demolish communist organisations or redesign them for the new order. A popular belief among Soviet central planners was that growth needs to be centrally planned, while counterparts in the West believed that a free economy is a precondition to growth. The transition period in the 1990s once more brought the search for the reason for growth as a blooming topic among scholars as theories could finally have a chance to be tested. This coincidence gave birth to a new area of study: Institutional Economics.

## **1.1 Institutions and their role**

Institutional quality and its effect on the outcome of the countries came into scholarship focus due to interest in determining the primary contributing factor of economic outcome. Douglass North defined institutions as “Humanly devised constraints that structure political, economic and social interaction” (North, 1991, p.97). His work introduced institutions as a crucial part of economics, and later scholars based their work on his establishments. Campos and Nugent (1998) stated that there is a link between institutional development and economic growth as institutions set the rules for economic agents and consequently give the economy a direction. Rodrik (2000) stated that institution building cannot follow a specific blueprint but can be built

via a participatory system that accommodates local understandings. Therefore, a democratic procedure is beneficial for the quality of institutions. Rodrik, Subramanian, and Trebbi (2004) found that institutions influence economic growth more than geographical location. Crowley, Hall, and Sobel (2010) and Acemoglu, Gallego and Robinson (2014) investigated the role of institutions in human capital. They realised that in the long-term, institutions would determine the economic outcome, and human capital has a more dependent position in comparison to the role of institutions in growth. Campos, Coricelli, and Moretti (2019), by comparing the integration process of the European Union countries, explained that institutional development and integration are the real causes of economic growth for new members, and the influence of membership is a secondary effect. Thus, institutional studies have been growingly proving the effect of institutions on the various aspects of human social life.

As a milestone of the discipline, Acemoglu, Johnson, and Robinson (2005) introduced the relationship between political institutions and economic outcomes in their paper on institutions and long-run growth. They claim that political institutions and distribution of resources in the given time of  $t$  will influence the de jure and de facto political power, which in return political power will determine political institutions and distribution of resources in  $t+1$  time, and then the same cycle will continue for the  $t+2$  time. Therefore, they see political and economic institutions as mutually beneficial factors. However, the influence of political power on economic outcomes is more prominent.

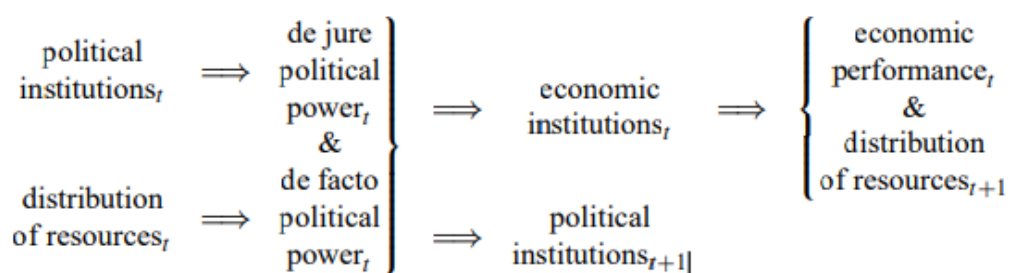


Figure 1. The relationship between political institutions and the distribution of resources is also known as economic outcome. (Acemoglu et al. 2005)

In an earlier paper, Acemoglu (2003) and Parisi (2003), based on the Coase Theorem introduced by Coase (1960), introduced the Political Coase Theorem, in which they explain that in a perfect situation of economic institutions, political institutions will

determine the outcome of the economy. However, this view is not complete, as later they explain that in imperfect conditions, political institutions will affect economic results by influencing economic institutions.

Campos, Coricelli and Moretti (2022) discuss a strong relationship between democracy and growth, explaining that democracy can cause higher income in the long term. On the other hand, Persson and Tabellini (2006) and Rodrik (2000) suggest that democracy as a whole cannot determine the growth in outcome and that more details or local factors within democracy should be analysed. However, most papers suggest that regardless of whether it is a democracy or not, the level of political freedom affects economic institutions through different measurements.

Yadav (2022) describes that authoritarianism, as a result of political changes and means of institution-making, can alter political institutions and thus influence political status. Moreover, according to Hanson (2013), authoritarianism can affect economic outcomes by adopting specific economic policies centred towards their political view rather than long-term economic growth. Therefore, authoritarianism can influence political and economic institutions; its study can explain these effects.

## **1.2 Institutional Quality**

Defining a measurement to analyse and compare institutions has been a developing idea among scholars, and several people have focused on different characteristics, origins, or related fields of an institution in order to compare it with itself, other institutions, or the same institutions but in different regions or countries. A common way to understand a studied target's function is to look for the results and categorise the outcome to have a measurable scale. The first widely accepted measure came from The International Country Risk Guide (ICRG), provided by the PRS group. Their measure of assessing risks proved influential after the Islamic Revolution of Iran in 1979 as it unprecedentedly changed geopolitical arrangements, thus ensuring political stability became an essential factor (About Us | the PRS Group, n.d.). Building on their achievement, scholars used ICRG as a scale for the quality of institutions.

Knack and Keefer (1995) and Chong and Zanforlin (2000) used the ICRG indices like Corruption in Government, Rule of Law, Quality of the Bureaucracy, Repudiation of Contracts, and Risk of Expropriation, as determinants of institutional quality. Following their definition, Islam and Montenegro (2002) used the same factors with

standardised coding to define their version of institutional quality. They suggest that institutional quality is influenced by three main factors. First, openness and transparency, as the accessibility of resources enhances competition and naturally makes the best equilibrium possible. Second, social equality and ethnic composition are influential at a minor level but not at the higher stage, using a continent dummy variable. However, other studies like Chong and Zanforlin (2000) and Kotschy and Sunde (2017) prove that inequality, in the long run, has a negative impact on institutional quality. Third, specific measures of freedom, like political checks and balances and freedom of the press, are positively related to the quality of institutions.

Based on Islam and Montenegro research, the World Bank has introduced an index to cover the need for institutional analysis, which, alongside PRS's ICRG, has become a defining criterion for assessing institutional quality for the countries with available data. World Bank's Institutional Quality Index consists of six factors that are collected and published every year. These factors include Control of Corruption, Government Effectiveness, Political Stability and Absence of Violence and Terrorism, Regulatory Quality, Rule of Law, and Voice and Accountability. Their founding about freedom and relation to the quality of institutions brings a novel political aspect by introducing political forces as the primary determinant. This connects their study to other papers like the aforementioned Acemoglu et al. (2005), as they project the influence of political power on political and economic institutions, which consequentially determines the economic outcome of a country.

A gap among the measurements introduced by the International Country Risk Guide and World Bank's Institutional Quality Index was the generalisation of institutions. Institutions were understood as one measurable unit, while based on the findings of Acemoglu et al. (2005), economic and political institutions are mutually influential and thus distinguishable. Based on the logic of understanding the outcome to understand the quality of the function, many took economic outcomes like growth as the demonstration of economic institutions. However, this method is not flawless as several factors are involved in economic growth, and institutions cannot be the sole influencers. Thus, economic outcome as a measurement cannot accurately define quality for institutions.

Kotschy and Sunde (2017), based on methods used by Acemoglu and Robinson (2008) and Gwartney, Hall, and Lawson (2013), defined a new way to measure

institutional quality. Based on Acemoglu et al. (2005), they divided the institutions into economic and political institutions and introduced separate measurements to analyse their respective qualities. The aim of their paper is to look for the relationship between institutional quality and inequality. They take the Economic Freedom of the World Index provided by The Fraser Institute as the showcase for the quality of economic institutions and the Political Rights and the Civil Liberties Indexes provided by Freedom House as indicators of political institutions' quality. Their method offers two advantages compared to other methods. First is a period during which data is available. Both Civil Liberties and Economic Freedom of the World contain datasets covering most of the second half of the twentieth century to the second decade of the twenty-first century, covering more than fifty years of data. Second is the availability of data for many countries. Even though datasets do not cover all countries and territories, still compared to the other measures, they include vast varieties of countries, enabling cross-country or regional comparison

In addition, scholars use other methods to define institutional quality and find a basis to compare it among countries or with other institutions. Henderson, Storeygard, and Weil (2012) developed a new approach to assessing economic growth. They used night light as an indication of growth to assess the economic development of nations, particularly those with lower levels of transparency, such as non-democracies. Since then, many studies have used their approach to expand estimation over the economic spectrum. Martinez (2018), based on their method, calculated that authoritarian nations frequently overstate their economic growth rates by a factor of 1.15 to 1.3.

The nightlife method can also give us a retrospective view of the democratic status of countries based on a comparison of reported data and their night light. Fouladgar and Feizi (2023) investigated the same technique in Iran by compiling the official local data on Iran's growth and data on night light reported by international satellites. After inserting certain controls, their result indicates a difference of 1.2 between the reported growth and the growth in night light. Therefore, their estimation is close to Martinez's findings. On the other hand, Global Freedom Status provided by the Freedom House reports Iran as a not-free state (Freedom House, 2024). Various other sources also consider the Islamic Republic of Iran as an authoritarian and non-democratic political system. As a result, official reports about economic growth or other economic outcomes from Iran cannot be fully trusted. Studies like the night light can open new approaches



to analyse institutional quality and economic outcomes by eliminating biases and untrustworthy data.

### **1.3 Institutions, Iran and the Islamic Revolution**

Unrest and turbulence have been central to Iranian life for the last five decades. Starting amid the Cold War to the modern age of AI technology, this period has gone differently for the Iranian nation compared with many other countries. While many countries, from South Korea to Chile, opened their gates to democracy and economic prosperity, Iran became more and more closed and devastated. In the 1960s' a decade before the oil shock, the implementation of structural reforms involved the creation of new institutions to supervise the development of the economy. The Planning and Budget Organisation and the Central Bank of Iran were among those organisations. GDP per capita increased at record-breaking rates between 1963 and 1976, averaging 8 per cent per year (Esfahani & Pesaran, 2009). In addition to internal causes, external forces such as the 1973 oil shock gave unanticipated excessive growth to oil-producing countries, which spurred economic expansion, even if it caused panic throughout the world. However, growth in the financial situation also fostered political demands, especially from the groups that opposed Shah's social and economic policies. When extreme Islamists and leftist organisations finally gained control in 1979, the Shah fled the nation and was forced into exile. Islamic Revolution, however, is not the only political operation that Iran had to endure. Involving groups in toppling the Shah's monarchy started the inner fight almost immediately after the initial success, and each side tried to gain a larger share of the power vacuum. Finally, Islamists under Khomeini prevailed in eliminating other groups and establishing themselves as the new rulers of Iran.

