

Privatization in Iran

Reasons and performance

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Abstract

After a state economic period, the government of Iran intended to privatize its economy in 1989. In this article we, first, will discuss about the reasons of this policy. In the second step, Privatization Process And Volume will be surveyed. As the third part of the paper, Performance Of The Government On Privatization will be explained and its success will be evaluated. In this part we will see that this policy was not so successful. The reasons of defeat or at list unsuccessfulness of privatization will be the last part of the paper which will be presented in two separate gropus i.e Non Economic Group and Economic Group

Key Words: Privatization, Economic Reasons, Non economic Reasons, Performance

Privatization in Iran, Reasons and performance

The economy of Iran has traditionally had some problems due to existence of governmental economic units in the 20th century. Because of the easily available oil revenues, not only the governments have never had a serious tendency to optimize the management of these institutions, but also they had never evaluated their efficiency and management system.

Before Islamic Revolution in Iran, these governmental economic units included some infrastructural industries, manufactures and corporations like telecommunications, metallurgy, railways, airlines, some sensitive industries like army manufactures and tobacco department. In that regime, however, there were a few large private factories and economic units like Iran National Automobile factory (which had about thirty thousands employees and used to produce about 100,000 cars, minibuses and buses), big banks like Export Bank of Iran, big industrial farms in some agricultural states and areas. The main purpose of that regime for governmental management of these units were national security, economic control, power and some other reasons.

After IR (Islamic Revolution), 1979, the circle of governmental economic units was notably expanded specially due to economic justice. In the first years of this period, every large unit or elastic economic units such as the banks, automobile factories, industrial firms, etc were expropriated and managed by the government. According to some statistics, the total number of these corporations was 2221¹. The ministry of heavy industries used to manage 110 factories like automobiles and machinery and National Industries Organization of Iran covered the others which had 170,000 employees in 1982.

In addition, there were many economic units which the government took over due to their owner problems. Some of these owners were related with last regime and some of them had left the country because they did not like or did not know the new social and economic conditions². Their fear used to be strengthened by a large propaganda against Iran in the media of western countries due to some political problems between the two sides.

1 -Majles va pajouhesh, no 7, p40

2 -In 1989 the Revolutionary Committee which used to act as parliament approved a law by which the companies and corporations which had to be governmental was specified. In this law these units were divided into four groups as follows:

A-In addition to industries like oil, gas, copper, etc which were already governmental, all of the essential and heavy industries.

B-All the industries whose owners had escaped out of the country.

C-Debtor companies to the banking system whose owners did not pay back their debt.

D-Other economic units which have remained in the private sector.

From 1981, Mr Moosavi came to power as the prime minister who used to seriously protect economic concentration. This centralism policy was continued till 1989 i.e. one year after ending the war with neighbouring country, Iraq, and the year in which president of Iran, Mr Hashemi Rafsanjani came to power through a general elections. The new government intended to decentralise and liberalize the economy of Iran through 3 main policies i.e. privatization, marketization and adjustment in forex rate. The first policy i.e. privatization is the subject of this paper. In this article, at first we will discuss the process and volume of privatization, secondly performance of the government of Iran in this respect will be explained and surveyed and finally we will end this paper by a conclusion.

1- Reasons of Privatization

There is no difference between the reasons of privatization in Iran with many other countries. We can categorise these reasons in three categories i.e. increasing economic efficiency, privatization as a part of marketization and financial problems of government. These all three reasons can be found in privatization process of Iran in the period under survey.

