PUBLIC ENTERPRISE REFORM PROBLEMS AND PROSPECTS:

A COMPARATIVE STUDY OF IRAN AND MALAYSIA

BY

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ABSTRACT

The thesis examines the process of privatisation of public enterprises (PEs) in Iran and Malaysia. The main proposition is that privatisation of public enterprises will not achieve successful outcomes unless sound and comprehensive provisions are established and followed. Public enterprises have different structures, objectives and degrees of obligation to the public interest and demand different tools to implement privatisation effectively. Knowledge of the modalities of privatisation and selection of the right modalities are contributing factors to successfully developing policies for privatisation. The socio-economic environment, cultural relations and legal barriers also need to be considered in the policy formulation process.

The argument which is put forward is that the privatisation program in Iran has not been so successful in the first stage of privatisation as Malaysia's, due to a short-term perspective and underestimation of the aforementioned issues. In order to examine this proposition, the thesis analyses first, the theories of privatisation, then, the factors that have been involved in privatisation in Malaysia compared to Iran. These factors are: (i) the socio-economic and political environment in which public enterprises operate; (ii) the role and the structure of public enterprises; (iii) the motives for privatisation; (iv) policy-making and provision of safety clauses for privatisation; (v) privatisation implementation; (vi) evaluation of the privatisation process; and (vii) reforms other than privatisation (managerial and administrative reforms).

This thesis provides important lessons for those involved in privatisation in Iran and Malaysia, for international agencies such as the World Bank and IMF, private entrepreneurs and the public.

DECLARATION

I certify that this thesis does not incorporate without acknowledgment any material previously submitted for a degree or diploma in any university; and that to the best of my knowledge and belief it does not contain any material previously published or written by another person except where due reference is made in the text.

MEHDI E N RAFSANJANI

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ACRONYMS AND ABBREVIATIONS

ACA	Anti-corruption Agency
ADB	Asian Development Bank
ASB	*Amanah Saham Bumiputra* (Bumiputra Trust Fund)
BOP	Balance of Payments
BOT	Build-Operate Transfer
BO	Build-Operate
CBA	Cost-Benefit Analysis
CBIRI	Central Bank of Islamic Republic of Iran
CICU	Central Information Collection Unit
CIMA	Cement Industries of Malaysia
CULS	Convertible Unsecured Loan Stock
ELSS	Employee Loyalty Share Scheme
EON	*Edaran Otomobil Nasional* (National Automobile Distributor)
EPU	Economic Planning Unit
ESOPs	Employee Share Ownership Plans
FFDP	First Five-Year Development Plan
FELDA	Federal Land Development Authority
GDP	Gross Domestic Product
HICOM	Heavy Industry Corporation of Malaysia
ICU	Implementation and Coordination Unit
IFC	International Finance Corporation
IDRO	Iranian Development and Renovation Organisation
IMF	International Monetary Fund
INIO	Iran National Industry Organisation
INTAN	National Institution of Public Administration
IR	Iranian Rial
IRI	Islamic Republic of Iran
KCT	Klang Container Terminal
KPA	Klang Port Authority
KLSE	Kuala Lumpur Stock Exchange
MAMPU	Modernisation and Management Planning Unit
MARA	*Majlis Amanah Rakyat* (Council of Trust for the Indigenous Peoples)
MARDEC	Malaysian Rubber Development Corporation
MAS	Malaysian Airline System
MCA	Malaysian Indian Congress
MOU	Memorandum of Understanding