In 1980, one year after his return to Iran, Khomeini's followers captured the US embassy, and the new regime decided to alienate itself from the diplomatic norms of the world and consolidate its power within the country using all measures possible. Soon after the hostage crisis, Saddam Hussein decided to invade Iran using Khomeini's provocation as *casus belli*. Eight years of war with the country that has the longest borders, Iraq, caused hundreds of thousands of lives and deprived Iranian wealth of what remained from the golden growth time of the 1960s and early 1970s. By the end of the war, sights of reform and reopening the country brought hope to have a better

future, but the autocratic essence of the now-settled Islamic Republic regime constantly resist to step down from any of its ideological values. Their aim has always been to create an international crisis and domestic despotism. Therefore, they tried to keep the country constantly revolutionary and warlike (Rivetti & Shirin Saeidi, 2023).

In the 1990s and early 2000s, the presidency of Mohammad Khatami, reformists tried to alter the furious face of the Islamic Regime by opting for more moderate policies. Their initial success, which can be seen in Figures 3 to 10, resulted in several years of improvements in various fields; however, this was also short-lived as the government and parliament are not the main bodies of political power, and the supreme leader has the final say in all topics. Ali Khamenei, the second supreme leader of the Islamic Republic, took power in 1989 following the death of his predecessor, Khomeini; however, he soon successfully freed the political atmosphere of his enemies and, until now, tries to keep his hegemony over the power ingredients of Iran. Reformists also became part of this purification after Khatami; they could never get the same portion of power again, even though they firmly aligned with all regime ideologies and stood against the will of the public whenever necessary.

The international relations of the regime have been based on making loud publicity, thus keeping Iran on top of the headlines for as long as possible. They tried to create proxy militia groups around the Middle East and beyond to project their power beyond the borders. However, this hospitality left Iran an isolated nation with few to no allies worldwide. The United States and its allies also confronted the regime by imposing heavy sanctions for more than forty years, firing Iran from international transactions with the US and many other countries. In 2014, the New Nuclear Deal temporarily lifted some of the sanctions which were related to the nuclear program of the Islamic regime, although this relief did not last long when the new US president, Donald Trump, entered the White House. Nevertheless, the internal codes of manner keep Iran isolated as the foreign policy agenda rotates around Supreme Leader policies (Bazoobandi, Heibach, and Richter, 2022).

Domestically, the Islamic Republic has faced internal unrest for its entire existence, from the women's protest of March 1979, a few weeks after Khomeini's return, to the recent Woman Life Freedom movement in 2022-2023. In many significant stages, like 1999, 2009, and 2020, the Islamic regime experienced existential threats due to domestic unrest, but it remained in power by using naked hard power and violence.

Hence, Iran has never been in complete peace since 1979.

All the above political changes left their immediate and long-term effect on the Iranian economy and, as per the topic of this research, on economic institutions. Depending on the internal and international conditions, Iran has been more prone to fluctuations usually caused not directly by external reasons but via a unique function of institutions heavily influenced by the theocratic authoritarianism of the Islamic Regime (Morid Moshtagh Sefat 2016). Institutions were among the first establishments that endured the changes. As the name revolution suggests, demolishing the former institutions from the monarchy to all lower entities was the priority of the new revolutionary system. Early in the revolution, business owners and entrepreneurs were the primary targets of the newly established revolutionary government. Their assets and companies were seized and nationalised, and many of them were forced to flee the nation or face harsh penalties, such as execution. Universities were shut down for several years, the banking system was changed to Islamic banking, many privately owned industries and corporations like Iran Khodro (car manufacturer) were nationalised, and many others evolved into new organisations under Khomeini's direct rule like the national television and Pahlavi Foundation which became Emam organisation, in charge of former Shah's wealth and belongings.

Article 43 of the Islamic Republic constitution (1979) leaves the government with power over individuals in all aspects of the economy as it considers self-sufficiency as the main objective of the economy. Therefore, a modified version of the Soviet central planning style was implemented in Iran, emphasising Islamic values and making Iran an economy like no other in the world. Alongside the constitutional rights to manipulate the economy, the Islamic regime also considered many other privileges. Institutions like the Islamic Republic Guard Core (IRGC) and numerous other institutions directly led by the Supreme Leader hold the majority of Iran's economy and act as its executive authority in economic affairs in addition to its military and political nature (Nick Pay and Omond, 2023). Therefore, Iran exemplifies how political power and institutions can influence economic institutions and outcomes with fewer obstacles.

## 2. Methodology

Analysing the institutional quality of economic institutions is a novel idea among scholars, and it has not yet been examined for the majority of countries. Iran presents a unique opportunity to explore this topic. Islamic Revolution was a game-changing phenomenon as it unprecedentedly altered some of the already established international ties. Governments and international organisations then tried to find ways to predict similar events and, as a result, increase their immunity to asymmetric changes.

Iran could be an excellent economy as it was flourishing in the 1960s and 1970s; however, fifty years later, it is far from its previous conditions, thus making it a case to study. Various academic institutions have conducted such studies. However, as analysing the institutions, specifically economic institutions, is a new perspective to analyse the outcome of economies, this paper aims to use the developed methodology of economic institutions' quality to bring a novel view of the changes in Iran.

This paper evaluates institutional quality using the same criteria as Kotschy and Sunde (2017). Since this paper focuses primarily on economic institutions, following their footsteps, data from The Fraser Institute's Economic Freedom of the World Index is utilised to measure the quality of economic institutions. To represent the changes that have occurred in Iran over the past few decades, a number of indicators related to political regimes, political institutions and freedom from different sources have been chosen as independent variables.

Considering economic institutions' quality as the dependent variable, several other independent variables are used to analyse the potential relationship between them and institutional quality. Independent variables try to capture several views implemented or influenced by political changes, including the Status of the Political Regime, the Status of Political Institutions and the Status of Freedom. All independent variables are chosen from widely accepted indices with detailed data on Iran and a sufficient group of countries to have a control group.

After building the primary model, non-linearities and interactions are analysed to depict more accurate relations and better view the strength of influences between independent variables and Iran's economic and institutional quality from 1975 to 2021. Finally, the main findings are analysed alongside the historical changes in institutions and power structures in Iran, bringing a historical view from the last years of the Shah's

regime to the Islamic Revolution and war with Iraq to the twenty-first century to have a better analysis.

## **2.1 Research Limitations and Solutions**

In order to comprehend the outcome of the research, it is necessary to understand the boundaries of studying the relationship between political changes in Iran and the quality of institutions. Firstly, although plenty of datasets are available to measure the state of democracy, economy, freedom and institutions, not all of them cover a long period of data for Iran, thus bringing some practical difficulties in finding the exact relations between them. Secondly, for the available data, there is a degree of misinformation derived from incorrect or manipulated data provided by the official reports. Although many indexes are available for Iran, it is not ideally accurate to directly consider the official given data as a correct piece of information. Thirdly, there is little literature aiming at institutional quality in Iran, considering the newest stages of the discipline, even though numerous scholars have been assessing Iran since the Islamic revolution.

However, there are some degrees of response to these limitations. Technical issues regarding the shortage of data can be solved by correcting the data or by using the average between two available data of different periods to fill out the data for the missing period. Moreover, to have a comparison, it is possible to use the panel data of some group controls, like the entire dataset or Middle East and North Africa, or even countries with similar levels of starting status. Then, it would be possible to see the general trends among them and compare them with Iran. To control the possibility of untrustworthy data, we can implement checks and robust measures to estimate the close probabilities of correct results. This would be possible by using alternative yet correlated variables to check the correctness of trends. Another measure to tackle the untrustworthy data is to use coefficients. For example, as suggested by the night light study of Martinez (2018), autocratic regimes tend to lie around 1.15 times the actual number in GDP growth. As per studies of Fouladgar and Feizi (2023), Iran is also inaccurate about the reposted data. Therefore, the same coefficient can correct the data and make it closer to reality. However, due to the limitations of this paper, these extreme measurements are not used as this research aims to find general trends. Finally, because of the lack of related literature about Iran, general academic papers on institutional

quality and the influence of authoritarianism and political changes can be used alongside studies focused on Iranian change in the political and economic situation in recent years and in the aftermath of the 1979 Islamic Revolution.

## **2.2 Research Question and Hypothesis**

The political situation in Iran has been under heavy turbulence in the last five decades. It is unclear how much the changes have influenced the country's economic institutions. The hypothesis is that Iran has gone through a different pattern compared to similar countries, and the political changes in Iran have contributed to the deterioration of the quality of economic institutions. This relation is to be investigated, whether it is a correlation or causality.

## **2.3 Research Design**

The first step in analysing the quality of economic institutions in Iran is to have a view of the country's general economic outcome and measure the available data based on the Economic Freedom Index to see the trend during the research period. To investigate the possible influential factors, the assumption is built on the findings of Acemoglu et al. (2005) on the influence of political power and institutions on the economic outcome and Islam and Montenegro's (2002) conclusion on the importance of freedom-related factors on institutional quality. Therefore, correlations are conducted to analyse the possible relations and causalities. In order to have a robust understanding, non-linearities and interactions of variables are considered to see the overall trend of Iran and control countries. The objective here is not to reduce and simplify the entire cause of Iran's institution quality to a few factors; instead, the aim is to find the most related effects that the changes in political regimes and policies have brought to the country. To materialise this purpose, this paper is designed to investigate relations between political changes and the quality of economic institutions. Political changes are seen through three main channels: political regime, political institutions and level of freedom. The results of the political changes in Iran during the last half a century will then be discussed.

## **2.4 Dependent Variable**

Based on the model from Kotschy and Sunde (2017), economic institutions' quality is represented as the level of economic freedom; thus, measuring a country's economic

freedom is seen as equal to the level of economic institutional quality. Therefore, an already-tested method will be used to measure Iran's changes. Economic Freedom of the World is used to indicate the economic institutions' quality. Especially as the data is available for Iran and a sufficient number of control countries to make the findings more accurate. Table 1 demonstrates the dependent variable of Economic Freedom of the World.

