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A Review of Privatization in Iran

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Abstract

Privatization has become a popular panacea for solving the organizational problems of governments by reducing the role of the state and encouraging the growth of the private sector enterprises. However, privatization takes a number of forms and has been approached in various ways during the move away from state control to other forms of ownership in developing and industrialized countries. Based on Iranian constitution, No.144, public companies must change to the private companies. The government of Iran urgently needs expanded and more dynamic private sectors, more efficient and effective infrastructure/utility provision, and increased investment from both domestic and foreign sources. The most important purpose of privatization in Iran is increasing the proficiency. In this article we will discuss about the reasons of this policy, forms and trends, privatization process and volume will be surveyed, article 44 and at the end performance of the government on privatization will be explained.

Key Words*:* Article 44, privatization, private ownership, performance, state ownership.

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Introduction

Privatization of state owned enterprises (SOEs), a contentious issue of public policy debate, has long been topical in policymaking and academic arenas. The extant literature has credited the policy with effectively pushing inward the state's frontiers while revitalizing and transforming SOEs into driving forces for economic growth and development (Li et al., 2011; Schuster et al., 2013). Privatization has been an integral part of the international policy mix, and a plausible policy prescription for decades (Harvey, 2005; Bjørnskov and Potrafke, 2011). Privatization has evolved governmental

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economics in the last fifty years. Some countries have been beneficiary and some experienced most losses. These countries did not follow the main purposes of the privatization correctly. Because of Iranian constitution, No.144, public companies must change to the private companies. This changing had a slow speed in the past. But in the last decade the companies number increase quickly. Also, the government of Iran urgently needs expanded and more dynamic private sectors, more efficient and effective infrastructure/utility provision, and increased investment from both domestic and foreign sources. The most important purpose of privatization in Iran is increasing the proficiency. On the other hand, we can say private section increase proficiency, when managers to be consisted high interest for conducting the company. Only thing that increase the motivations of managers are their benefits and revenues. Then, they try to show the best performance and have enough incentive to manipulate earnings.

Definitions of Privatization

While the term "privatization" generally conjures up a consistent theme, a review of the literature on privatization and offered the following spectrum of definitions (Erel, Liao and Weisbach, 2012): **1.** engaging the private sector to provide services or facilities that are usually regarded as public sector responsibilities; **2.** shifting from publicly to privately produced goods and services. Transferring government functions or assets, or shifting government management and service delivery, to the private sector. **3.** Attempting to alleviate the disincentives toward efficiency in public organizations by subjecting them to the incentives of the private market.

The Objectives of Privatization

Greater efficiency: Privatization fasters competition and thereby results in efficiency and effectiveness within sectors. Competition is very important to obtain more efficient and effective public services.

Revealing the true and full cost of the service provided: Publicly provided goods and services are under-priced because of some political and economic reasons. Politicians want to maximize their votes and people would like to get services free of charges. So public pricing of goods and services tends to be below the cost of production of these services.

Promotion of technological advancement: Competition as a result of privatization forces entrepreneurs to introduce new methods of production which will generate additional output with the same amount of inputs.

Development of capital markets: The main purpose of establishing a capital market is to withdraw some of the savings of individuals and private firms and to lead them toward productive investment fields.

Curbing inflation: In many countries public economic enterprises do not work efficiently and effectively they are usually in need of supplementary funds from general

