

Privitization meanings, methods and cases- a short note

Ebrahim Hoseini Nasab

Samira Motaghi

Afshimn Motaghi

Abstract: Privitization is one of the cornerstone projects of the countries seeking to speed up their economic growth. It is the project of prioterizing the market mechanism by returning to it the functions unduly overtaken by the forces of the state. In more realistic terms, the domain of privitization may extend from total ceeding the ownership of publicly owned and opperated enterprises to the private sector at the one end of the spectrum to restructuring of government owned and operated enterprises based on comercial principles at the other end. Therec are however certain prerequisite that need to be met before privitization can work effectively that for the most part amount to provision of an environment that is conducive to large scale and effective private sector engagement in economic activities. Contries that are more successful in providing this environmrnt are in a superior position to rip the advantages of privitizatiois. A first task in the the study of privitization in varuis contries , therefore, is to study how suceessful they are in providing an environment conducive to privte sector opperatoions. This paper's focuss is on privitization in Iran; It includes an analysis of privitizations from the stand point of both the required environment including the institutional requirements and also of policies. The experience of privitizations in certain other countriies is reviewd in order to give the analysis a comparative perspective.

Key words: privitization preconditions, privitization policies, Iran's economy

1. Introduction.

Privitization of government companies has become a world wide phenomenon. First, developed, and then devoping countries have embarked on ceeding a diverse range of government owned enterprises. The international lending institutions such as the World Bank and the International Monetary Fund are said to have set privitization as a pre-condition for approval of loan and other types of finnnacial assitance requests.

The process of privitization is sometimes slowed down due to the reluctance of government officials who find it hard to let go of the companies under their jurisdiction. On the other hand, even though government dis-involvement in the economy may yield positive outcomes at the comercial level, its simultaneous impact at the social level may not always be positive and as desirable. Hence, countries embarking on privitization need to mitigate, or eliminate altogether, the negative social outvcomes of privitization through measures and practices such as deregulation and good governance Boubraki,(1998)

Privitization in different countries is carefully timed to mach country specific condition and economic environment. Iran also needs to time its privitizations in accordance with its own specific conditions and economic environment. Iran also needs to take initiarives to provide for the tranquility, stability and security pre-conditions usally required for motivating long term private sector investment in the economy that facilitate provitizations

kikeri, (1994)

On the otherr hand, Iran's prospects for further integration into the world economy, especially the WTO structure can be enhaced possibly by giving some initial support to the private sector through adopting the needed supporting rules, regulations and policies that lay the ground for more extensive presense of the private sector in the economy with the private sector feeling a real sense of competition with lessr government role as an owner and manager of enterprises.

Having said that, one could argue that due to the strutural problemd prevalent in the Iranian economy, the process of privitization has suffered from certain impedients that include among others, certain ambiguities and non-transparencies in the laws and regulations governing privitization. On the other hand, given the still hirearchial structure of the Iranian socieity, and a public who still views the government as its a guardian, policy makers have opted to exercise certain expediency in privitizations in order not to disappoint the public opinion. So as one analyst observes in spite of the fact that privitization has been a main agenda of the Iranian government over the last two decades or so there still is widespread incidences of a heavy presense of government owned companies in the economy and also of an increase in government or government dependent employment under various pretexts

Torkeman (2003)

This paper is intended to collaborate on privitization both conceptually including the required preconditions and also empirically as the case is unravelling in Iran. The experience of some other countries als are reviewed in order to put the Iranain case in a comparative perspective. Section 2 that follows this introductory section is a conceptual treat ment of privitization

including its pre-requisites. Section 3, gives a brief historical introduction and presents privatizations as implemented in England and Turkey. Section . Section 4 focusses on Iran and 5 summarise and conclude the paper.

2. Meanings and Pre-conditions

2.1. Meanings

Privitization in simple terms is ceding government owned industries and enterprises to the private sector; it is a process of relinquishing government companies and establishments for acquisition by the private sector. Privitization in international jargon is sometimes understood as delegation of responsibility for the economic affairs to the people. Privitisation in more general terms is a culture through which the government and all its decision making bodies will reach the belief that in reality what is of concern to people must be ceded to people because people can manage their own affairs better than the government can do it for them. In other words, the government should cede to people those affairs that people can operate better than the government. According to this understanding, privitization in all arenas especially in the economic arena, can provide a ground for more active participation of people in social, political, cultural and economic affairs and undoubtedly this wide participation of people in a society can strengthen the pillars of democracy with an enhanced role for people to increase their supervision over the government's operations particularly government's economic operations.