#### **2.4.1 Economic Freedom of the World Index, The Fraser Institute**

Since 1996, when The Fraser Institute started to publish the Economic Freedom of the World Index, it has become a defining score for many studies and has been referred to by various interest groups. Their unique way of constituting the index makes it reliable and multi-dimensional. It includes 40 factors divided into five areas: Size of Government, Legal System and Property Rights, Sound Money, Freedom to trade internationally, and Regulation (Fraser Institute, n.d.). Size of Government explains the amount of governmental expenses, taxation, and government share of the economy. A larger government size means less freedom for the economy. Legal System and Property Rights focus on individuals' safety, judicial impartiality, and the rule of law, as they are known as the primary duty of a government and a basis for any development in the economy. Sound Money counts for economic fluctuations such as inflation as it undervalues the economic outcome of society members. Freedom to Trade Internationally explains the degree of isolation a country or region may suffer from. Being able to exchange in international markets is necessary for economic freedom worldwide. A necessity that Iran is heavily deprived of due to internal embargos and international sanctions. Regulation demonstrates how a legislative system influences economic outcomes and, by purpose, can foster or halt economic freedom.

The final index is in a range of 0 to 10, representing the least economic freedom to the most. Data is coded and defined in three periods. The estimation period uses fewer variables in intervals of five years from 1950 to 1970. Second, five-year intervals from the 1970s to 2000 are available for the standard new Economic Freedom index, which includes all factors. The last phase consists of the annual statistics from 2000 to 2021.

Only two observations from 1970 and 1975 are available for comparison before and after the Islamic Revolution. Since the 1970s data was insufficient to create a control group, 1975 was used as the starting point for this study. Moreover, five-year intervals

from 1975 to 2000 are split into five yearly observations to have a unified sample for the entire period. Said otherwise, if a country's data showed 10 in 1985 and 15 in 1990, the difference would be evenly adjusted, 11 for 1986, 12 for 1987, 13 for 1988, and 14 for 1989. The final understanding is unchanged because this adjustment was made for Iran and the control groups. The objective is to observe any differences throughout the period. The final set of data includes 47 yearly observations for Iran and control countries from 1975 to 2021 to evaluate the quality of economic institutions based on the Economic Freedom of the World Index.

## **2.5 Independent Variables**

To analyse the influence of political changes on the quality of economic institutions, this paper channelled political changes in three different views: the Status of Political Regime, the Status of Political Institutions, and the Status of Freedom. For each factor, a separate group of variables are chosen to demonstrate their relations with the Economic Freedom of the World Index as the dependent variable to show economic institutions' quality. Table 2 shows the list of all used independent variables.

### **2.5.1 Status of Political Regime: Democracy Point of Polity V**

Polity V, one of the most well-known and widely used indexes in the world, provides a variety of information about the political conditions of countries for more than 200 years. Various coding versions have been applied in published studies. In order to fulfil the requirements of this article, more specialised coding is used because the majority of the variables that construct the Polity V are binary. Primarily, the type of the political system is evaluated in the published data source, which spans 1800 to 2018. A British organisation called Global Change Data Lab works with a number of datasets, and their Polity V model provides a Democracy Point that codifies the original dataset into one variable. Data from the Democracy Point, which includes 44 observations per nation, is comparable to data from the World Economic Freedom Index for most of the same time from 1975 to 2018. The Democracy Point is a more descriptive metric that depends on a nation's political system. It is predicated on assessments of the characteristics of authoritarian and democratic power in governing bodies. The Polity V consists of six component metrics that document essential aspects of executive recruitment, limitations on executive authority, and political competition (Centre for Systemic Peace, n.d.). It also documents modifications to the institutionalised



characteristics of the executive branch. However, it offers a straightforward but comprehensive perspective on the overall state of political systems.

### **2.5.2 Status of Political Institutions: Political Rights and Civil Liberties, Freedom House**

Political Rights (PR) and Civil Liberties (CL), which Kotschy and Sunde (2017) used as a measure of the quality of political institutions, are generally recognised as the standard way to assess political performance. Similar to the majority of indices now in use, they are factor variables with several subcategories, as it is impossible to accurately determine a country's political, social, and economic functions using a single metric like GDP or national debt. Thus, having a multi-dimensional view is necessary to understand a political system's outcome. Freedom House's calculation of the average of PR and CL measures whether a country is free, partially free, or not free. Variables are coded from 1 to 7. If the average of Political Rights and Civil Liberties is below 3, the country or territory is not free; between 3 and 5 is Partly Free, and between 5 and 7 is Not Free. With the exception of three relatively free years from 1979 to 1981, which were the early years of the revolution, and no single group had enough power to impose its will, Iran was not free for the whole study period from 1975 to 2021. A higher PR and CL score means lesser freedom. Many of the control countries were initially reported as unfree; however, many of them began to transform during this time, an opportunity that Iran was not able to actualise.

### **2.5.3 Status of Freedom: World Bank's Freedom variables**

Defining and measuring the concept of freedom are ongoing challenges in scholarship. Although hard to define, freedom is a sensible element of human life. It is not possible to understand freedom through a single approach. Therefore, several variables should be considered to assess the changes in freedom. World Bank, as one of the primary providers of data on different aspects of freedom, offers a suitable dataset of variables that can be used to demonstrate the changes in the status of freedom. In the first phase, the overall situation of the autocratic theocracy is depicted using a set of freedom-related indicators available for Iran and control nations. This new combination of variables is called the Freedom Selection throughout this paper. The Freedom Selection variable consists of Freedom of association and assembly, Freedom of expression, Freedom of movement, Freedom of religion, and Freedom of thought,

conscience, and religion. For simplicity, the average of all the variables for Iran and control countries is used to show the status of freedom.

Three additional variables of harassment of journalists, impartial administration, and judicial independence were chosen to assess Iran and the control nations in order to provide a different perspective on freedom when comparing Iran to other nations. They can serve as a highlighter of the distinctions between Iran and other countries, as well as supplementary aspects of freedom.

<b>Dependent Variable (representing Economic Institutions' Quality)</b>	<b>Publisher</b>	<b>Available Period</b>
Economic Freedom of the World Index	The Fraser Institute	1975-2021 (47 observations)

Table 1, List of the Dependent variable. The Economic Freedom of the World Index from The Fraser Institute is used as the indicator of Economic Institutions' Quality.

<b>Independent Variables</b>	<b>Publisher</b>	<b>Available Period</b>
Democracy Point	Polity IV coded by Global Change Data Lab	1975 to 2018 (44 observations)
Civil Liberties	Freedom House	1975 to 2021 (47 observations)
Political Rights	Freedom House	1975 to 2021 (47 observations)
<b>Freedom Selection (consists of below indexes)</b>		
Freedom of association and assembly	World Bank	1975 to 2021 (47 observations)
Freedom of expression	World Bank	1975 to 2021 (47 observations)
Freedom of movement	World Bank	1975 to 2021 (47 observations)
Freedom of religion	World Bank	1975 to 2021 (47 observations)
Freedom of thought, conscience, and religion	World Bank	1975 to 2021 (47 observations)
<b>Other Freedom related indexes</b>		
Harassment of journalists	World Bank	1975 to 2021 (47 observations)

Impartial administration	World Bank	1975 to 2021 (47 observations)
Judicial independence	World Bank	1975 to 2021 (47 observations)

Table 2, List of Independent variables. Including Democracy Point from Polity IV, Political Institutions variables (Civil Liberties and Political Rights) from Freedom House and Freedom variables from World Bank.

## 2.6 Control Groups

In order to compare the results, two groups were chosen for better observation and to point out the changes in Iran. The selection was based on the availability of the data for the entire chosen time, which ran from 1975 to 2021. Iran had an excellent rating in 1975, coming in at 32nd place with an index of 5.98 out of 108 sovereign nations for which data was available. The first group of countries consists of 14 countries with available data from Pakistan to Morocco, as shown in Table 3, to give a comparative view of Iran in its surrounding region. The second group of countries are chosen based on their 1975 rankings. This group, as shown in Table 4, includes 17 countries worldwide, ranging from rank 24 to 40, with an index of 5.60 to 6.36. Bahrain and Iran are present in both control groups. Bahrain is included because of its 1975 ranking and geographic position, which suits both control groups. Iran is included in both samples because the objective is to measure the average outcome of the control groups during the study period.

Control-1 Countries	Economic Freedom	Rank
Algeria	3.61	97
Bahrain	5.6	84
Egypt, Arab Rep.	4.14	78
Iran, Kingdom.	5.98	32
Israel	4.43	59
Jordan	5.06	55
Kuwait	5.16	66
Morocco	4.89	60
Oman	5.05	95
Pakistan	3.66	87

<b>Syrian Arab Republic</b>	<b>4.06</b>	<b>40</b>
<b>Tunisia</b>	<b>5.4</b>	<b>46</b>
<b>Türkiye</b>	<b>4.41</b>	<b>79</b>
<b>United Arab Emirates</b>	<b>6.48</b>	<b>22</b>

Table 3, List of Control-1 group of countries and their Economic Freedom in 1975 and their rank among 108 assessed countries. (Monfared Nik, 2024)

<b>Control-2 Countries</b>	<b>Economic Freedom</b>	<b>Rank</b>
<b>Ireland</b>	<b>6.36</b>	<b>24</b>
<b>United Kingdom</b>	<b>6.31</b>	<b>25</b>
<b>Barbados</b>	<b>6.3</b>	<b>26</b>
<b>Nicaragua</b>	<b>6.28</b>	<b>27</b>
<b>Mexico</b>	<b>6.27</b>	<b>28</b>
<b>Panama</b>	<b>6.22</b>	<b>29</b>
<b>Guatemala</b>	<b>6</b>	<b>30</b>
<b>Thailand</b>	<b>5.99</b>	<b>31</b>
<b>Iran, Kingdom.</b>	<b>5.98</b>	<b>32</b>
<b>Niger</b>	<b>5.98</b>	<b>32</b>
<b>Cyprus</b>	<b>5.89</b>	<b>34</b>
<b>Italy</b>	<b>5.74</b>	<b>35</b>
<b>Spain</b>	<b>5.67</b>	<b>36</b>
<b>Paraguay</b>	<b>5.66</b>	<b>37</b>
<b>South Africa</b>	<b>5.64</b>	<b>38</b>
<b>Greece</b>	<b>5.62</b>	<b>39</b>
<b>Bahrain</b>	<b>5.6</b>	<b>40</b>
<b>Fiji</b>	<b>5.6</b>	<b>40</b>

Table 4, List of Control-2 group of countries and their Economic Freedom in 1975 and their rank among 108 assessed countries. (Monfared Nik, 2024)

### 3. Results

The Iranian economy has been under severe fluctuations under the Islamic rule of clergy for 45 years. Initial unrest caused by revolutionary forces fighting each other, followed by war with Iraq for eight years, made the first ten years of the young Islamic state overwhelmingly unstable. The afterwards reconstruction period brought a sight of prosperity, but soon, internal and external factors proved that steady growth could not be imagined for Iran. Figure 2 shows Iran's annual percentage of GDP growth for the sixty years of 1963 to 2023. Two main observations can be seen from the trend. First is the instability of growth as fluctuations of +20 per cent to -20 per cent are happening throughout the period, showing the unpredictability of the political and economic situation. Second is the general shift that happened after the Islamic revolution. The trend line from 1963 to 1977 shows an average of +10 per cent, while the general trend from 1979 to 2023 has an average of +2 per cent. This understanding shows that the growth of the Iranian economy has become five times less on average after the 1979 revolution. Therefore, GDP growth is one of the main indicators of the general economic outcome, and it indicates that the country's political situation has impacted the Iranian economy.