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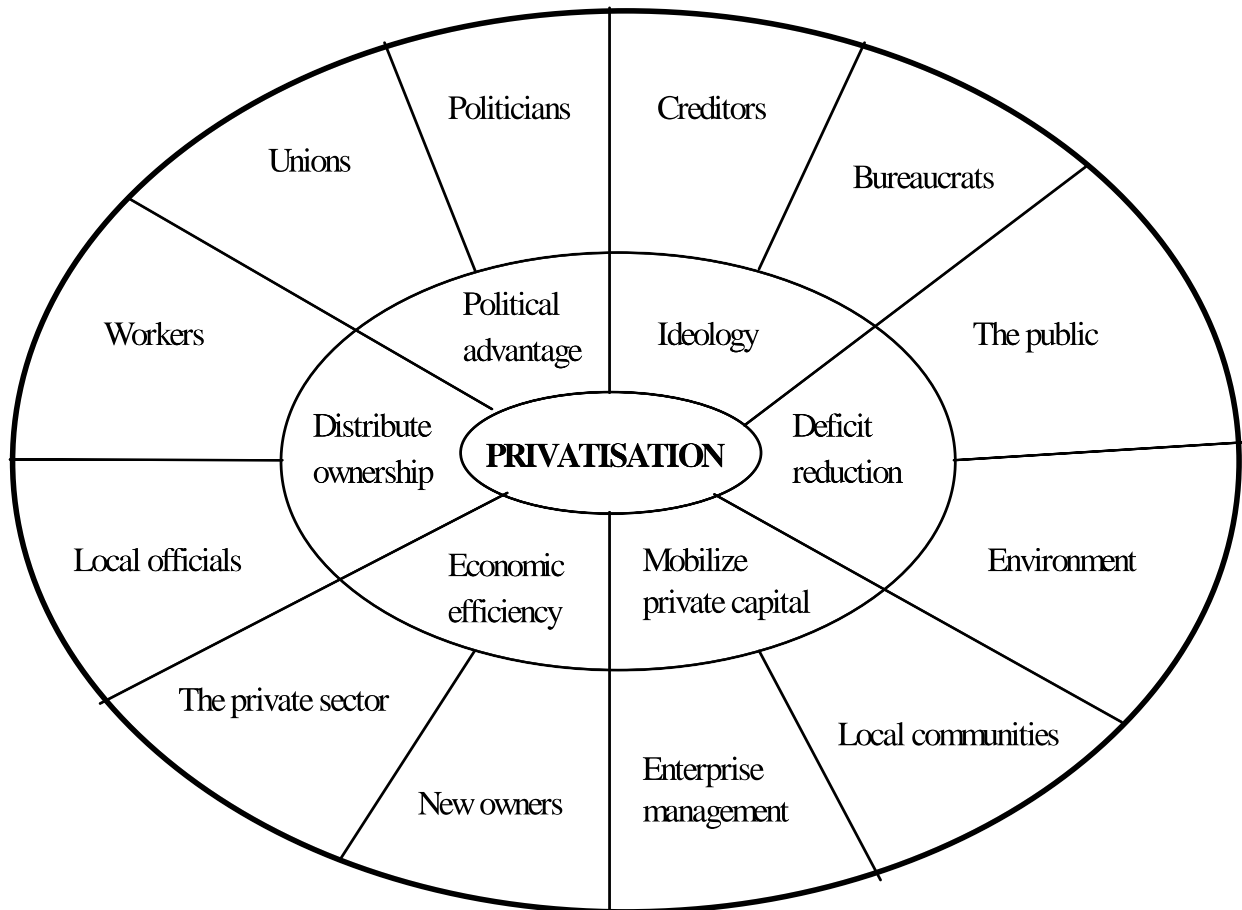
account budget. So they cause cost push inflation. Privatization can be considered as a dis-inflatory tool.

Raising extra revenues for the government: One of the objectives of privatization would be to raise revenues for the government. This strategy would be important when the government encounters a financial crisis (DFID).



Source: ILO, Socially Responsible Enterprise Restructuring - forthcoming

State versus private ownership

In the aftermath of the Second World War the state was actively involved in entrepreneurial activities such as supplying certain goods and services, financing key industries through subsidies, and regulating public utility markets in most industrial countries (Schuster et al., 2013). SOEs were then tasked with achieving social welfare objectives and thereby improving on the strictly profit-seeking decisions of private enterprises, especially when monopoly situations or externalities create a divergence between private and social objectives (Shleifer and Vishny, 1994), at which point, SOEs were productively more efficient and constituted a means of curing market failures with pricing policies closer to social marginal costs (Boubakri et al., 2008). Accordingly,

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arguments for state ownership or control rest on market failure or a perception thereof (Prager, 1992), Over time, however, SOEs' inefficiency became ostensible, and as a result, the justification for their continued existence has become a wedge issue dividing left- and right-wing governments, chiefly, on the role of government in the economy (Bortolotti and Pinotti, 2008; Bortolotti et al., 2004; Pitlik, 2007; Potrafke, 2010). Whereas right-wing governments have been more active in promoting privatization (Bortolotti et al., 2004; Bortolotti and Pinotti, 2008); leftist governments stuck to public ownership much more strongly (Bjørnskov and Potrafke, 2011). Particularly, Kikeri and Nellis (2004) and Elinder and Jordahl (2013) show that privatization of public services is mainly driven by government ideology and less by efficiency concerns, leading Prager (1992) to postulate that if indeed the private sector can provide efficiently produced goods and services in a broad variety of circumstances and public enterprises cannot or do not, then privatization becomes a goal worth pursuing. Economists have long expressed their views on contemporary (political) economic restructuring and the role of the state in the provision of goods and services.