Privitization can encompass many different actions. The immediate action as the term privitization connotes, is ceding the ownership and control of activities to the private sector perhaps via selling shares. Another is a reduction in government interference in the economy altogether including elimination of subsidies, deregulation or any combination of these thereof.

In the terminology of Adams(1996), privitization means any action that targets the expansion of the domain of the activities of the private sector. It is a process through which the government studies the feasibility of transferring to the private sector of its functions and establishments at all levels and if warranted performs the actual transfer. Beesly and, Little Child(1983) see privitization as a means for improving economic activities through the role played by the market subject to the requirement that at least 50% of shares in any venture is held by the private sector. Veljanovski(1987) considers privitization as private sector undertaking of economic activities while asset ownership is transferred to the private sector.

During the first session held by the Asian Productivity Organization in Indonesia in 1993 under the banner of coordination privitization in member countries, privitization was referred to as denationalization, deregulation and liberalizations with total transfer of legal control over firms with implications for retuning to the private sector of nationalised entities, removal of all barriers interfering with the prevalence of perfectly competitive market conditions in the production units. So in general terms, it can be said that privitization is a process that celebrates the rebirth of commitment to the belief that markets are more efficient than government and that the Smithian Invisible Hand knows best. It makes questionable the efficacy of government activities and requires the public sector (the government) to limit its activities and cede to the private sector the ownership or the management of some of the entities under its ownership and control.

2.2. Preconditions

The basic objective of privatization is to change the role of government in the economy from operational to policy making and monitoring activities and cede to the non-government sector operations such as industrial, production and service activities (Bell, 1995).

There are two preconditions for any successful privatizations:

- a) openness of the trade regime in the country concerned and existence of an appropriate and secure environment for investments that meet the soundness and developmental requirements which motivate developed capital markets and competitive commodity and service markets (Kikeri, 1994).
- b) the ability of the market to absorb the labour released in the process of privatization (Adams, 1992).

After setting objectives and meeting the pre-conditions, attention should be turned to two important principles of profitability and reinforcement of private ownership. A review of privatization in countries such as Germany, Britain, France, Russia, South Korea, Czech Republic, and Slovakia that differ in some fundamental ways in their economic, social, cultural and behavioural set up reveals that these two principles have been adopted in the transition from a public dominated economy to a market dominated economy and relative to their time, space and situation have provided for the following grounds:

- 1) taking managerial measures internal to the firm with the purpose of increasing firm's productivity. These include measures such as shaping the correct attitude among employees and managers, development of human resources, putting into effect better financial management practices and practices that increase the productivity of capital, restructuring engineering with the purpose of reducing the managerial and administrative hierarchy levels, integrating homogeneous activities, eliminating parallel activities, development of the international affairs for facilitating capital and technology inflow, revising contracts with the purpose of increasing transparency and also defining and offering standards and private contract provisions.

- 2) Creation by government of an environment that acts as the engine of privatization.

This paper argues for the deficiency of these elements in the context of the Iranian privatizations. It is apparent from even a cursory examination of the laws, development plans and privatization proceedings that the government falls short of having a comprehensive, well-coordinated (particularly among institutions and organizations) and complementary package set that reflects on the strategy and objectives of privatizations in Iran.

3. Actual Cases of Privatization .

3.1. A historical overview.

During the period after the first world war (1914-1918) with the socialism of the Ex -Soviet Union (1917) in place, government interference in economic affairs was at a peak. Notable economic achievements were made by expansion of demand and public and welfare services, reduction of unemployment and mobilization of economic potentials. The public ownership domain was expanded and many industries and economic activities in European countries were nationalized. The nationalised enterprise included: many investment banks and bank affiliated industries in Italy, banks, coal industries, railways, airlines and gas in England, and insurance institutions, banks, weapon manufacturing, and airplane manufacturing in France. Hence during the post war period, Europeans experienced extensively with managing government companies and national monopolies. But at the end, the governments failed to control for efficiency in nationalised industries and there grew an awareness for the need to change direction from nationalization to de-nationalization.