Figure 2, Annual percent of GDP growth of Iran from 1975 to 2021. Data from the World Bank (Monfared Nik, 2024)

To see how political changes influenced Iran's economy, this paper focuses on their

effect on the quality of economic institutions. As stated earlier, based on Kotschy and Sunde (2017), the Economic Freedom of the World Index from the Fraser Institute is used as the indicator of economic institutions' quality. Figure 3 demonstrates the changes in the index throughout the study period (1975 to 2021). Although Iran periodically experienced some growth, over the length of the study period, Iran ended up lower than where it began, reducing the quality of economic institutions from above six units in 1975 to 4.5 units in 2021. This change may not look nominally significant, but it is essential to mention that the general condition of institutions varies very little over time, even though their impact is much higher on politics and the economy. Three separate views can be explored to observe how Iran's institution's quality has deteriorated, as shown in Figure 3. First is the comparison of Iran with Iran. Except for the short period of 1997 to 2002, which coincided with the first round of Khatami's presidency and the implementation of some reforms, Iran experienced either deterioration or stalemate for the rest of the period. This shows that even hopes of reforms cannot resist the entirety of the system. After every short period of growth, all changes would eventually be reverted to even lower than the beginning.

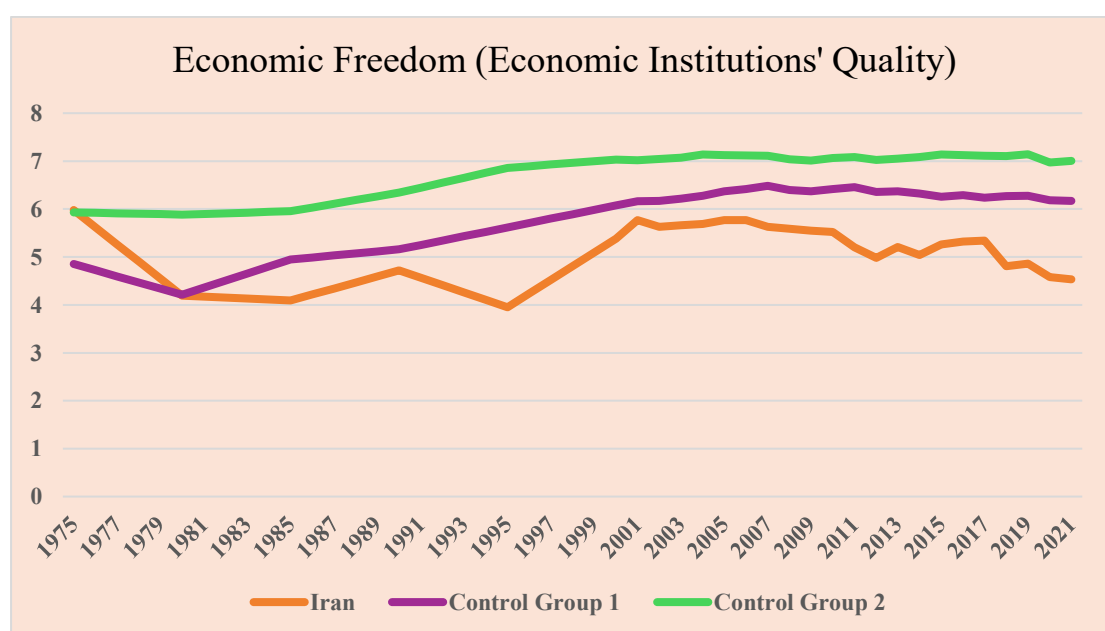


Figure 3, Changes of Economic Freedom Index between 1975 to 2021 in Iran and Control groups 1 and 2 (Monfared Nik, 2024)

The second observation is the comparison of Iran and the first control group's economic institutions' quality, which includes countries that have geographical, historical and cultural similarities with available data. Starting in 1975, only one

country, the United Arab Emirates (UAE), out of 12 countries in the sample, had a better record than Iran. UAE was established recently, and its institutions were still under development. Other countries, as reported in Figure 3, had significantly lower scores and ranks, as closest to Iran was Tunisia, with a 5.4 score and ranked 46. In contrast, Iran had a score of 5.98, occupying the 32nd rank. The average of the first control group was one entire unit lower than Iran, deducting Iran's involvement in the calculation; the average of the first group dropped down to 4.6, which shows how Iran was doing better compared to its neighbours and the more significant regions of the Middle East and North Africa. However, in 2021, results are highly reversed, except for Syria, which has been under a decade of civil war, and all other countries reported higher scores in the Economic Freedom of The World Index than Iran. The first difference between control group 1 and Iran is the relative stability. While Iran was experiencing turbulence for four decades, on average, other countries tried to slowly but continuously better off their institutions, which resulted in higher economic institutions' quality for most of them at the end of the period. The second difference is how, immediately after the Islamic revolution, Iran's economic freedom index decreased to the level of the first control group's average and could never reclaim its position again. At the end of the period, the first group's average increased by around 1.5 units, reaching the stage Iran had in 1975, while Iran's score of 4.5 shows the gap between them. In summary, from 1975 to 2021, other countries of the region reached the level of Iran in the beginning, while Iran also reached as low as other countries' average at the beginning of the series.

Control group 2, as shown in Figure 3, contains various countries on four continents. Although they had similar levels of quality in terms of economic institutions in 1975, they came from different backgrounds, from the United Kingdom to newly independent Bahrain. Many of the second group control counties experienced political changes in the same period as Iran or after, like Nicaragua and Niger. Despite all the differences and instabilities that some of the group 2 counties went through, the average still outperformed Iran significantly. With an economic freedom rating of 4.5 in 2021, Iran placed considerably behind all other nations, with Niger being the closest to Iran at 5.8. The group average is 6.6. Taking similar group control two as the representative of potential Iran's performance in case of not having the political changes, Iran's economic institutions' quality could be more than two unites higher. This indicates that

the opportunity cost of political changes is much higher than the loss in the quality of institutions. As shown in Figure 3, the outcomes of the two control groups were similar, although on different scales. Group 2 had a growth of 1.5 units, while Group 1 saw an increase of one unit. Iran, however, suffered severe losses at the same time, particularly when compared to control group 2, as at first, they were all identical.

The secondary analysis level focuses on the impact of different measures of political change and their correlation with changes in economic institutions. As for this paper, political changes are seen through three different windows. Level of authoritarianism, political institutions and level of freedom. As we know, political power influences economic outcomes. However, defining the leading figures within the political power can determine the scale of this influence, which is still a developing discipline.

Nevertheless, it is still possible to determine the more influential factors that have a deeper relation for one specific country, in this case, Iran. Adopting the difference-in-difference method seems beneficial for that goal since it would allow for precisely observing the elements that define Iran's economic institutions' quality by imposing controls on other nations or other potential independent variables. Nevertheless, the prerequisites of the difference-in-difference method are not fulfilled. Control countries differ from Iran and other countries in their group in many areas, politically, socially, economically, historically, and geographically, although they were similar in the region and in terms of economic freedom in 1975. Correlations and correlation comparisons are thus utilised to analyse the relationships.

Table 5 shows the correlations between the quality of economic institutions in Iran, the first and second control groups, and the independent variables of political change. The findings show a strong correlation between the three independent variable groups and economic freedom (representing economic institutions' quality). Nonetheless, the direction and importance of these relationships differ depending on the group controls and independent factors. In general, control groups 1 and 2 demonstrate more observable and direct relations compared to the results for Iran. One possible explanation for this result is having a higher number of observations. Nonetheless, it makes it evident how differently Iran behaved from other nations. To unveil the results, each variable trend over the period and its correlations are analysed separately.



**Table 5**

Effect of Political Changes on Economic Institutions' Quality

	Economic Freedom of The World Index		
	Iran (1)	Control 1 (2)	Control 2 (3)
<b>1- Status of political regime</b>			
Democracy Point	0.035 (0.024)	0.458*** (0.031)	0.188*** (0.009)
Observations	44	616	792
<b>2- Level of political institutions</b>			
Civil Liberties	-0.006* (0.175)	0.368** (0.434)	0.188** (0.105)
Political Right	0.487*** (0.212)	1.742*** (0.544)	-1.071*** (0.100)
Observations	47	658	846
<b>3- Level of freedom</b>			
Freedom Selection	10.230*** (1.980)	35.864*** (5.080)	7.652*** (0.472)
Harassment of Journalists	5.876*** (1.083)	16.966*** (0.886)	7.733*** (0.431)
Impartial Administration	-0.162 (1.522)	-43.96*** (6.532)	23.467*** (1.590)
Judicial Independence	-6.687** (3.160)	33.967*** (8.293)	17.235*** (1.743)
Observations	47	658	846

Table 5, Simple Regressions. \*p<0.1; \*\*p<0.05; \*\*\*p<0.01. (1) represents the Economic Freedom of Iran, (2) represents the Economic Freedom of Control Group 1, including the countries in the region of Middle East and North Africa, (3) represents the Economic Freedom of Control Group 2, including the countries with a similar level of Economic Freedom in 1975. The first part of the table represents regressions between Economic Freedom and variables provided by Polity V (democracy point), Freedom House (Civil Liberties and Political Rights) and World Bank (Freedom Selection – consistent of Freedom of association and assembly, Freedom of expression, Freedom of movement, Freedom of religion, and Freedom of thought, conscience and religion-, Harassment of Journalists, Impartial Administration, and Judicial Independence). (Monfared Nik, 2024)