Performance in the privatization versus government-ownership

A common argument is that privatizations remove obstacles to proper resource allocation posed by government control and facilitate the dismissal of poorly motivated government appointed managers whose objective function is vastly different from value maximization. Thus, privatization reforms can jump start performance improvements in formerly state owned enterprises (SOEs). By comparison, sectors that remain public continue to lag behind, exhibiting incrementally worse performance due to ongoing investment inefficiencies and agency costs, resulting in the empirical prediction that privatized sectors outperform sectors remaining in government ownership (Li and Xu, 2002) (In our earlier paper, we provided another reason for improved performance: in cases of governments facing severe budget constraints, there can be an underinvestment in publicly owned enterprises, which is corrected under private ownership Alternatively, privatized industries could actually do worse than publicly owned industries in the several years following the ownership reform. Importantly, the full benefits of private ownership do not arise automatically or immediately after privatization. Instead, firms enter a transition period, during which they may post losses or perform poorly. Private owners have to deal with the direct costs of restructuring (including any last minute asset stripping that may have preceded the privatization deal). In addition, while agency problem from government ownership may be mitigated, private owners need to address intra-firm agency conflicts due to separation of (usually, more disperse) ownership and control as well as manage the new risk of expropriation of the now private firm by the government. If the state-owned enterprise used to rely heavily on subsidies, such subsidies are most likely going to be reduced or eliminated altogether after privatization as soft budget constraint lifted, which may mean a short-term reduction in profitability that lasts until long term efficiency improvements are realized. In that case, performance need not improve in the short run. Thus, the alternative hypothesis is that privatized enterprises do not outperform those remaining public and that property rights protections and contracting institutions are more significant in determining performance than the ownership regime itself. As an aside, although our focus is on privatized enterprises, we expect that property rights variables might be significant for public sector performance as well, as a measure of overall quality of public governance and

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effectiveness of government administration. (Note, to the extent that is true, it implies that our measure reflects far more than property rights, since there is no risk of government expropriation of government enterprises.

In most cases private ownership of previously state-owned enterprises, without an explicit focus on social objectives, does result in services of higher quality and more competitive prices for the public, than public ownership. Privatization is hypothesized to originate a process of change in the organization's goals, incentives, controls, strategy, structure and culture, which bring about such improvements. Privatization engenders gradual and incremental change in actors' 'public sector' norms towards new 'public sector' norms (Johnson, Smith and Codling, 2000). Elinder and Jordahl (2013) enumerated several weaknesses of public ownership: (1) pay differentials between public and private enterprises; (2) poor accountability; (3) ownership dispersion and constraints on transfer of property rights; and (4) inadequate monitoring by the state (Boot et al., 2006). These differences imply a demand for a lower quality of financial reporting, where "quality" is defined in abstract terms as the usefulness of the financial statements for contracting, monitoring, valuation and other decision making by investors, creditors, managers and other parties contracting with the firm.

Privatization: forms and trends

Privatization may take several forms depending upon a country's initial stage, public sentiments, leaders' ideology, depth of financial markets development, type and size of firms slated for privatization, market structures, and goals and objectives set by ruling elites. The many forms of privatization include divestment or the transfer of SOEs' assets to private sector operators, frequently achieved through assets sales or auctions, spin-offs, liquidations, and reinstatement of the formerly nationalized SOEs into the private domain in accordance to market rules and principles. Privatization can be achieved through delegation or transfer of management and control of an incumbent SOE to the private sector. The new management team, therefore, is subject to market guidelines allowing it to adopt incentive structures and investment priorities that align with the firm's objective function. It may also be achieved through shifting or via tender, a set of practices whereby the public sector induces private firms to expand into some activities through outsourcing or contracting out key production functions performed by SOEs. Among the most popular forms are shares issue privatizations (SIPs), voucher privatization, employee buy-outs, corporatization, and private-public partnerships. Regardless the form retained to implement the policy, it culminates in an expansion of the share of the private sector in the creation of economic value added resulting from managing productive assets in an economy. In the broader sense, privatization is a characteristic of an economy where the number of private firms and the share of the private sector to GDP tend to rise; while the number of SOEs and the share of the public sector in GDP decline as new policies to incubate investments and sustain the growth in private ventures take shape. The state should look to the private sector to undertake the role of providing goods and services that can be produced more efficiently by private firms; and in fact, most view the policy as a positive sum game. Privatization has been an integral part of the economic agenda of many countries, and there are strong indications that countries that have disengaged the state in direct management of See Bennett (2001) for a detailed discussion on measurement of