NCA	National Action Council
NFPEs	Non-Financial Public Enterprises
MIC	Malaysian Chinese Association
MIDA	Malaysian Industrial Authority
MISC	Malaysian International Shipping Corporation
MNCs	Multi-National Companies
MOU	Memorandum of Understanding
NEP	New Economic Plan
NICs	New Industrialised Countries
PAP	Privatisation Action Plan
PAS	*Partai Islam Se Malaysia* (Islmic Party of Malaysia)
PBO	Plan and Budget Organisation
PE	Public Enterprise
PEs	Public Enterprises
PERNAS	*Perbadanan Nasional* (National Corporation)
PETRONAS	*Petroliam Nasional Berhad* (National Petroleum Company)
PIHP	Pernas International Hotel and Properties
PNB	*Peromodalan Nasional Berhad* (National Equity Corporation)
PMP	Privatisation Masterplan
PSP	People Share Program
PROTON	*Prusuhan Nasional Otomobil* (National Automobile Company)
RISDA	Rubber Industry Smallholder Development Authority
SAP	Structural Adjustment Policy
SEDC	State Economic Development Corporation
SFDP	Second Five-Year Development Plan
SOCs	State-owned Companies
STM	*Syarikat Telekom Malaysia* (Malaysian Telecommunications Company)
TEN	*Tenega Nasional* (the National Electric Utility)
TQM	Total Quality Management
TFP	Total Factor Productivity
TQM	Total Quality Management
UMNO	United Malay National Organisation
UNDP	United Nations Development Plan
USAID	United States Agency for International Development

CHAPTER 1

INTRODUCTION

Privatisation has become a central feature of the economic policies of a variety of nations in the developed and developing world and in capitalist and socialist states. During the 1980s, there was a worldwide movement to transfer public enterprises (PEs) to the private sector. Malaysia is one of these countries whose experience offers a model for countries embarking on the implementation of reform of public enterprises. Iran began its privatisation program in 1989 as an element in a package of economic adjustment policies. In both countries, PEs had a significant role in the economy. However, there are some similarities as well as differences in the means and the ends of the privatisation programs instigated in both countries.

Malaysia

In Malaysia, PEs were considered devices for achieving socio-economic objectives in the 1970s and the means of achieving the aims of the New Economic Policy (NEP) (Noorani,1989). PEs were also established as a response to market failure; for achieving income distribution goals and restructuring society; for the pursuit of socio-economic objectives; and for the creation of a heavy industrial base.

According to Shaikh (1992:217), the choice of PEs as instruments of redistribution increased the difficulties in monitoring the financial performance of

PEs. Malaysia's PEs were estimated to contribute between 29-31 per cent of the country's GDP in spite of several types of privatisation and restructuring measures which had been attempted since 1987 (Shaikh, 1992:207, 209). This proportion was among the highest in the world and the highest among the ASEAN countries. Nonetheless, Malaysia was able to sustain large losses from some PEs for a long time because PEs involved in the petroleum industry made large incomes and compensated for those loss-making enterprises.

However, cases of mismanagement and the failure of some PEs detracted from the image of the public sector and its management in the 1980s. Some PEs, for example, have undergone investigation to eliminate corruption and inefficiencies (Tsuruoka, 1991). *Tenaga*, National Malaysia's state-owned electricity enterprise, was one of these enterprises. A catalogue of corruption and inefficiency was also revealed in Bank Rakyat in 1976 (Gale, 1981:177).

These difficulties had occurred because adequate systems of monitoring and accountability had not been set up. As a result, reforms such as corporatisation and privatisation were implemented to overcome the problems associated with PEs.

There have been several different views about public enterprise reform in Malaysia. Mahmood and Mat (1992:423) state that the strategies and efforts for reform in Malaysian administration were motivated by Malaysia's own unique socio-economic and political environment and experience. The broad focus of these reforms and changes can be distinguished in administrative structures, planning and budgeting systems, personnel management practices, and systems and procedures as well as privatisation initiatives.

In addition, Malaysia's program of selling off the large PEs is one of the most extensive of its kind and is often held up as one of the leading examples of privatisation amongst developing countries (Adam et al., 1992:211). The privatisation program was initiated in 1983, but PEs have not been fully privatised. Instead, many of them have been corporatised to the extent that they have been restructured as private entities through issuing shares to the public and by recruiting new boards of directors from the private sector (Tsuruoka, 1990). Therefore, the government has preserved public ownership in many enterprises through corporatisation.

The objectives of privatisation in Malaysia are to:

(i) relieve the financial and administrative burden of the government;

(ii) improve efficiency and productivity;

(iii) facilitate economic growth;

(iv) reduce the size and presence of the public sector in the economy; and

(v) help meet the national economic policy targets (Privatisation Masterplan, 1991:21)

Privatisation in Malaysia was based on the government's New Economic Policy (NEP: 1970-1990), which aimed to redistribute up to 30 per cent of the nation's wealth and corporate assets to "indigenous Malay" citizens between 1970-90 (Tsuoruoka, 1990:42). It seems that some form of "people's capitalism",[1] which is concerned about selling shares to a variety of consumers, has been considered in

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[1]– People's capitalism could be defined as increasing the dispersion of shareholding amongst the wider population.

the reform of public enterprises in Malaysia. The aim of increasing participation of indigenous Malaysians in private business is a political issue. Therefore, as in many other countries, political and economic factors influenced the privatisation process.