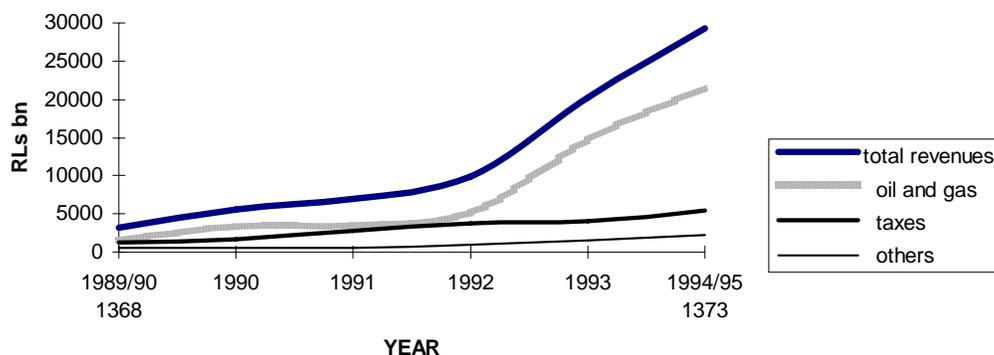
- a- **Increasing Economic Efficiency:** low level efficiency in governmental economic units is an accepted idea between economists, experts and even ordinary people. Iranian governmental economic units had same situation also. They should pay a fix salary to their managers and employers independent on production of the unit. In many times the factory or productive unit was bundled due to the war, shortage of intermediate commodities, etc. In these situations the government should pay the full salary of personnel. There was no incentive to think about increasing of quality and quantity of production between managers and other employers because they used to earn their full salary without any inconvenience. In case of the loss or lack of income the government should solve the problem by general budget.
- b- **Privatization as a Part of Marketization:** As mentioned earlier, marketization was an important policy of liberalization process and going towards open economy. The government decided to decontrol commodity prices and gradually accept market prices. It was very difficult to execute this policy for state economic units and corporations because of the people protest. People believed that governmental units' products should supply in a very low price without any increase while production costs were increasing day by day. The only distinguished way to going out from this problem was privatization.
- c- **Financial Problems of Government:** Many countries privatize state economic units to earn money for government expenditures. The

government of Iran had no such a goal from privatization because he had enough money (both Iranian Rial and forex) through oil incomes. International price of oil was relatively high in those days and government had no forex problem. In addition, Iran devaluated his money and government used to earn much more money from selling forex, so, had no Rial problem also. For example, oil revenues of Iran rose from \$ 7 bn in 1988 to \$ 1 bn in 1989 and \$ 14 bn in the next year. In addition, as table and figure no 1 show, the governments' income continuously increased due to increasing of forex rate and oil incomes year by year. Nevertheless, the government had some other financial purpose from privatization. In those years governmental economic units added losses year by year due to earlier mentioned reasons. If the government could transit these units to private sector, he could remove these losses.

Table no 1
Iranian Government Revenues

	1989/90	1990	1991	1992	1993	1994/95
	1368					1373
Revenues	3174.6	5632.5	6933.5	9884.5	20250.7	29244.5

Figure no 1
Government Revenues by Sources



2-Privatization Process and Volume

There were three ways for transferring governmental economic units to private sector i.e. selling through stock market, direct negotiation between the government and the buyers and public auction depending on their importance. Since there is no separate data about the public auction, we will discuss it in connection with direct negotiation.

In November 1989, Iran stock exchange organization began its activities again as an instrument for privatization. This organization which had been established before IR had no activity during the war and economic conservatism period.

The process of selling an economic unit through this organization has three steps. In the first step, when an economic unit applies for supplying its share through this organization, the stock exchange organization evaluates its financial situation. If the applier unit has a good condition like acceptable profit rate, acceptable accounting system etc, it is accepted by the organization. In the second step, the stock exchange and economic unit's managers agree on the worth of the company and the rate of each share and finally in the third step the shares of company are supplied in the stock exchange.

In the direct negotiation the company managers directly talk to the buyers who are, in most cases, employees of the company. In this way anything like price, payment duration, etc value of each portion, etc defined by negotiation. According to the table no 1, in the years of first plan (1989-1994) 75.5% of total sold shares have been sold through Iran stock exchange. We can see in the figure no 1.1 that the value of sold shares has fallen in the last years of first plan. In addition, the share of direct negotiation has risen in these years relative to stock exchange share. Table no 1 shows the value of the shares which have been sold through stock exchange and direct negotiation by four the most important governmental organisations which have managed the most of governmental companies. According to this table all these four organisations gradually preferred direct negotiation to the stock exchange in the period under survey.