### 3.1 Status of Political Regime (result for Democracy Point)

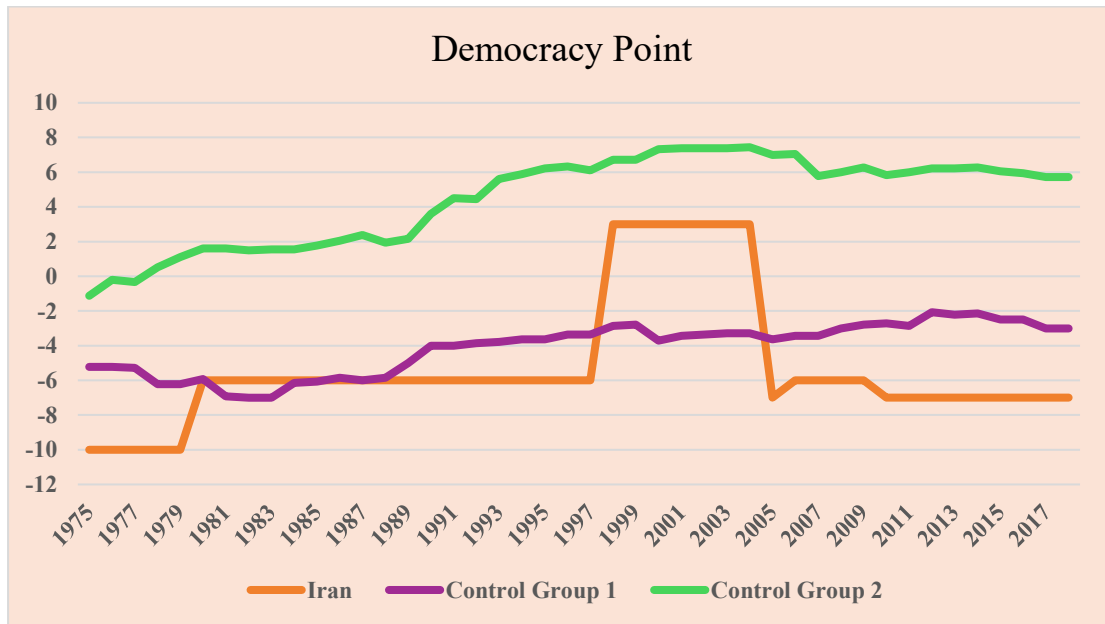


Figure 4, Changes of Democracy Point by Polity V between 1975 to 2018 in Iran and Control groups 1 and 2 (Monfared Nik, 2024)

Democracy Point for Iran remained relatively unchanged in the last four and half decades. Other than some small progress in the middle of the period, it demonstrates a still number the rest of the time. However, all records categorise Iran as a not democratic state. The steady situation of Iran in terms of Democracy Points while its deteriorating economic freedom index shows that these two variables do not correlate. However, at the same time, both other group controls demonstrated a rational reaction, and their Democracy Point, on average, correlated with the quality of their economic institutions, adding to the understanding that Iran acted as an outlier compared to similar countries.

However, compared to other independent variables, the correlation for the democracy point is less significant and of lesser value. This indicates that while democracy is essential, it is not as important as other aspects of political change. However, it should be noted that the democratic point only serves as a simplified illustration of democracy, indicating whether a nation is democratic or not based on a limited set of assessment factors.

### 3.2 Status of Political Institutions (result for Civil Liberties Political Right)

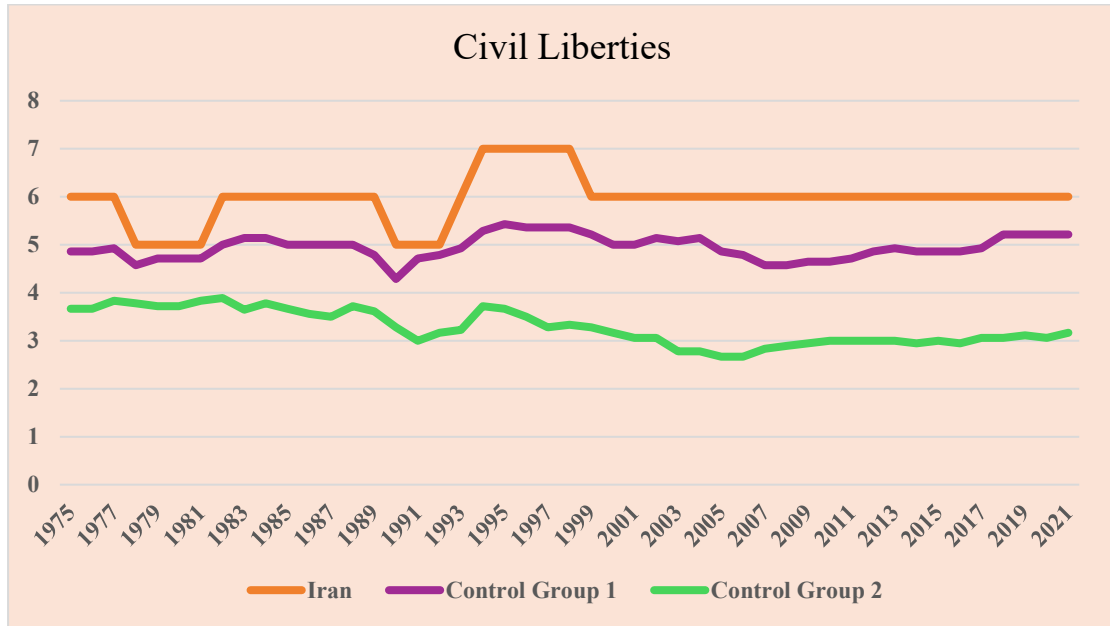


Figure 5, Changes of Civil Liberties Index of Freedom House between 1975 to 2021 in Iran and Control groups 1 and 2 (Monfared Nik, 2024)

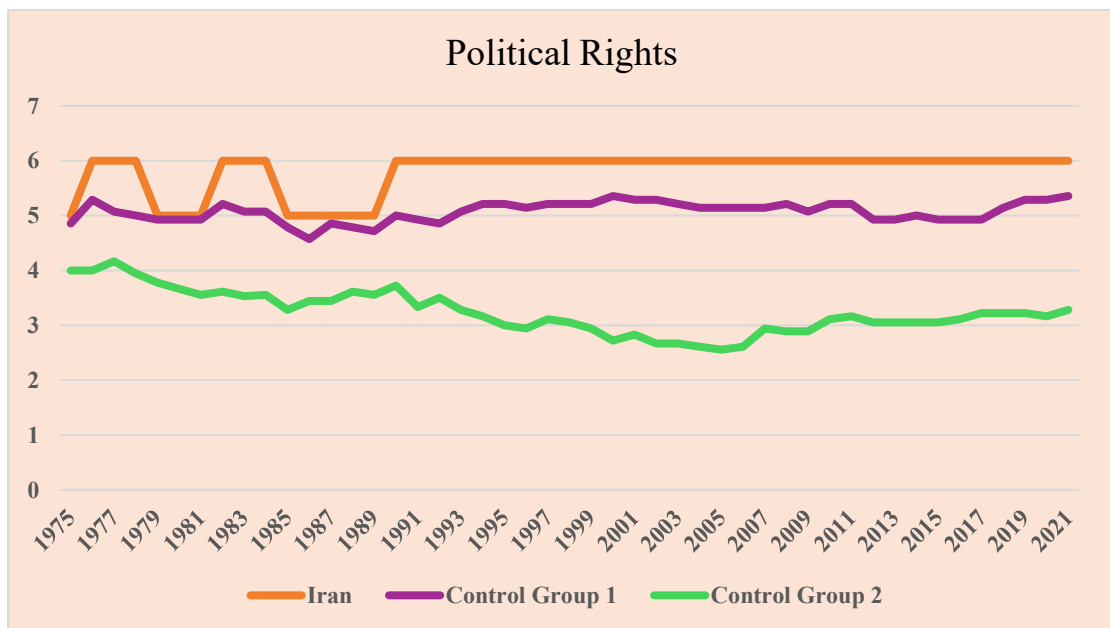


Figure 6, Changes of Political Rights Index of Freedom House between 1975 to 2021 in Iran and Control groups 1 and 2 (Monfared Nik, 2024)

As the indicator of political institutions' quality, the first important point in reading the results is that Political Rights (PR) and Civil Liberties (CL) are their scales. CL and PR are on a scale of 1 to 7; however, 7 means the least Civil Liberties and Political Rights. This means that a higher score on CL or PR means the political institutions are

of lesser quality. Figures 5 and 6 show the Civil Liberties and Political Rights trend from 1975 to 2021. Both indexes demonstrate minor changes for Iran, which is also captured in Table 5. For group controls 1 and 2, CL and PR negatively correlate with Economic Freedom (economic institution's quality), which is a reasonable reaction due to the scaling mode of both indexes. However, in the first control group, which are countries similar to Iran, both CL and PR tend to be more indifferent over time. This suggests that, in these regions, increased civil liberties and political rights do not necessarily lead to higher economic freedom. Despite progress in other areas, the relatively unchanged status of many regional countries may contribute to this pattern. In contrast, the second control group, which includes more democratic countries, shows a positive relationship, indicating that higher civil liberties and political rights could be associated with improved economic freedom in different contexts. However, their effect on the Economic Freedom Index (economic institutions' quality) is minor, and the correlation is not intense.

The correlation results for Iran indicate that the quality of political institutions has a minor relationship with and impact on the quality of economic institutions. Findings in both Table 5 and Figures 5 and 6 suggest that Iran has a different pattern than other groups and did not act predictably. Nevertheless, the pattern suggests that the relationship between political changes and economic outcomes is complex and context-dependent.

### **3.3 Status of Freedom (result for freedom variables)**

The factor variable of Freedom Selection and other variables under the Status of Freedom have the most noticeable correlations. Economic institutions' quality (measured by the Economic Freedom Index) of Iran and the control groups demonstrate a strong response to shifts in the status of freedom. Results that are statistically significant indicate that there might be a correlation between the level of freedom and the quality of economic institutions. The parameters selected in this work to symbolise freedom do not coincide with the criteria that define the Economic Freedom of the World Index. Therefore, economic freedom can either independently affect or be influenced by the level of freedom in a given nation. This correlation, however, is insufficient to describe the direction of the relation. Additional research may be necessary to uncover this relationship because other hidden criteria may influence the

third element. Figures 3 and 7 demonstrate the nearly identical patterns for both trends. To better understand this relationship, one can examine their lag together with econometric measures to find how much changes in the level of freedom can predict the changes in the level of institutional quality. Figures 8, 9, and 10 depict the progress of the Impartial Administration, Judiciary Independence, and Journalist Harassment throughout time. According to their pattern, Iran did not change or get worse between 1975 and 2021, while other countries performed better. It was expected that the second group would perform better based on results from the Democracy Point (figure 4) and political institutions (Figures 5 and 6). The second group of countries became increasingly democratic within the study period. Table 5 demonstrates that other indicators of the status of freedom are as significant as the Freedom Selection, demonstrating that other factors may have a more pronounced effect or at least a predictable correlation with economic freedom in addition to the direct political features of an authoritarian regime. Statistical significance, together with highly correlated trends, shows that an economic institution's quality is more sensitive towards the level of freedom, which confirms the finding of Islam and Montenegro (2002), as they believed that freedom and institutional quality are highly related.