In late 1970's disenchants with governments grew mainly due to governments following confusing objectives, reduced work incentives, bureaucratic pressure, growth of wasteful monopolies and managerial weakness. This gave rise to the idea of calling an end to government involvement in the economy, a sort of political liberalism, associated with market friendly economic policies.

The theoretical underpinnings of the industrial revolution of the second half of the eighteenth century and the idea that government interference in the economy was best minimalised and limited to certain special spheres while leaving economic affairs to the workings of free markets based on Adam Smith well known thesis were used to feed the new movement towards market economy.

Privatization was recommended globally as a strategic alternative to state ownership and control of the economy. England became a pioneer in privatizations followed by many other countries in the world. The World Bank and International Monetary fund initiatives to make their loan and financial assistance programs contingent upon privatization as recommended by their staff provided additional incentives for the countries to privatize. Models of 1950's through early 1970's had to be rewritten to reflect the new drive for privatization. The successful models suggested for 1980's and 1990's were models that depended upon private markets.

The group of small and medium size firms that did not operate profitably due to financial mis-management could be privatized by means of negotiation and/or bidding. In England, when Margaret Thatcher reached power, about 5.11 percent of the Gross National Product belonged to government companies. When she won re-election for the third time in 1987, this share was 5.7 percent and during this period, more than 500 thousand labourers were relocated in the private sector and 90 percent of them became factory shareholders.

An OECD report shows that in 1966 the member country governments earned \$billion 88 from privatizations. In the meantime privatization spread to developing and OECD non- member countries, but the share of these countries in total privatizations were only 17 percent or \$billion 4 in 1990.

Given the world wide drive for implementing liberalization and privatization policies and given the fact that government enterprise in Iran often operate at efficiency losses, the Iranian privatizations and transferring certain government affairs to the private sector the Iranian law and policy makers came to believe in privatizations as a practical solution for improving the profitability of the Iranian firms(www.ipo.ir)

3.2. The Case of England.

The beginning of privatization in England goes back to 1979. England is one of the countries to start privatizations without there being any prior experience with privatization anywhere.

The history of England is a witness that up to the year 1979, the government involvement in the economy was extensive. During the nineteenth century, numerous enterprises were put under the government custody. In the twentieth century, certain market failures, the Great Depression, the second world war, and the influence of labor parties lead to the expansion of the role of the government in the economy of England. The justification offered by the ruling power was rationalization of resource allocation and increase in efficiency.

When too much government control of the economy precipitated an economic crisis, the conservative seized the opportunity to take political power in its own hands. The party, lead by Margaret Thatcher, then, made privatization as its main agenda. The main privatization methods geared to government desired objectives in England included: sales of common stocks, direct sales, ceding to the managers and employees and finally sale of assets to the private sector.

To facilitate the progress of privatization policies, the British government implemented certain reforms during and after privatizations. These reforms included improving the financial position of the firms, removing the non-economic objectives governing the firms and putting emphasis on commercial and economic objectives, relocating the labour released as a result of privatizations, devising the needed rules and regulations at each stage, exercising transparency in public announcements and information dissemination and total political commitment and consensus building among political authorities and factions.

England began privatizations with ceding of small industries and non-essential services. To reduce the government size, it decided to cede public monopolies to the private sector that included ceding companies in communication, gas, airline industry, and vehicle manufacturing. The British steel company, shipbuilding, railways, transportation companies were ceded directly to the managers and employees of these companies. The British government's main concern was to distribute the ceded shares to as many people in the society as possible in order to encourage wider participation and responsibility in maintaining the ceded assets.

and that is why the government offered to sell shares at low prices as an additional incentive to encourage a wider population to buy shares. Bonuses (prizes) were offered to shareholders who held on to their shares for longer periods of time. The London stock market acted as the medium where shares of large companies were offered for sale.

Privatizations in England were rather quick to achieve their objectives. The number of shareholders reached 12 million persons and revenue obtained from the ceding of large companies amounted to \$billions 58. The share of nationalized industries as a percentage of GNP was %11.5 in 1986 (Vickers(1988)). Gains in efficiency were observed too. In short, it appears that privatizations in England are geared towards long term goals even if they might not bear drastic short term commercial results.