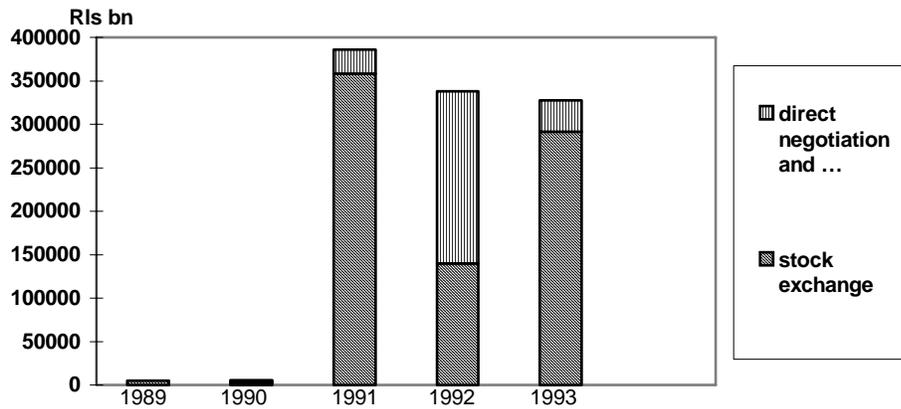
Table No 1

Value of Sold Shares of Governmental Corporations in 1989-93

	stock exchange		direct negotiation and ...		total	
	value, Rls bn	share, %	value, Rls bn	share, %	value, Rls bn	share, %
1989	4606	99	49	1	4655	100
1990	3344	93	2464	7	35908	100
1991	358539	92.9	27397	7.1	385236	100
1992	139999	41.4	198320	58.6	338318	100
1993	291418	88.9	36219	10.1	327637	100
total	824570	75.5	26449	24.5	109246	100

Source: Majles VA Pajouhesh magazine, no 7, p30

FIGURE NO 1
VALUE OF SOLD SHARES OF GOVERNMENTAL CORPORATIONS
IN 1989-93



The composition of the buyers of the governmental companies' share is another main subject that we have to explain in this part and explore in the next part. According to the report of the Ministry of Industry during the years 89 to 93, 33.4% of total sold shares has been sold to the small private buyers, 25.8% has been bought by the large private capital owners, 24.1% has been sold to the public sector which are under governmental management and finally 9.5% of these shares have been bought by the banking system³ which was completely governmental. Table no 3 shows this

3 -IBID, p35

composition in the different years of the first economic plan and the figure no 2 shows the share of private sector in the same years. We can easily see in this table and this figure that the public sector and banking system began to buy these shares in the last years of the first plan so the share of private sector has come down in spite of a notable growth in the value of their purchase.

Table No 2
Value of Sold Shares by the Most Important Governmental Organizations

RIs 1000 bn

	1989 (1368)		1990		1991		1992		1993 (1372)		total	
	SE	DN	SE	DN	SE	DN	SE	DN	SE	DN	SE	DN
INIO	-	-	10.5	-	20.1	22.3	78.9	45.2	91.3	4.9	380	0.72
IMB	2.9	0.05	21.7	2.2	84.9	-	0.6	55	108.8	10.9	218.8	68
OEBII	-	-	0.4	-	29.6	2	42.5	33.7	80.6	9	153.1	44.7
MJF	1	-	0.2	0.3	4.7	3.1	1.5	62.2	3.3	9.2	9.8	66.5