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privatization and related issues. These include Adam Smith and Milton Friedman. SOEs will continue on that path. Revenues from privatization started to rise strongly since in the mid-1990s. Recent trends show that privatization is quite active, with the year of 2007, when 51 developing countries completed privatization deals worth US $132 billion, being particularly buoyant. Comparing cross-national trends in privatization may be difficult due to the numerous methods of privatization as well as SOEs' own characteristics such as their intrinsic value. Bennett (2001) observes that actual net proceeds from privatization have often been disappointingly small because of slow program implementation, and due to a policy of starting with the smaller, more easily privatized enterprises and also because of the high costs of personnel termination payments, debt relief and consultancy fees. Proceeds from privatization may also be affected by the ability of government officials in charge of reforms to value the firms slated for privatization. Economic problems, especially public sector indebtedness and mounting budget deficits compel governments to earmark privatization to raise revenues that can be affected to infrastructures, health, education, public safety, and the social safety net with the hope of collecting a stream of tax revenues from the privatized firms. In general, macroeconomic problems (such as slow growth and high degrees of public debt), right-wing parties in government, and the influence of institutions such as the EU and the IMF tend to increase the likelihood of privatization (Schuster et al., 2013). Previously, Harvey (2005) notes that in return for debt rescheduling the IMF and the World Bank require indebted countries to implement institutional reforms such as SOE privatization. The many goals of privatization are generally concordant with wealth creation, economic efficiency and growth. Among other things, they include: (1) revitalizing inefficient SOEs by introducing market-based governance principles into their operation, (2) reducing the size of the public sector to free-up productive resources for enhanced economic value added both in terms of productive assets and human capital, (3) attaining fiscal stability by directing proceeds from sales of SOEs toward the budget while releasing pressures on governments' budget, and (4) mobilizing resources, i.e., tap on domestic and foreign sources of finance (financial markets development) to finance investment and growth. Nonetheless, Banerjee and Munger (2004) note that the privatization policy is much more likely a crisis-driven, a last ditch effort to turn the economy around, rather than a carefully chosen policy with explicit long-term goals. Although privatization has been commonplace around the world, there remain important pockets of state involvement in producing goods and services. Spanning over banking, insurance, manufacturing, telecommunication, industry, healthcare, infrastructure, utility and other public services, governments continue to own productive assets, assumedly holding back innovation, investments, and economic growth and development. Specifically, they point out that many assets slated for privatization remain in government hands mainly because of volatile political environments, a significant hindrance to large-scale privatizations.

Global trends and the impact of privatization

The push to expand state ownership in the 1960s and 1970s has met with a radical reversal in the 1980s, where governments have progressively reduced their involvement in service provision by increasing private sector involvement. (Boubakri, 2009). Privatization has gradually taken global dimensions. It has been estimated that during 1984–1995, global infrastructure privatization projects averaged about 60bn US. Dollars

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in annual value and that during 1995–2000 privatizations are expected to take place in more than 100 countries and raise over 200bn US Dollars (Economist, 1998). Privatization in broad terms involves the transfer of ownership and/or control of state-owned organizations to private investors. More specifically, privatization can take several forms: it can be complete or partial, in terms of the amount of equity sold to private investors; it can be full or selective in terms of which parts of the state enterprise are sold; it can involve liberalization, where a competitive climate and market forces are promoted in place of the previous monopolistic or oligopolistic climate; and lastly, where it does not involve transfer of ownership, methods used include leasing of state facilities for a fee, bringing in external management, or contracting out the provision of a particular service. The particular motivations for privatization vary from country to country (Miller, 1997). Developing countries have relied more on SOEs than developed ones, and in many cases SOEs became a heavy fiscal burden on the state. In addition, the growth of the private sector in many developing countries has been slowed down through government regulation of industries and the directing of scarce credit to inefficient SOEs (Kikeri, Nellis and Shirley, 1994).