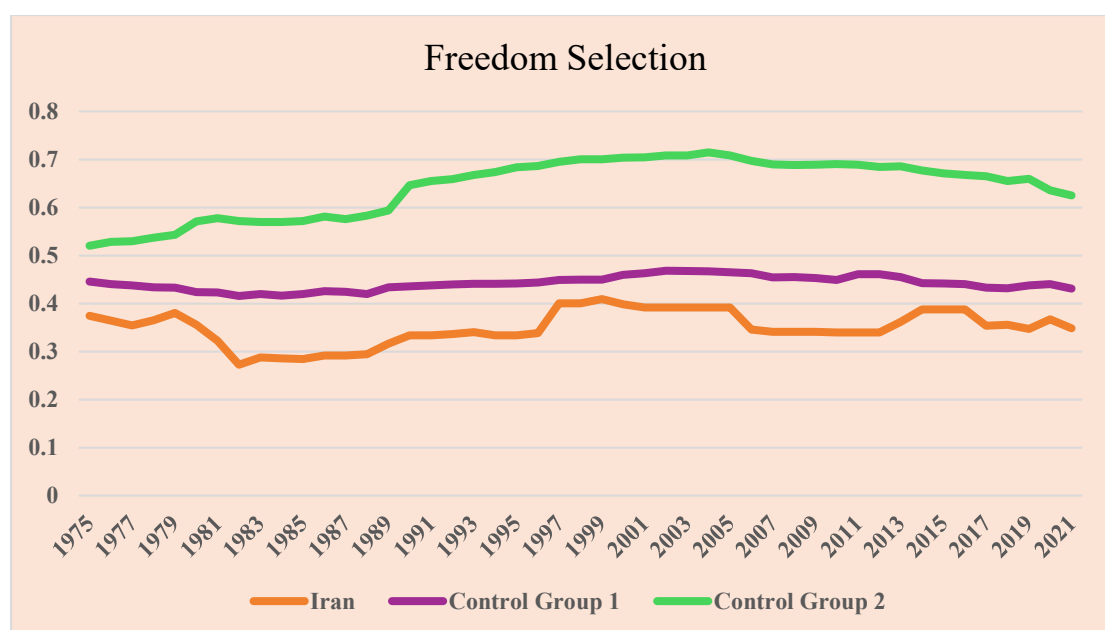


Figure 7, Changes of Freedom Selection (including Freedom of association and assembly, Freedom of expression, Freedom of movement, Freedom of religion, and Freedom of thought, conscience, and religion) by World Bank between 1975 to 2021 in Iran and Control groups 1 and 2 (Monfared Nik, 2024)

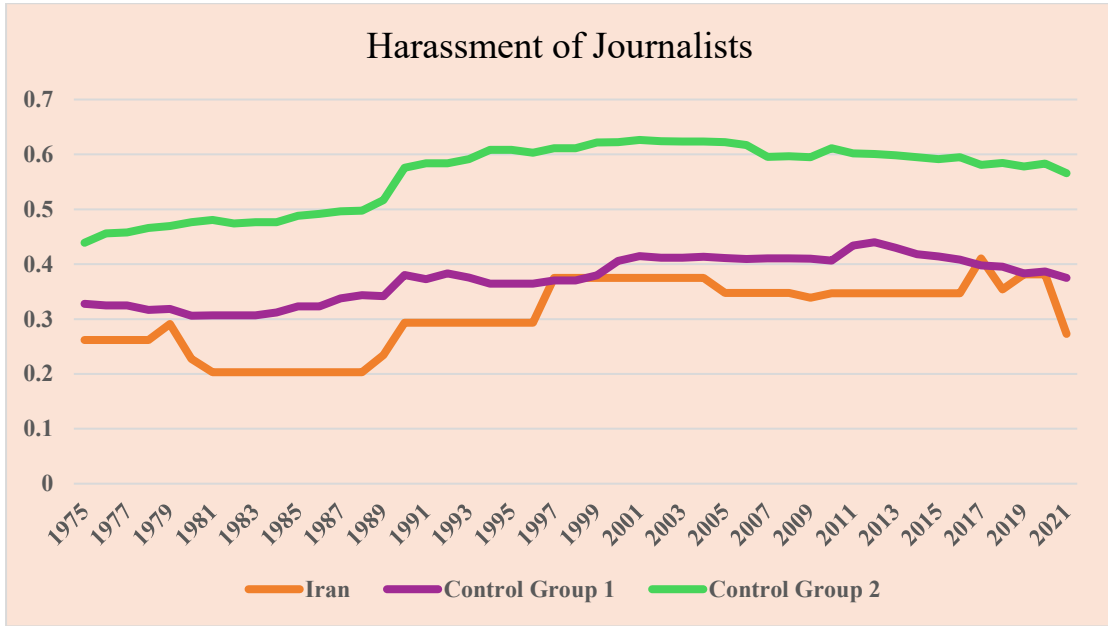


Figure 8 Changes of Harassment of Journalists by World Bank between 1975 to 2021 in Iran and Control groups 1 and 2 (Monfared Nik, 2024)

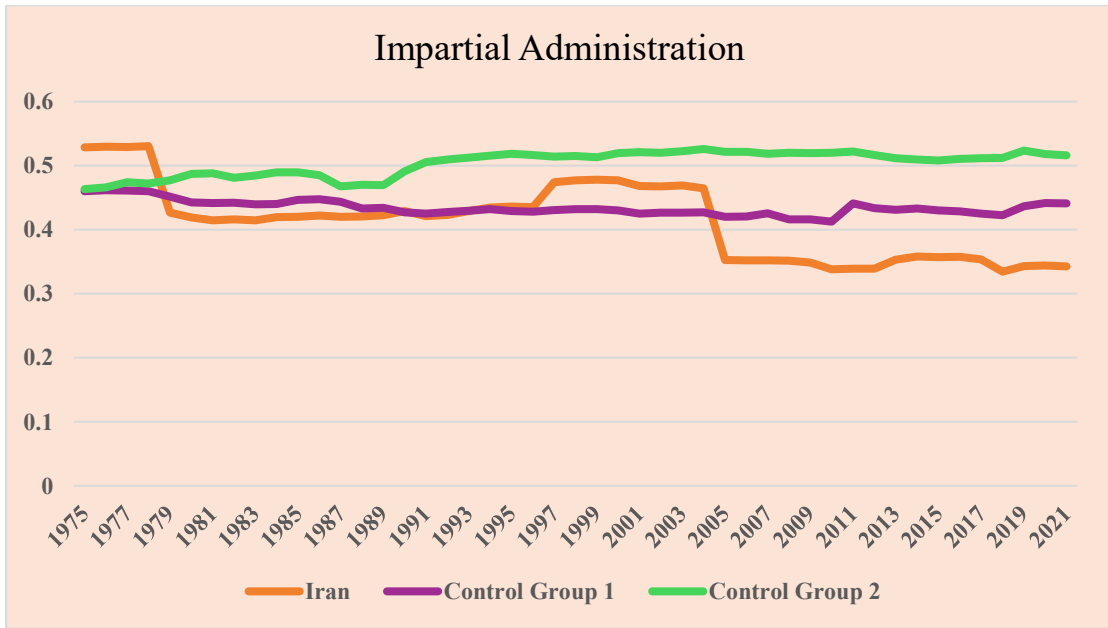


Figure 9, Changes of Impartial Administration by World Bank between 1975 to 2021 in Iran and Control groups 1 and 2 (Monfared Nik, 2024)

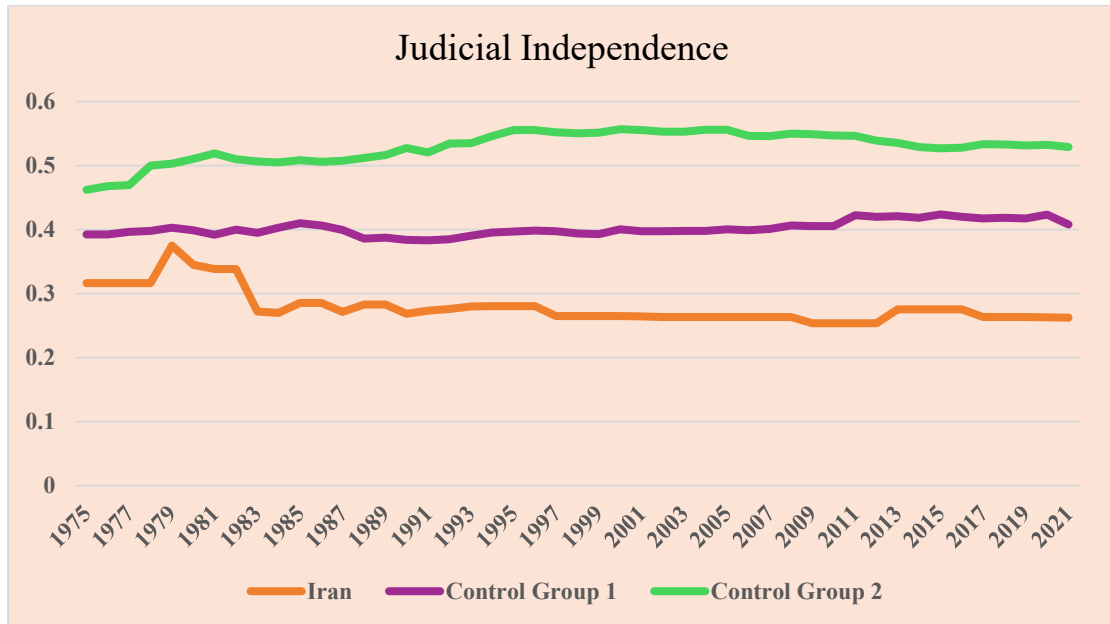


Figure 10, Changes of Judicial Independence form World Bank between 1975 to 2021 in Iran and Control groups 1 and 2 (Monfared Nik, 2024)

### 3.4 Robust Test

To compare all of the factors from a different angle and have a more comprehensive understanding of them, Table 6 uses the non-linearities of independent variables to illustrate the same correlations as Table 5. The goal of such modification is to observe the influence of variables in their square form. The same reasoning is applied in Table 7 to examine the correlations of economic institutions’ quality with the interaction of different indicators.