In the strategy pursued by the Malaysian authorities, the emphasis is on private sector activity as the main engine for growth. The public sector, while continuing to consolidate its fiscal policies and operations, was geared to providing a supportive environment for healthy economic expansion. From the point of view of achieving an efficient sub-sector, Nankani (1990:43-5) maintains that in Malaysia there has been relative freedom to use a variety of instruments for the aim of reform, although it is not clear that this has always resulted in the most desirable method being chosen.

Thillainathan (1990:134) notes that Malaysia responded to deregulation and globalisation of the world economy on several fronts such as taxation, investment and labour market reforms. He contends that Malaysia pursued the right set of policies with respect to growth and income distribution. However, in the initial stage of development, there is a trade-off between growth and distribution and thereafter, Thillainathan believes, more growth produces less inequality (ibid., 123).

The reform program in Malaysia is seen as a key element of the NEP and, therefore, constrained by its policies. Adam et al. (1992:211) argue that the net impact of the reform policy on the relative balance of private and public sector has been minimal. The effects of the privatisation program have been constrained by government intervention, through the structures and consequence of the NEP, and the ethnically-based affirmative action program which has shaped the conduct of economic policy since the 1970s.

On balance, however, Malaysia succeeded in its privatisation reforms and its experience offers a model for countries embarking on the implementation of reform (Somogyi, 1991:35-8).

Iran

Since the revolution in 1979, the Iranian government has undertaken responsibility for maintaining a large public enterprise sector. The scope of the sector is broad, because most PEs are involved in a wide range of activities and control important parts of economic activity.

On 7 and 25 June 1979, the Revolutionary Council of Iran nationalised twenty-seven privately owned banks and fifteen insurance companies. The government's justification for the nationalisation was (a) the heavy domestic and foreign debts of some banks, especially the development banks, and (b) the risk of the outflow of funds to accounts abroad (Rahnama and Nomani, 1990). In large industrial establishments, government supervision became increasingly unavoidable due to the departure of the owners, outstanding debts and increasing dependence on government funds. This also applied to firms which were closed or unable to continue their operations and needed government help.

The law also obliged the government to determine the ownership of strategic industries within the framework of "Islamic Law". This included:

> All large-scale and mother industries, foreign trade, major minerals, banking, insurance, power generation, dams and large-scale irrigation networks, radio and television, post, telecommunication services, aviation, shipping, roads, railroads, and the like (Article 44 of the Constitution).

After the nationalisation of some major industries and companies and the exodus of owners and trained administrators, there was a shortage of experienced managers. The government tried to tackle this problem by finding persons who possessed the qualities of "ceaseless effort and endeavour, intellectual and practical guidance and leadership" (Latifi, 1992:22). This approach to choosing managers compensated for the lack of experts and skilled managerial teams. It also lessened the problems the government confronted in administering various kinds of companies under its supervision. However, training employees and recruiting educated managers in some PEs occurred rather late and this slowed the progress of these enterprises compared to what was planned originally. The war with Iraq also added a significant financial burden and affected the operation of PEs.

The Iranian government has been implementing a policy of privatisation since 1989. The strategy of new liberalisation and privatisation was described by President Rafsanjani as follows:

> ... to turn Iran back into a market economy by privatisation of nationalised companies, promoting the stock exchange, and encouraging foreign and local private investors (Timewell, 1992:24).

The other reason for privatisation in Iran is, as the head of the Plan and Budget Organisation (PBO) expressed it, transferring a burden of nearly 300 huge companies to the private sector. These companies account for approximately 20 per cent of GDP and 60 per cent of government receipts and payments in the budget (Banker, 1991:46). The Minister of Economic and Finance Affairs, Mohsen Nourbakhsh declared that "I have come up with a list of 500 companies out of 800 in state ownership to privatise" (Evans, 1991:79). He argued that Iran had to reduce the role of government in economic activity as much as possible.