Privatization in Iran

The economy of Iran has traditionally had some problems due to existence of governmental economic units in the 20 the century. 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 thousand 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 was 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 2221. Figure 1. shows process of privatization in Iran.

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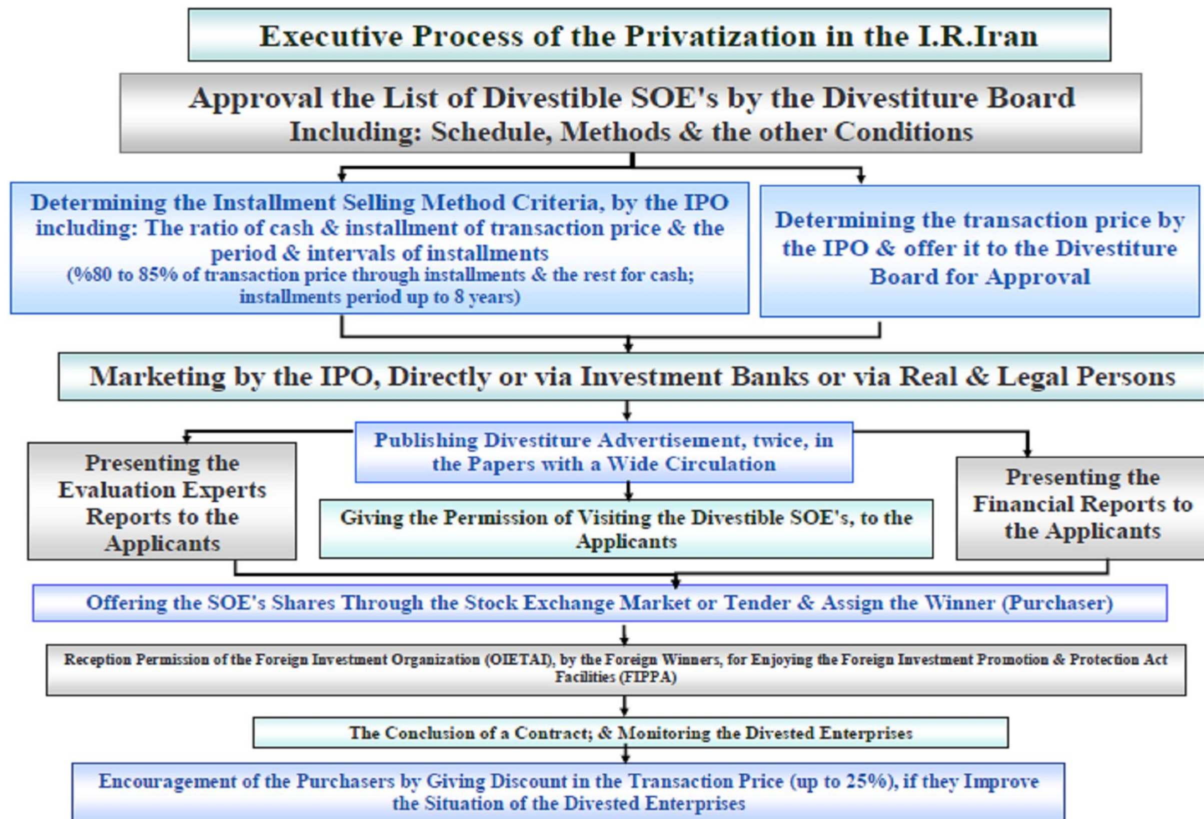
Figure1. The process of Privatization in Iran



Source: www.ipo.ir

Article 44

According to Article 44 of the Islamic Republic's constitution, Iran should have a planned economy in which "the state sector is to include all large scale and mother industries, foreign trade, major minerals, banking, insurance, power generation, dams and large scale irrigation networks, radio and television, post, telegraph and telephone services, aviation, shipping, roads, railroads and the like; all these will be publicly owned and administered by the state."Beyond the state sector, Article 44 also defines a so called cooperative sector, which includes "cooperative companies and enterprises concerned with production and distribution, in urban and rural areas," as well as a private sector, which consists of "those activities concerned with agriculture, animal husbandry, industry, trade, and services that supplement the economic activities of the state and cooperative sectors."