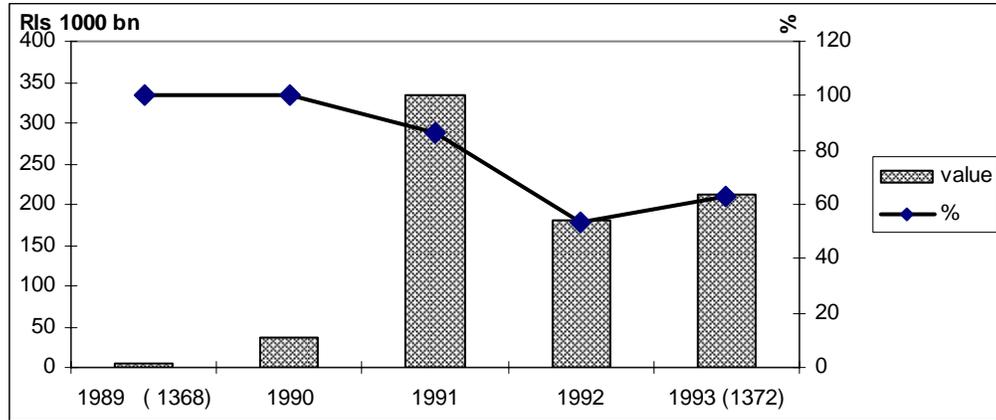
Source: IBID, p35
 INIO: Iran National Industries Organization
 IMB: Industry and Mines Bank
 OEBII: Organization of Expansion and Building of Iran Industries
 MJF: Foundation of Mostazafan and Janbazan

Table No 3
The Composition of the Buyers of Shares from 1989 To 93

	1989 (1368)		1990		1991		1992		1993 (1372)	
	value	%	Value	%	value	%	value	%	value	%
private sector	4.7	100	36	100	335	86.7	181	53.2	213	63
public sector	-	-	-	-	36.3	9.4	70.3	20.8	55.6	17
banking system	-	-	-	-	15	3.9	88	26	59	18
total	4.7	100	36	100	386	100	338	100	328	100

Source: IBID, p 37

FIGURE NO 2
THE SHARE OF PRIVATE SECTOR IN BUYING THE
GOVERNMENT CORPORATIONS



2-Performance of the Government on Privatization

Today the Iranian economists and economic decision makers strongly believe that privatization process has not succeeded in the first economic plan of Islamic Republic of Iran.

According to table no 1, the total value of sold shares in every year is very low and it is amply clear that the purposes of first plan in this area have not been achieved. It has been announced by the government that 391 governmental corporation would be sold in the first 5- year economic plan. It is not possible to determine how many of these corporations have been completely sold in these years because many of them could sell only a percentage of their shares⁴ but we can easily say that the value of sold shares is much less than pre-planned values. As an example of this failure we can say that the parliament of Iran determined a minimum value of shares (1050000 bn Rls)⁵ which had to be sold in 1993 (the last year of the first plan) because it wanted to initiate this process. In spite of this, the value of sold shares was only RIs 327000 bn (33 percent of target) according to the table no 3.

In addition, the values which have been shown in the table no 3 show that the total value of sold share has fallen in the years after 1991. If we add the inflation rate (about 20% per year) and calculate the real value of these amounts the problem will be larger. It is clear that for a country like Iran which has a big governmental sector and low level value of the sold shares,

4 -The latest information say that 300 corporations have been completely transferred till mid 1995.

5 -The budget law of Iran 1374(1993)

it is necessary that the rate of growth in selling of shares should be positive and high.

We have to pay attention to two points in this connection. The first point is that in the last years of the above period, the value of the sold shares is notably higher than first years like 1989 with about 5000 bn Rls sold shares. The second point is that a notable amount of the sold shares has been sold to non private sector like trade banks and insurance corporations which are actually governmental. For example, the share of these organizations is 12.7%, 46.8% and 35% in the years 1991, 92 and 93 respectively. This fact states that real amount of privatized corporations and companies is notably less than what the figures in the table no 3 seem to suggest. We have shown in the last part that the share of the Iran stock exchange has gradually come down during the years of first plan and the share of selling through direct negotiation has risen at the same time. We can say that the reason of this change is that some managers of the governmental companies prefer the direct negotiation because in this way they have more authority. They can choose the buyer and change the conditions whereas in the stock exchange they have no authority over this organization.