3.3. The Case of Turkey.

The idea of privatization began to attract the attention of the political leaders of Turkey since the middle of 1980's as a way of speeding up Turkish industrialization. But Turkish authorities faced formidable problems: a limited stock market, lack of corporate accounting standards, unfamiliarity of the public with the exact operation of stock markets, prevalence of financing budget deficits through selling government bonds and finally the rigidity of the managerial structure of government companies. But in spite of these problems, the government took the first steps of privatization in 1987 where it announced ceding of 22 government companies that included the largest electric appliance manufacturers and steel and other manufactures of industrial products followed by privatization of other companies.

The year 1988 witnessed privatization of communication equipment and 1992 privatization of airline companies. The method of privatization was sales to the public through the stock market. A number of the companies offered for sale were bought by foreigners. Based on existing statistics, Privatizations in Turkey have led to faster economic growth (www.ceri.ir; IMF 2000).

3.4. The Case of Iran

Privatizations in Iran were first outlined in 1989 by the policies of the 3rd Five Year Development Plan and decrees for implementations were issued in 1991 by the board of Ministers. During the 1st and 2nd Five Year Development Plans, policies had been outlined in the form of Notes for improving the operation of government companies and a more active presence of private sector in the Iranian economy. Note 32 of the law of Development Plan, decrees issued by the Board of Ministers in 1991 and 1992, the law of the manner of ceding government shares to benevolents (war security related veterans) and workers, the law passed by the Islamic Consultative Assembly in August, 1994. Note 35 of the law of the country's budget for 1998 and 1999 are among the initiatives taken to prepare the grounds for privatizations according to the dictates of 3rd Development Plan. The program of privatization, then, proceeded according to the dictates of the 3rd Development Plan. In the second and third chapter of the 3rd Development Plan Law, there are 23 articles that determine the manner of overhauling government companies and ceding shares belonging to the ministries, organizations, and government companies. The articles of these two chapters rule the shaping of relevant policy making and executive bodies needed to overhaul the government companies and offer them for sale in the stock market.

Shares belonging to government between 1991 and 2001 amounted to rials billions 8329. However, ceding of public enterprises to the private sector moved rather slowly in 2000 mainly because of the lack of transparency in pricing the shares of government enterprises offered on the stock market. The method of privatization during these years included offering the shares of government establishments in Tehran stock exchange, selling shares to employees and managers mainly through the Ex- organization of extended government ownership of production units and direct negotiations on sale of government units. However in 1998, the negotiation method was abandoned due to the lack of pricing transparency and occasionally fraud. Among enterprises that were included in ceding were: the organization for expansion and renovation of the Industries of Iran, the organization of national Industries of Iran, the financial organization of the expansion of government ownership. Over the said time frame, the privatization organization has ceded 127 million shares of production units to workers mainly through the stock market. Furthermore, in recent years based on

Note 10 of the country's budget law it was determined to transfer the shares of the government companies to the retirement organizations as a repayment of government debt to this organization (Safarzadeh, 2002).

The policies of privatization in 4th Development Plan follow closely those of the 3rd and are a continuation of the same. The Article 6 of the law of the 4th Development Plan calls for privatizations in all cases including the cases that fall under the Article 44 of the constitution and the general policies of the plan with the aim of strengthening the non-government sectors by an assortment of privatization methods including: deregulation, ceding management (like signing general lease contracts, management contracts) and ownership (including lease ending in ownership, sale of part or all of the shares, ceding assets), breaking enterprises into smaller entities suited to ceding, dissolving and integrating companies. But as the main campaign of the current government is centered on social justice, special attention is given to privatization rationing (justice shares) in order to prevent an income gap among the various segments of the population and make for a fairer distribution of ownership and income in Iran. The system of "share rationing" is meant to promote equity in ownership, achieve economic development accompanied by social justice and optimize the government size. Share rationing, relative to other methods of ceding, facilitates and speeds up the ceding of a larger number of enterprises that lack attraction to private investors. The bylaw governing the distribution of justice shares as passed by the vote of the board of ministers comes in 13 articles and the government in intent to cede the shares of public enterprises to the lower income quintile of the population with a 50 percent discount and collect the proceeds on a 10 year installment basis in the form of keeping the dividends accruing to these shares. This will be done by investment companies and justice share cooperatives established in the center of each State and each Township respectively, under the supervision of the privatization organization. It should be noted, however, that during fifteen years of privatization only 3 percent of government companies have been ceded and expansion of government companies during this period has paralleled the expansion of privatizations.