For the purpose of wealth distribution and providing services, such as education at a lower price, the government had to concentrate on those activities that the private sector might not go into. Regarding the government's obligations to the public interest, the government would also create a framework to achieve social and economic goals. Although the government has been pursuing a policy of privatisation, the principal and important industries remain in the hands of government.

The government has attempted to reconstruct the economy and relieve the impact of the $1,000 billion damages bill from eight years of war. For example, some of the expenditure of the war had to be financed by foreign loans taken up during the five-year planning period (1989-94). Privatisation is also part of the program suggested by the International Monetary Fund (IMF) for repaying loans in order to reconstruct the economy after the war. Finally, privatisation has been applied as an internal fiscal policy in order to solve economic problems of inflation and liquidity.

From the managerial viewpoint, public enterprise reform has been applied as a means to redress problems such as inefficiency, ineffectiveness and a lack of accountability in the public enterprise sector. Under-utilisation of industrial capacity is one of the crucial problems of economic performance in Iran. It is a consequence of factors such as the war, the decline in oil revenue and dependence on external resources. Furthermore, problems of inefficiency and the lack of a work ethic are observed in some PEs (Amirahmadi, 1990). Therefore, there was a need for reform in PEs because of economic, political and administrative problems.

In Iran, the privatisation initiatives occurred after a trend towards rebureaucratisation and organisational consolidation to bring about necessary order and regulation after a revolutionary period. Therefore, privatisation seems not to be contradictory but complementary to the aim of bureaucratisation (Farazmand, 1991:755-67). This occurs while privatisation is often considered to be a solution to the problem of economic inefficiency and growing bureaucratisation in administration.

The strategy was built around selective privatisation of the productive public sector, deregulation of certain sections of the economy, limited import liberalisation and controlled financial liberalisation. The government moved further in the direction of a market economy. This was aided by the kind of stabilisation or structural adjustment policies that were prescribed by the World Bank and IMF (Amirahmadi, 1990).

Privatisation was applied as a reform alternative to solve the aforementioned problems. The Minister of Economic and Finance Affairs stated that the objective of privatisation was further utilisation of the country's existing potential capacities (*Keyhan Havai*, 19 May 1993:31). However, the political and economic reasons for privatisation of public enterprises in Iran seem to outweigh the managerial reasons for reform.

However, there is an argument that this trend could lead to increased inequality and economic exploitation of the lower classes. This contradicts the earlier strategy, in the immediate post-revolutionary period, which was built around an emphasis on the productive role of the public sector in the Islamic Republic of Iran. There have also been doubts about the effectiveness of the privatisation policy of selling public assets to the private sector.

In 1992, the Iran Chamber of Commerce, Industries and Mines declared that the rate of GDP growth had increased 10 per cent during the last three years (1992a, No.6:11). However, the impact of other factors on this increase was not mentioned in this report.

Unfortunately, little research concerning public enterprise reform has been conducted into the factors influencing reform initiatives, strategies taken and outcomes so far. The current research is the first attempt to study these issues and it is anticipated that it will provide strong theoretical and practical frameworks with which to enhance the performance of PEs.

Definition of the Problem

Privatisation and reform of PEs is a sensitive and complicated undertaking. PEs play a significant role in developing countries and their privatisation creates social and economic changes. Thus a topic such as this demands a comprehensive study of a variety of factors.

PEs are government organisations which have established business or commercial responsibilities and they can be the main means by which governments are involved in developing and operating the economy. Shaikh (1992:208) defines a PE as "a productive entity that is owned and/or controlled by public authorities and whose output is marketed".

Enhancement of the performance of PEs through increasing profitability, productivity, and responsiveness to market forces is an important economic objective of governments. There are also other significant objectives which are in line with the public interest. Social, political and managerial objectives of PEs are also interdependent with the economic objectives.

The critical and substantial role of governments in the process of economic and social change has brought about some problems in developing countries. Government agencies often tend to be more interested in developing their autonomy and independent power positions than in the implementation of policy. Moreover, accusations of corruption, lack of initiative, and arrogance with the clientele observed in some PEs, were reasons for reform in PEs.