Now, we will take up the question as to why privatization process has been so weak. Many reasons can be considered. We can divide these reasons in two main groups, non economic and economic reasons.

2.1. Non Economic Group

There are five reasons for unsuccessful privatization in this group which are: non existence of investment security, instability in economic policies, non existence of a clear legal framework, non existence of a good information system, non existence of a responsible organization and finally authority of companies and corporations for selling themselves.

A-Absence of Investment Security

When we look at the conditions of the first years of the privatization process, we can say that every investor was right to be worried about his investments namely buying governmental economic units, because a strong economic conservatism had newly been left behind and in spite of power of a new political party which protected privatization, the opposite party was relatively strong and was able to affect new policies. Besides this, it was expected that this party could come to power in the next elections. In addition, there were many articles and essays in the newspapers, magazines, speeches etc about social and economic justice, which was the main word for the protection of economic conservatism in the last period and with this may be added the fact that many companies, corporations and capitals had

been nationalized in that period. In spite of the above signs for worry of investors the government has not strongly approved a law for this purpose in parliament of Iran, although we don't think that the security problem could actually be solved through activities like approving a law. It will be solved when the power of present governor and his party rises, so, it needs a longer time to establish confidence among private companies.

B-Instability in Economic Policies

We know that stability of economic policy in general principles and details is very important for an investor. Every investor likes to have confidence about this matter because his decision about an investment like buying shares depends on economic policies and conditions and certainly a good investment will have good results if these policies and conditions don't basically change. Because of a few reasons, stable economic policies and conditions in both general and details were absent in Iran. For example nobody could tell whether the general policies under liberalization like privatization, marketization and foreign exchanges rate will be unchanged. Besides, there were some changes in the above policies like forex rate and marketization during the first five year economic plan which strengthened this lack of confidence among businessmen, producers and investors in this period. For instance the Central Bank of Iran could not control the forex rate as it had already announced and changed the rate a few times. In addition, the gap between official rate of forex and black market rate was rising day by day and this gap created some doubts about stability of the forex rate policy. There were problems about marketization policies too. There were some speeches in the parliament, Friday's Namazes (a prayer), and many articles in newspapers, magazines which advised price control by the government because of high inflation rate. These strong advertisements against marketization caused a fear among economic agents that the government would change marketization policy sooner or later. In addition, the government was at the beginning of new economic regime and every man, especially economic experts, knew that it naturally needed some time to have stable economic policies. The above matters were about general policies of liberalization. There were also some problems about details. For example, it was not properly clear which economic sector like industrial and agricultural sectors will be protected by the government. This ambiguity led to decision problem among a part of investors who could not find the optimum investment portfolio. Therefore, many capital owners preferred not to invest in such conditions.

C- Absence of a Complete Legal Framework

As we already said, liberalization and privatization had just begun in the first five year cultural, social and economic plan of Islamic Republic of Iran. The new governors of Iran had no experience in this new economic environment and after IR there was not such an experience. Therefore it is natural that there were some problems, mistakes and weaknesses in this regard. An important one of these weaknesses was the absence of a thorough legal framework for this matter. There was only a remark in the first five year plan in which transferring of governmental economic units to private sector had been mentioned without any details. This remark had been approved by the council of government and the parliament.

The cabinet had been authorised for defining and approving of other details. Because the cabinet and all of the ministries had also many other works to do, they could not prepare a proper law for privatization in complete details and the approved law had some weaknesses and many ambiguities.