The main impediments to privatizations in Iran are: an overvalued exchange rate volatility that discourages capital goods and intermediate goods and technology imports, the underdevelopment of organized capital markets, unpredictability of government regulatory system, constraints imposed by the constitution, the labor law, the tax and commercial law, procedural deficiencies and gaps, multiplicity of decision making bodies and an insecure economic environment that propels private sector activity.

In addition to what just was said, there is some concern among the public that privatizations might lead to GNP decline, unemployment, isolations from the government and welfare reductions. Perhaps this is because Iranians are not yet ready to trust the private sector as they trust the government with all its deficiencies. Besides, privatizations have not yielded the desired results homogeneously across various host countries. The outcome of privatizations in India, for example, have not produced the same positive results as in Canada, Malaysia, the Czech Republic and Poland.

For the most part, governments tend to retain profitable enterprises and only financially bankrupt companies are offered for privatizations that fail to generate an effective demand.

Public decision makers at lower levels also are concerned about their own job security and that is why they exercise extreme expediency in implementing privatizations.

So in all, it may be said that unattended privatizations will not necessarily produce the desired outcomes in Iran. There is now enough experience in the world that can help Iranian policy makers choose the privatization scheme and mix of government/ private sector cooperative sector and NGO's that best meets the Iranian long term economic objectives and also the public expectation of restructuring the Iranian economy.

4. Summary conclusions.

To summarize, privatizations have a wide ranging epistem. They can convey several interrelated concepts such as transference of ownership to private sector- total or in part. It does not necessarily connote ignoring the plight of the workers, and social services the less advantaged. It does, however, bear strongly on eliminating inefficiencies, and wastes resulting from governments burdening the economy in the form of government ownership, management, control and interference in the working of the markets.

In Iran, the foundations for privatizations were laid by a revisit of Article 44 of the constitution that called for denationalizations in a manner that would encourage more participation of the private and cooperative sectors in the economy. The just share method of privatizations is intended to promote equity in the distribution of shares. The Iranian authorities have acted rather cautiously in their privatization moves and this has slowed down the process of privatization. That, at least in part, is because the environment and the preconditions of privatizations are not yet built. It is also because, privatizations are politically sensitive and as the cases of the countries reviewed indicate, because of the nature of methods adopted in privatizations, one sometimes gets the impression that privatizations are not really privatizations per se.

In the specific Iranian case, it appears that the infant industry argument once popular in developing countries applies to the private sector as well. It cries for help in order to start walking and if this is the case what happens to the need for reducing the government role in the economy. Or perhaps Iran should move slowly until the private sector starts walking by itself.

References:

Boubraki, Narjess and Jean-Claude Cosset, 1998. "The financial and operating performance of newly privatized firms: evidence from developing countries". Journal of Finance, 53 (3): 1081-1110.

Kikeri, Sunita, John Nellis and Mary Shirley, 1994. "Privatization: lessons from market economies". World Bank Research Observer, 9: 241-272.

Bell, Stuart, 1995. "Privatization through broad-based ownership strategies: a more popular option?". World Bank, Viewpoint, note 33.

Adam, Christopher, William Cavendish and Percy S. Mistry, 1992. Adjusting Privatization: Case Studies from Developing Countries (London: James Currey Ltd.).

Beesly, Michel and Little child, Stephan. Privatization: principles, problems and priorities. Lloyds Bank Review, July 1983, P.1

Veljanovski, Cento. Selling the state. Butler and Tanner Ltd, 1987, P.1.

<http://www.ipo.ir>

Vickers, John and Yarrow, George, An Economic Analysis, The MIT Press, 1988, P.1.

www.ceri_sciencespo.com

IMF-international financial statistics yearbook-2000