Reform in PEs has been considered from different aspects. Three strategies for reform have been identified by Thynne (1991:33-48) as alternatives for performance enhancement in public enterprise. These strategies are (a) commercialisation, (b) corporatisation, and (c) divestment or privatisation. The first strategy views transformation through changes in the mode of operation, and recognises public enterprise as working within a commercial context. Therefore, PEs are expected and allowed to operate similarly to private enterprises. The second strategy, which is transformation through legal-structural arrangements, involves the reconstitution of departments and statutory bodies as government companies. This creates an integrated corporation within which there could be considerable autonomy with a limited degree of political control. The third strategy is transformation through changes in ownership. This strategy is said to be an appropriate response to enterprise inefficiencies and related problems of budget deficits.

Advocates of privatisation contend that the monopoly status of PEs has generally bred inefficiency and lack of competitiveness. Lieberman (1993:9) characterises PEs as being poor financial performers, overstaffed, dependent on subsidies and unilateral budget transfers, highly centralised and politicised organisations, which exclude competitive imports, and have poor export performance, corrupt practices and are vehicles for capital flight. The belief is that the private sector also could not be competitive in a protected market environment. There has also been an emphasis, by Lieberman (1993:17), that corporatisation and commercialisation which are necessary for privatisation, should not be viewed as privatisation itself.

Pointing out the tension between the failure of the market and the failure of regulation as well as the need to find structures to minimise the extent of either, Bishop (1990:241-57) suggests that the real objective of policy should be to construct the organisation of public enterprise activities so as to create conditions that make private sector operations effective and efficient. For Bishop policy should specify objectives, a clearer framework of constraints and the pressure of competition. The organisation of industries, therefore, needs to be given careful consideration before privatisation occurs.

The key issue is whether privatisation alone will generate the incentives for enterprises to behave, permanently, like competitors, i.e. to become cost effective, innovative and responsive to demand. Pelkmans and Wagner (1990:3-28) maintain that singling out privatisation as the panacea, without attempting to create a competitive and undistorted market, is unhelpful and belongs to political rhetoric. Privatisation is not a cure for all that ails troubled PEs. To Hammer et al. (1989:19-28), mere selling of shares in state-owned industries cannot create new powerful management nor can it guarantee a company's survival. However, the suggestion is that a management with long-term vision will anticipate this change and prepare strategies for managing and ensuring the success of privatisation (Hammer et al., 1989:17). Similarly, Emy and Hughes (1991:388) believe that "If an enterprise is not in a competitive environment, selling it cannot improve competition". Changing a public monopoly to a private monopoly does not improve competition. Indeed in these circumstances, privatisation makes it more difficult to introduce competitive incentives in future. Regarding the public interest, there is a belief that the marketplace has neither the willingness nor the capacity to do anything other than be self-interested and profit maximising. Wettenhall (1988:47) believes that the group of public interest questions involving issues such as public accountability, equity and consistency in service development come in a very poor second. This argument suggests that private enterprises want to capitalise profit and socialise losses. Wettenhall (1988:48) refers to Langmore's expression that selling productive collectively owned enterprise is clearly a "squandering of public assets".

Dixon (1991:82) states that the view that privatisation will improve things by itself is pure ideology and no more than that. He points out that privatisation is not a way to achieve social and economic goals. The only goal of privatisation, by itself, is to achieve the goal of private ownership, i.e., to change ownership from public to private.

Regarding the enhancement of public enterprise efficiency, Habir (1991:63) believes that "not all public enterprises lose money", some of them are profitable because of good management, others because of their monopoly positions and the protective policy of government. He recommends measures to improve public enterprise performance, to use the resources invested in the firm (productive efficiency) and to gain the economic benefit of optimal resource allocation (allocative efficiency). Then he illustrates the dynamics of ideology, culture and the values of the individual manager as well as macro-environmental factors involved in improving efficiency in PEs (Habir, 1991:63-77).

Another argument is that privatisation or corporatisation is not the only option for reforming PEs or the public sector. Improvements in efficiency, effectiveness and accountability can be achieved without privatisation and corporatisation. Examples exist to demonstrate that traditional PEs can sometimes outperform those that are included in privatisation reform, through effective reforms other than corporatisation and privatisation. For example, McCarthy and Spall (1992:3-25) show that improvements in efficiency can be achieved as well as addressing accountability and equity issues.