The above mentioned ambiguities and problems caused many difficulties in the execution of privatization law. Many of ministries and main decision makers in governmental organizations preferred to keep the economic units under their management due to these ambiguities and problems because they naturally had some fears of possible accusations. It was probable that they could be suspected for something like selling the companies cheaper than real price, selling to family persons, friends and etc. In addition, the managers who executed the privatization law faced many problems. There was no rule or law for the manner of selling like selling through stock exchange or direct negotiation just as there was not any rule for price determination, buyers etc And the managers had to decide in any stage according to their distinction and assessment. It is natural that privatisation in such a manner will take a long time and will falter at every step.

D-The Absence of a Good Information System

Another main problem which has resulted in the slowness of privatization movement is that buying of the share of companies is an unknown thing in the economy of Iran. We can say that about 90% of Iranian people do not know this way of economic activity or at least they do not know its advantages. It is natural that we strongly need an information system in such a situation. In an ordinary situation, the responsibility of an information system is to make people become aware of something like profit of the share, different industries and sectors etc. But, at present situation of Iran economy in which most of people do not know the share and it's

institutions like stock exchange, the responsibilities of such information system is doubled or even more because in addition to the above duties, it has to educate the people about preferences in purchasing of companies' shares as a way which leads to an extra income.

Unfortunately, it should be said that in spite of this strong necessity, the privatization process was not interlinked with a good information system. There were only some news about foundation of the Iran stock exchange and value of sold shares in Iranian newspapers and media without any description or advertisement about this new economic way. It is very useful to show the importance of propaganda in this regard. There was, for example, a good propaganda about selling of an industrial agricultural corporation in the Khorasan state. Due to this propaganda a large number of people entered into this purchasing partnership and bought a large number of shares of the above corporation.

E-The Absence of a Responsible Organization for Privatization

The last of the non economic reasons for weakness of privatization is the absence of a special organization to manage this process and to be responsible about it. It is very marvellous to say that in the privatization process of Iran, every ministry had the duty of selling the companies and corporations under its control and management. In addition the managers of every governmental company and corporation had the main role in selling their economic unit to private sector. In such conditions the probability of selling an economic unit was very low because its managers do not easily decide to sell. It was natural that most of these managers who did not want to risk, used to avoid transferring the companies to the private sector due to some political problems which have already been mentioned. In the year 2000, the government of Iran established Iran Privatization Organisation and removed the above mentioned problem.

2.2-Economic Group

In this part we survey the economic reasons for weakness of privatization in Iran. There are five matters that we can explore as economic reasons of the slow progress of privatization. These are as follows:

A-The absence of a strong financial urgency for privatization

B-The absence of necessary liquidity

C-Control of stock exchange by competitors

D-Distortions in investment decisions

E- Inaccuracy of the first five year plan targets

A-The Absence of a Strong Financial Urgency for Privatization

It is a fact that when a government has serious financial problem, he will seriously try to transfer and sell governmental corporations to private sector and earn money for his expenditures. There is a strong belief among the Iranian economic experts that the oil revenue of Iran is the main source for most of problems in the economy of Iran including privatization. Since the government of Iran has every time been able to prepare its annual budgets from the source of oil revenues especially in the period under survey, he did not insist on selling the governmental corporations. It is important to say that the government of Iran even had a better situation in its annual budgets in the years under survey due to some changes in economic policies and structure of budget. The most important of the changes are the raising of the official rate of foreign exchange and increases in tax receipts. Due to the former change, the government used to sell its oil exchange revenues at a notably higher rate and its income in terms of Iranian Rial went sharply up. For example the extra revenue due to selling foreign exchange at a higher rate rose from Rls 717.3 bn in 1989 to Rls 4072.9 bn in 1992⁶. Increase in the tax receipts caused notable increases in the revenues of government. This revenue was about Rls 986.5 1000 bn in 1988 and Rls 3775.5 in 1992⁷. It is enough to substantiate our claim about revenues of government to say that the budget deficit was about zero in 1993⁸ whereas it was about 50% of total budget in 1988.

The existence of a high level income from another sources means that there was no a financial urgency for Iran's government to insist on selling governmental companies and corporations and to speed up privatization process.