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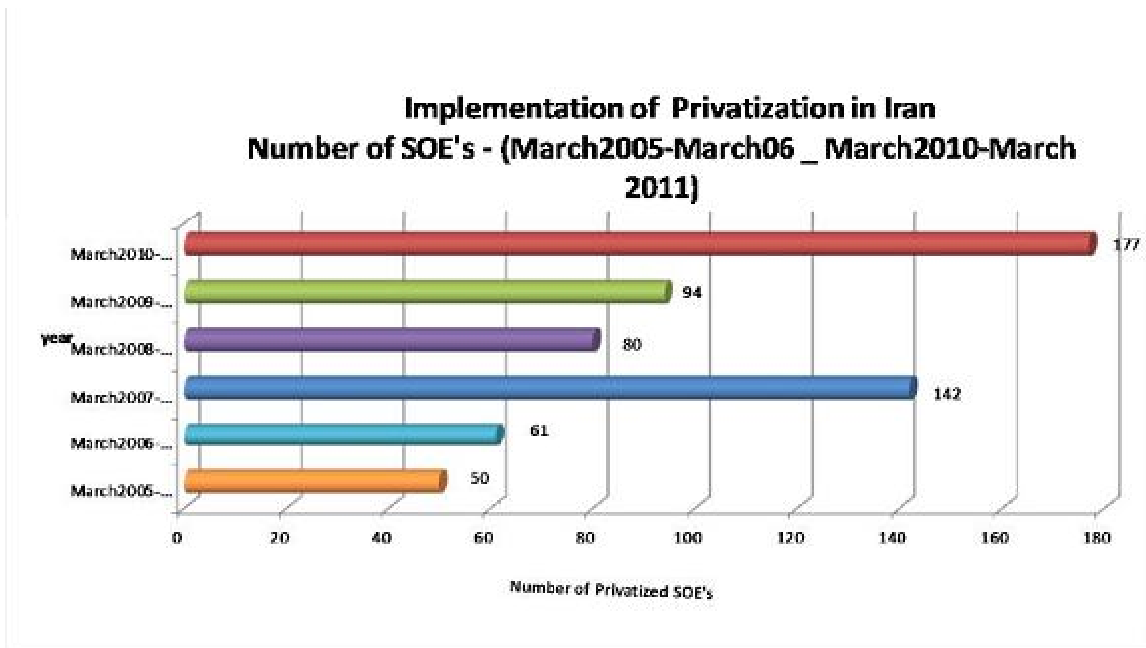