#### 3.4.1 non-Linearities

Table 7 depicts the more in-depth impact of variables. All independent variables in Table 6 are multiplied by a power of two to increase the significance of their correlation with the dependent variable. Apart from civil liberties, all independent variables are statistically significant with low standard errors. This suggests that in analysing the quality of economic institutions, it can be more accurate to use the squared form of the independent variables. Non-linear regression, however, highlights the distinctions between the Iranian and control groups as well as the importance of status Freedom over other political changes.

**Table 6**

Effect of Political Changes on Economic Institutions' Quality - Non-Linear

	Economic Freedom of The World Index		
	Iran (1)	Control 1 (2)	Control 2 (3)
<b>1- Status of political regime</b>			
Democracy Point	0.002* (0.003)	-0.049*** (0.003))	0.0245*** (0.001)
Observations	44	616	792
<b>2- Status of political institutions</b>			
Civil Liberties	-0.003 (0.014)	0.037 (0.044)	-0.180*** (0.015)
Political Right	0.044** (0.019)	0.173*** (0.054)	-0.162*** (0.015)
Observations	47	658	846
<b>3- Status of freedom</b>			
Freedom Selection	14.669*** (2.899)	40.386*** (5.756)	6.130*** (0.381)
Harassment of Journalists	10.559*** (2.210)	17.644*** (1.935)	6.572*** (1.172)
Impartial Administration	2.214*** (1.520)	-43.96*** (6.532)	10.764*** (3.402)
Judicial Independence	0.161*** (5.359)	13.912*** (4.617)	-6.745*** (2.581)
Observations	47	658	846

Table 6, Non-linear Regressions, all independent variables are analysed in their squared form. \*p<0.1; \*\*p<0.05; \*\*\*p<0.01. (1) represents the Economic Freedom of Iran, (2) represents the Economic Freedom of Control Group 1, including the countries in the region of Middle East and North Africa, (3) represents the Economic Freedom of Control Group 2, including the countries with a similar level of Economic Freedom in 1975. The first part of the table represents regressions between Economic Freedom and variables provided by Polity V (democracy point), Freedom House (Civil Liberties and Political Rights) and World Bank (Freedom Selection – consistent of Freedom of association and assembly, Freedom of expression, Freedom of movement, Freedom of religion, and Freedom of thought, conscience and religion-, Harassment of Journalists, Impartial Administration, and Judicial Independence). (Monfared Nik, 2024)



### 3.4.2 Interactions

Table 7 indicates the influence of independent variables when they interact with each other. For this purpose, only the Status of Political Institutions and Status of Freedom are selected, as the Status of Political Regime shown via Democracy Point reported less significant results in standard correlation and non-linear calculations. Thus, political changes in this view can be seen as a combination of political institutions and the level of freedom. Both interacted new variables demonstrate significant relations with economic institutions' quality. However, it can be seen that Iran is more sensitive towards freedom than political institutions. This and other findings show that results for freedom are more related to the situation than other independent variables.

<b>Table 7</b>			
Effect of Political Changes on Economic Institutions' Quality - Interactions			
	Economic Freedom of The World Index		
	Iran	Control 1	Control 2
	(1)	(2)	(3)
<b><i>1- Status of political institutions (interactions)</i></b>			
Civil Liberties	0.023	0.122**	-0.194***
x	(0.020)	(0.122)	(0.012)
Political Right			
Observations	47	658	846
<b><i>2- Status of freedom (interactions)</i></b>			
Freedom Selection			
x			
Harassment of journalists			
x	80.821***	169.096***	18.311***
Impartial administration	(20.132)	(11.824)	(1.097)
x			
Judicial independence			
Observations	47	658	846

Table 7, Regression between Economic Freedom Index and Interactions of Independent variables. \*p<0.1; \*\*p<0.05; \*\*\*p<0.01. (1), (2), and (3) are the same as Tables 1 and 2. Interacted variables are Freedom House's Civil Liberties and Political Rights and World Bank's Freedom Selection (consisting of Freedom of association and assembly, Freedom of expression, Freedom of movement, Freedom of religion, and Freedom of thought, conscience, and religion), Harassment of Journalists, Impartial Administration, and Judicial Independence. (Monfared Nik, 2024)

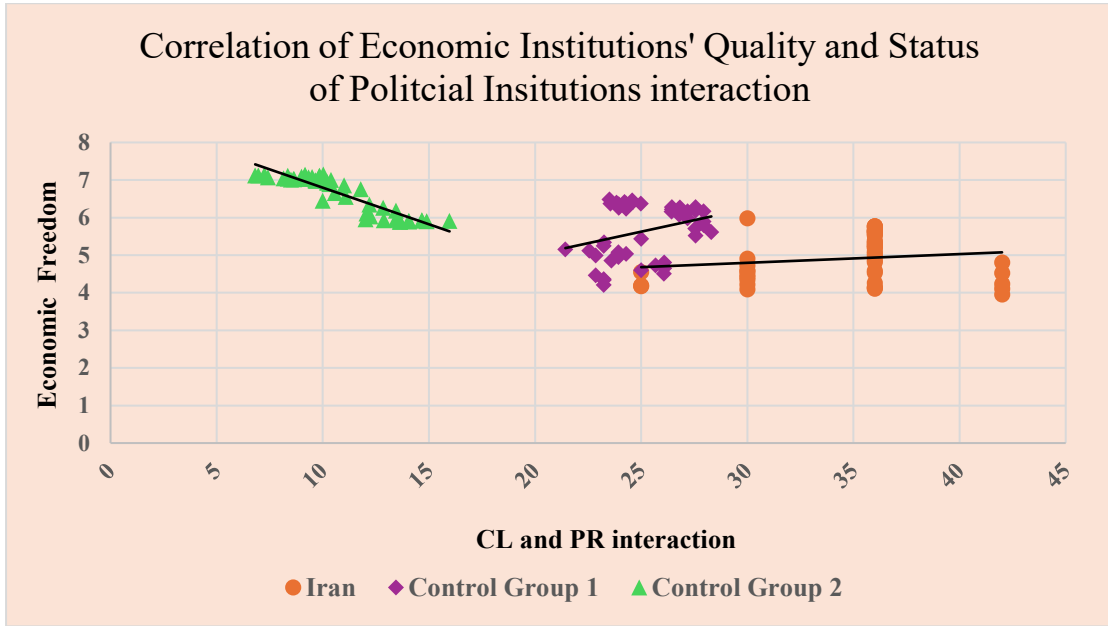


Figure 12, Correlation between Economic Freedom of the World and Interaction of Freedom House’s Civil Liberties and Political Rights (CL\*PR) (Monfared Nik, 2024)

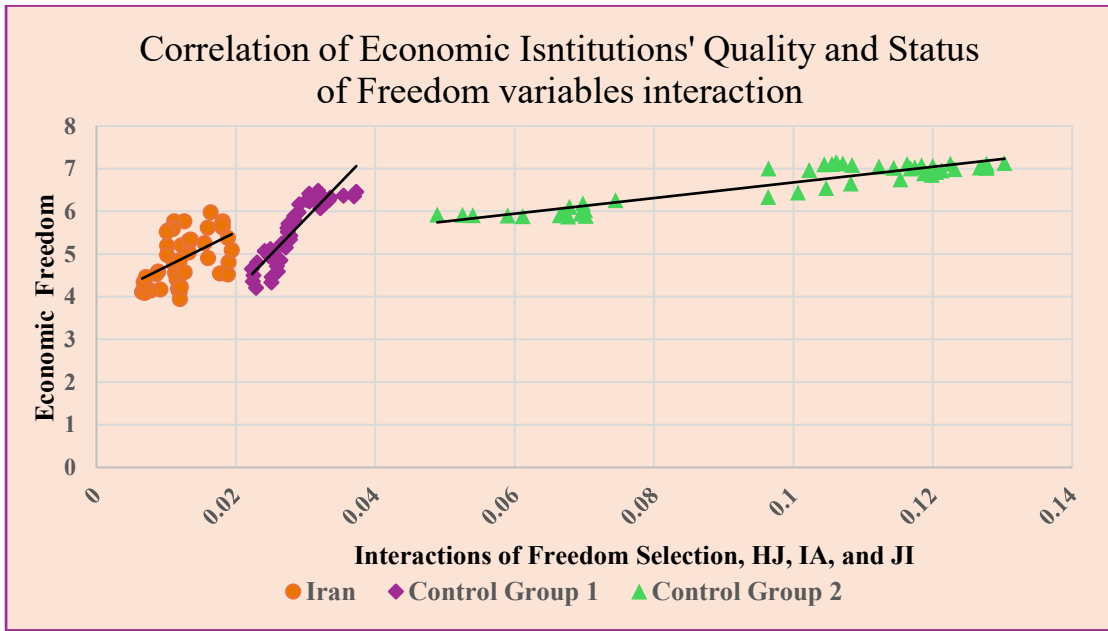


Figure 13, Correlation between Economic Freedom of the World and interaction of Freedom Selection variable (consisting of Freedom of Association and Assembly, Freedom of Expression, Freedom of Movement, Freedom of Religion, and Freedom of Thought, Conscience, and Religion) and variables of Harassment of Journalists, Impartial Administration and Judicial Independence (Freedom Selection\*HJ\*IA\*JI) (Monfared Nik, 2024)

Figures 12 and 13 show the correlations between the quality of economic institutions and two more significant independent variables (Status of Political Institutions and Status of Freedom). Figure 12 demonstrates the predictability of group control two as countries act rationally and with negative correlations, which is aligned with the reverse

grading of CL and PR, which, for Iran, is not direct and unpredictable. Figure 13 indicates the correlation between the quality of economic institutions and the interaction of the status of freedom indicators. Iran and the control groups all show positive effects in this measurement. However, compared to the second group, Iran's and Group 1's slopes are substantially steeper. This demonstrates the strong correlation between social and economic freedom and that in a country lacking freedom, like Iran and many other countries in control group 1, improvement in freedom is closely linked to the development of economic institutions. However, more investigation is needed to determine whether this relationship is causation or simply a strong correlation.

### 3.5 Main Model

The findings of the correlations shown in Table 5 cannot determine the constituting factors of economic institutions' quality, as such a strong statement needs more in-depth analysis and Iran, as an outlier, cannot clearly show the optimal results. However, this paper shows that freedom has a more substantial relation with economic institutions' quality (economic freedom of the world index), and based on this relation, we can develop a relative model to explain the outcomes. The significance of the correlation results indicates that economic institutions' quality can potentially be influenced by political changes. For this influence, we can imagine:

$$\text{Economic Institutions' Quality} \sim a(F) + b(R) + N + e, a > b$$

In this potential equation, F indicates the status of freedom. R represents the status of democracy and the status of political institutions. N indicates other factors that can potentially influence the quality of institutions, and e is the standard error. As Tables 6 and 7 show, non-linearity and interaction are more correlated with economic institutions' quality. Lastly, *a* is the constant for the status of freedom, and *b* stands as the constant for the status of democracy and the status of political institutions. According to Tables 5, 6, and 7, the status of freedom is more influential than democracy and political institutions, and thus *a* is bigger than *b*.