B-The Absence of Liquidity

The next main economic reason for the weakness of privatization was liquidity. It was a problem for privatization that this process had been accompanied by a tight monetary policy. In the war time, the high level liquidity was a large problem for economy of Iran and caused notable difficulties specially a high inflation rate. Therefore, one of the first economic targets of government was to control the volume of money and liquidity and so the government introduced a tight monetary policy in the first five year plan and began to collect the money through many ways. Changes like increase in foreign exchange rate, rise in tax receipts, changes in banking system loans etc led to a liquidity shortage in the private sector

6 -ERBS, 1992, P223-229

7 -IBID

8 -IBID, 1993

which could not absorb the shares of governmental corporations. For example, after the devaluation a large number of sectors faced too much of a financial crunch to even think about new investment or the purchase of shares.

C-Control of Stock Exchange by the Competitors

According to the table and figure number 2, the stock exchange has been the main way of privatization and more than 75% of sold shares have been sold through this organization. There is a strong belief among Iranian economic experts that the managers group of stock exchanges was a main problem of this organisation. According to this belief, the managers of the greater banks of Iran like Bank -e- Melli (national) Iran, Bank -e- Sedate (exports) of Iran etc were also the members of the managers group of stock exchange while they were competitors. The bank managers do not allow to stock exchange to sell a large number of shares and collect too much money. They used to define some hard conditions for accepting companies in the stock exchange and restricted the privatization process.

D-Distortions in Investment Decisions

There has always been an old wound on the body of the economy of Iran in the last three decades which has moved capitals and investment towards business sector. This large wound was the existence of a notably higher rate of profit in the business activities than productive ones. Problem became more serious after the IR particularly in the war period due to the war dangers for factories and low level of production of them. After war and in the first 5 year economic plan the economy faced this problem due to some reasons. We already monitored that after devaluation many companies and producers had difficulty to gather necessary money for purchasing their foreign exchange requirements. This inability led to a decline in their production so their profit naturally came down whereas the profit rate in business activities especially in the gold and foreign exchange markets was very high. Despite the existence of many companies with a high profit rate, the low profit rate in other industries created a situation among the capital owners in which they were induced to invest less in the production sector and more in the business sector.

E- Inaccuracy of the First Five Year Plan Target

As a last reason for the weakness of privatization we can say that the target of the first five year plan in this relation was inaccurate. There was not any notable research and exploration about the number of governmental

companies which had to be privatized. We can really say that the definition of 391 governmental corporations was an administrative decision. For more explanation, we can guess that in the period of decision making about this affair every ministry announced the number of corporations under his management which it wanted to transfer to private sector and total of these announced number was 391. Nevertheless, it is clear that they did not see economic matters like liquidity, profit rate etc which are connected with this decision because they were in a hurry and the most important thing was to begin this process as soon as possible.

Conclusion

In view of previous discussions, we can say that privatization was not successful in so far as the transfer of governmental corporations to private sector was concerned. But, this process is only one part of privatization. There are some other aspects of the process. Transferring of governmental services like foreign trade which had no assets for selling was also an important part of privatization. In the economic conservatism time, most of foreign transactions used to be done by governmental organizations specially the Ministry of Commerce. They had established 17 governmental centres which had the duty of providing imported requirements. During the first 5 year plan, these centres have been dissolved and private sector has been very active in foreign trade. Besides, together with new policies, the government has prevented the expansion of governmental corporation circles and share of private sector has gone up in the economic activities. This matter will lead to adjustment of the structure of economy gradually. We can finally say that although the transferring of governmental corporations has not been properly done, the privatization process as a new experience was relatively successful and we hope that its problems will be solved in future.

An important notice: the above mentioned unsuccessful process was continued till the year 2004. In this year the supreme leader of I.R.Iran issued a new serious command for speeding privatization. After this command, this process has been fasted and the government sell a new state economic unit every day. It is very soon to say anything about prosperity of the new wave of privatization. The only thing that we can say is that willingness is more serious.

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