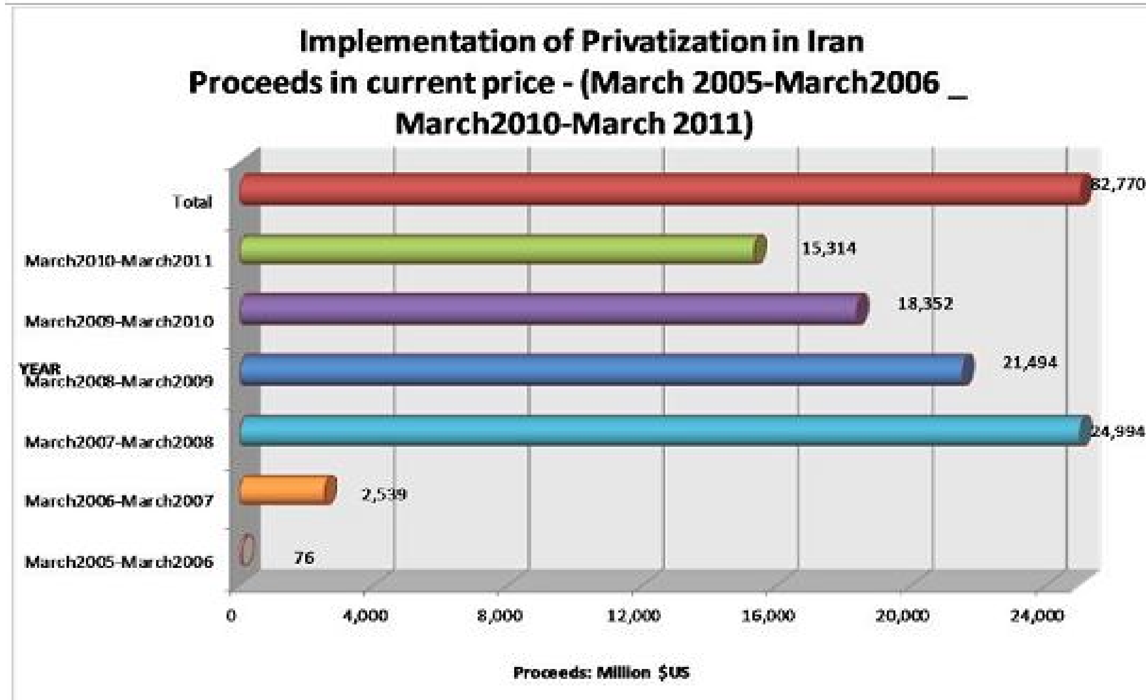

Source: www.ipo.ir

Revision of Article 44 of the Constitution Law

An executive order for privatization envisaged by Article 44 of the Constitution Law of the Islamic Republic of Iran was issued in July 2006. According to the action plan, the government is assigned to cede 80 percent of the shares of major state-owned enterprises to the people in order to support the targets envisioned by the 20 Year Strategy for Economic, Social and Cultural Development. The executive order indicates that ceding 80 percent of the shares of large companies will serve to bring about

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economic development, social justice and elimination of poverty. By putting into practice the action plan, the government's role will undergo a shift from direct involvement in ownership and running the large companies to supervisory and guidance of different sectors of the economy to meet the regulations of the World Trade Organization (WTO) gradually. Pricing of the outputs of the large companies should be made in line with the world trade regulations and a special team will be formed to monitor full implementation of the action plan on privatization.

Major industries in the downstream sectors of the oil and gas industry (refineries and petrochemical plants and complexes, as well as the distribution of refined products and gas at the domestic level) with the exception of the National Iranian Oil Company and those companies involved in the upstream activities in oil and gas sectors. Some of the major banks, all insurance companies except Central Insurance Company and Iran Insurance Company; this includes 35% of the whole national market. All air lines and shipping companies, and port's management. All power Plants, electricity producing and distribution companies except the main national electricity grids and transmission lines. Almost, all activities in the area of Post and telecommunication except major national grids and some of the monitoring area and fields. Main objectives of the initiative: 80% shares and stocks of major public companies and enterprises which worth totally 130bn US dollars. will be sold to the private and cooperative sectors.

10% of this amount, 13bn US dollars is allocated to the foreign investment. The role of the government will change from ownership and direct management to the macro policy making and monitoring. The government should contribute to the enhancement of private and cooperative sectors in the economy and will create a supportive environment for their competition at the preparing the domestic enterprises to be able to conduct their activities in accordance with the prudential rules and regulations of international trading system in a targeted and a sequential process. According to official figures from the Iranian Privatization Organization, since 2006 some 82,770 US dollars has been received by the Iranian government through its program of privatization, representing over 60% shares in large companies. Plans are currently underway to divest another 20% by 2015. So far the program has led to sale of refineries, banks, petrochemical industries, steel, aluminium, shipping, telecommunication and insurance companies. By far the largest privatization of the Iranian public sector to date has been the sale of a majority stake in Iran's only state-owned telecommunications firm September 27, 2009. In this sale three Iranian firms part of a consortium called Etemad Mobin Development bought 50% plus one share of the Telecommunications Company of Iran for 7.8 billion dollars. Most recently on the 17 of July 2012, the state divested 50.5% of its shares in Khuzistan Steel Company on the Tehran Stock Exchange. Plans are also being drawn up to divest total shares of Sefidroud Agricultural and Animal Husbandry Company in the near future.

Conclusion

It is important to note that privatization is a political process and has important economic and social implications that not only affects enterprise performance, but also social welfare and stability. In conclusion, if privatization must of necessity bring forth the desired benefits it has to be viewed not as an end itself, but as a means to get

government interested in fostering a new division of labour between the public and private sectors in order to increase the efficiency and contribution to development of both sectors. Therefore, the success of privatization should be judged not in terms of the sale or contract itself or the price paid to government, or even the survival or expansion of the enterprise sold, but rather, on the basis of whether there are net benefits to the economy. Privatization must result in better service at lower prices the ongoing privatization is a good policy measure, which the government must pursue with vigour.

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