## 4. Discussion

Several aspects are needed to analyse the effects of a specific event on the general outcome of an enormous organism like a society. Understanding Iran's political structure and changes in how the political apparatus runs the country and its economy

is no exception. Iran was going through a path similar to many other countries, slowly compensating the gap with modern Western countries and preparing itself for the age of communications and information. However, living in an area of revolutions and political movements, Iran went in a different way. Shah's regime, although not the most democratic regime by the mid-twentieth century measurements, kept Iran in steady growth for several decades. His resistance to certain political oppositions turned them into radical revolutionaries, which finally succeeded in overthrowing him in February 1979, leaving Iran in the hands of Islamic clergy and leftist groups, which both had a long history of opposing Shah's policies in various fields. As with any other revolution, chaos became the norm of the country for the first few years, accompanied by war and international isolation alongside domestic unrest, which continues to this very day.

Iran, after 1979, experienced significant changes in all aspects, including political and economic institutions, caused by the new cleric regime. In a few decades, by maintaining its revolutionary governing style, the Islamic Republic tried to impose its desires on Iran's total atmosphere. Iran, as a cleric-based autocracy, has been experiencing various changes in political and economic situation since 1979. Numerous Iranian and foreign academics have examined the Islamic revolution's impact on Iran from various angles. Most of them agree that the revolution and the following historical happenings had a deteriorating impact on Iran's society, politics, and economy.

Studying the quality of economic institutions can reveal the known and novel aspects of political changes in Iran. Starting a year before the revolution up until 2021, Iran lost more than 25 per cent of its economic institutions' quality while other countries of the control groups, on average, experienced growth of 30 per cent, leaving Iran far behind in its region and the countries which in 1975 had a similar status as Iran. As the first outcome of this study suggests, Iran not only went out of the standard path with other countries but endured significant losses, which are not easy to compensate for in the short term.

Many groups, entry points, and variables can be assessed to understand how political changes channel their effect on the economic regime. Three main assumptions were that the level of democracy caused by the political regime, the quality of political institutions, and the level of freedom are the potential influencers of a country's economic freedom as the representative of economic freedom. Political changes altered the level of democracy as Iran experienced two different political regimes, one

constitutional monarchy with the relatively unquestioned rule of the Shah and one Islamic Republic, which, based on Islamic values, tried to make its version of non-monarchic political systems. Within these two regimes, many different governments were formed, and although they were following the leader's requirements, they still had a certain degree of internal disagreement. Political Rights and Civil Liberties, as the standard representative of political institutions' quality, also demonstrate how many countries tried to pave the way for long-term development by increasing the rights and liberties of people over the political regime. The last channel of political interruption to economic institutions includes the level of civil and political freedoms caused by the impartiality of the state and judiciary systems and restrictions on people's lives and political will, demonstrating how political power by limiting its subjects can help the demise of the economy and the country.

Analysing these three channels shows that all of them have an influence on the outcome of the economic institutions, and this relation is more predictable for countries other than Iran, which chose an alternative way of political life. This relationship can be seen in the results of the analysis, as Iran also acts differently in empirical research. Freedom-related variables, however, demonstrated a much stronger relation with the quality of economic institutions, as was predicted by earlier research like Islam and Montenegro (2002), who believed freedom and institution outcomes are highly related. This outcome of the paper is aligned with the real life of Iranians living under the autocratic rule of the Islamic regime for the last forty-five years and living under the complete control of the state, losing their fundamental rights, as the ruling system values its existence over the will of domestic and international forces and is not willing to compromise. This leaves Iran in constant exposure to political changes that impact Iran and Iran's institutions, causing the demise of the level of freedom and, eventually, the economic institutions' quality.

## Conclusion

Emerging from the political changes of the second half of the twentieth century, institutional economics, as a new area of economics, reveals the unseen aspects of political changes and the economic outcome. Since the clergy overthrew the Shah's government in 1979 and instituted an authoritarian theocracy, the state of the economy, individual liberties, and democracy have all been either stable or deteriorating. An innovative institutional quality viewpoint is examined in order to assess the economic situation and investigate this loss from an institutional point of view. Economic freedom is chosen, based on a study by Kotschy and Sunde (2017), to illustrate the quality of economic institutions alongside a number of other factors under the main categories of the political regime's status, the political institutions' status and the freedom's status are used to compare Iran and two distinct control groups. One being the countries from a similar region, and another being the countries with the same level of economic institutions' quality in 1975.

The first correlation result in linear, squared, and interacted forms explains why, in spite of being one of the freest economies in the world with relatively high-quality economic institutions and possessing a better status than its regional counterparts in 1975, Iran was unable to keep up with global economic progress and lost the quality of its previous economic institutions. As a result, by 2021, Iran is not comparable to its competitors from 1975 or its regional counterparts, who had a lower status at the start of the analysis period. This paper's second result is that indicators related to freedom are more useful in assessing the quality of economic institutions than those that reflect political or democratic conditions. The autocratic spirit of the Islamic regime and its constant revolutionary status alongside the ideological background of the clergy are driving factors for the ruling class to see freedom as an existential threat, and therefore prioritising the constraints on freedom over improvement, which has resulted in keeping Iran off the standard track and damaging the quality of its institutions.

In the case of Iran, the decay in freedom has contributed to a noticeable decrease in the quality of economic institutions, proving the findings of previous papers and aligned with the flow of political changes in the last four and half decades. The findings of this paper can help policymakers, transition planners and people of interest in Iran's economy to have a better understanding of the economic institutions and their quality

in Iran and the potential ways that the political system has been influencing them. To fully understand the extent of the losses resulting from the political shifts of the 1970s and onwards, more investigation is necessary to establish the causal links between the quality of the economic institutions and the independent variables included in this study.

## Summary

This thesis tried to connect the worlds of institutional economics and Iranian contemporary history. Working on the established knowledge of institutional quality, we expanded the research realm by examining the influence of political changes on the concept of economic institutions' quality.

Firstly, we defined the status of academia by explaining the origins of institutional economics and stating the cornerstones of the field. Building on that, common measurements of assessing institutional quality are outlined, emphasising economic institutions and their outcomes. We briefly explained Iran's political path in the last five decades by highlighting the critical political changes that the country has endured.

Secondly, after explaining the limitations of the study we designed, the research method uses the previously used measurements to analyse the quality of economic institutions as the dependent variable. Following that, we defined political changes in three channels: political regime, political institutions, and level of freedom, using related variables or a group of indexes as the independent variables. We set two different groups of control countries to have a comparative view of Iran. The empirical research aimed to investigate the relationship between different channels of political change and the quality of economic institutions in Iran.

In the third part, the trend of each variable from 1975 to 2021 is analysed alongside the result of correlations to assess the relation and strength of variables. Non-linear and interacted forms of variables are tested to further understand the impact of political changes on the quality of economic institutions in Iran. Results suggest that: first, Iran went out of the pattern it was taking alongside other countries and did not act predictably and positively, and second, among the political changes, changes in the status of freedom have the most relations with the economic institutions' quality.

Lastly, we discussed the results from the perspective of existing knowledge and the situation in Iran to understand the influence of political changes on the quality of economic institutions in Iran. We also outline the areas of further research and the implications of studying the relationship between politics and the outcome of economic institutions.



## Souhrn

Tato práce se pokusila propojit světy institucionální ekonomie a současných íránských dějin. Na základě zavedených poznatků o institucionální kvalitě jsme rozšířili oblast výzkumu zkoumáním vlivu politických změn na pojetí kvality ekonomických institucí.

Nejprve jsme definovali status akademické sféry vysvětlením původu institucionální ekonomie a uvedením základních kamenů oboru. V návaznosti na to jsou nastíněna běžná měření hodnocení institucionální kvality s důrazem na ekonomické instituce a jejich výsledky. Stručně jsme vysvětlili politickou cestu Íránu v posledních pěti desetiletích zdůrazněním kritických politických změn, kterými země prošla.

Za druhé, po vysvětlení omezení studie, kterou jsme navrhli, výzkumná metoda využívá dříve používaná měření k analýze kvality ekonomických institucí jako závislé proměnné. Následně jsme definovali politické změny ve třech kanálech: politický režim, politické instituce a úroveň svobody, pomocí souvisejících proměnných nebo skupiny indexů jako nezávislých proměnných. Stanovili jsme dvě různé skupiny kontrolních zemí, abychom měli srovnávací pohled na Írán. Cílem empirického výzkumu bylo prozkoumat vztah mezi různými kanály politické změny a kvalitou ekonomických institucí v Íránu.

Ve třetí části je analyzován trend každé proměnné od roku 1975 do roku 2021 spolu s výsledkem korelací pro posouzení vztahu a síly proměnných. Nelineární a vzájemně se ovlivňující formy proměnných jsou testovány za účelem dalšího pochopení dopadu politických změn na kvalitu ekonomických institucí v Íránu. Výsledky naznačují, že: zaprvé, Írán vyšel ze vzoru, který nabíral vedle jiných zemí, a nechoval se předvídatelně a pozitivně, a zadruhé, mezi politickými změnami mají změny statusu svobody největší vztah ke kvalitě ekonomických institucí. .

Nakonec jsme diskutovali výsledky z pohledu dosavadních znalostí a situace v Íránu, abychom pochopili vliv politických změn na kvalitu ekonomických institucí v Íránu. Nastíníme také oblasti dalšího výzkumu a důsledky studia vztahu mezi politikou a výsledky ekonomických institucí

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<sup>1</sup> This paper was an assignment related to the thesis topic. Calculations, tables and charts were produced there and used with modifications in the thesis.

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## List of Appendices

Appendix no. 1: Detail of Calculations (Excel file)

Due to issues with the SIS, which has limitations on the variety of file formats to be uploaded, appendix file is to be stored externally. Thus, the appendix has been uploaded online and can be retrieved from <https://independent.academia.edu/arianmonfarednik>. Moreover, appendix is also available on demand by e-mail request to the author at [96293568@fsv.cuni.cz](mailto:96293568@fsv.cuni.cz). Any further inquiries related to the appendices should also be directed to this address.