This research examines the implications of the privatisation initiatives of both Iran and Malaysia within the context of their respective political, economic and social environments. It will also provide important lessons for policy-makers dealing with privatisation issues and international agencies such as the World Bank and International Monetary Fund (IMF).

Objectives of the Study

This study aims to examine the problems and the prospects of public enterprise reform in Iran compared with those in Malaysia. The reform efforts undertaken in Iran are examined, analysed and compared with the outcomes of the reform initiatives implemented in Malaysia. The analysis seeks to explain the reasons why changes have occurred and identify the major influences on reforms. Policies for reforms are also addressed, the successes and the failures of the reform initiatives are assessed and the means available for improving the reforms process are examined.

Therefore, the aims of the study are:

(i) to evaluate the performances of PEs in Iran and Malaysia;

(ii) to identify the reasons for the reforms in Iranian and Malaysian PEs;

(iii) to examine the policy initiatives and modalities applied to improving public enterprise performance in Iran and Malaysia;

(iv) to evaluate the privatisation program in achieving its objectives; and

(v) to investigate the effective reform alternatives, if any, for Iranian and Malaysian PEs.

Research Questions

In order to determine the problems and prospects of public enterprises reform in Iran and Malaysia this research will examine the following questions:

1 What factors were responsible for the emergence of public enterprises in Iran and Malaysia?

2 What reform initiatives were taken, and why?

3 How and to what extent have external, internal, and ideological factors influenced the policy process?

4 Did the reform policies achieve the desired goals?

5 Are there any effective alternatives to the selected reform measures?

6 Are the changes being evaluated, and how?

Significance of the Study

Public enterprise reform is an important issue in developing countries for the following reasons. First, PEs are engaged in a variety of activities. They play a key role in maintaining social and economic development and they are vital components of national economic and social planning. There is a strong belief in many developing nations that rapid economic growth cannot be achieved without resorting to the device of public enterprise (Hope, 1982). These organisations are devised by governments as the instruments by which they acknowledge their obligations to help achieve social and economic goals. PEs are not created for the single purpose of profit making. The main objective of PEs is serving the public interest. They are also involved in achieving other objectives such as profitability, productivity, efficiency and effectiveness. These objectives may be achievable provided an effective system of accountability and auditing by a skilled and trained cadre of managers is established.

On the other hand, privatisation is prescribed by the major international institutions such as the World Bank and IMF as the only way to improve economic and managerial performance of public enterprises. It is claimed that social objectives such as distribution of wealth and social justice can be achieved by implementation of privatisation in the form of transferring public assets to the private sector (Thillainathan, 1990; Hensley and White, 1993). Nonetheless, commitment to reforms such as privatisation in PEs may create a negative public image for the government. Thus reform initiatives need to be based on a comprehensive program and logical agenda and consider public interest as well as managerial efficiency and effectiveness.

This research seeks to clarify the impact of reform initiatives and privatisation of PEs on the economy and management performance of Iran and Malaysia. It is hoped that the results of the study will be used as an academic resource in both countries as well as other developing countries. International institutions also can take advantage of the Malaysian and Iranian experience as this study clarifies the impact of their policies on these countries.

Iran and Malaysia have been chosen because of their economic and cultural similarities. They are both developing Asian countries with a major economic resources base such as petroleum.[2] Both countries inherited the same Islamic culture. Therefore, it is useful to provide some basis for assessing the extent of reform, the methods employed and the complementary policy requirements. The findings of the research will be applicable and useful to both countries.

Methodology

The focus of this study is to examine the prospects and the problems of public enterprise reform in the context of Malaysia and Iran. Malaysia and Iran are both developing countries in which the role of PEs has been extremely significant. While both share Islamic value systems, however, each has taken a markedly different path in PE reform to date. Attempts will be made to analyse the causes, means, ends and the outcomes of public enterprise reform in both Malaysia and Iran. The thesis will first explain the reasons why changes have occurred and identify and analyse the major influences on reform. Strategies for reform will be

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[2]– However, Malaysia is considered as one of the New Industrialised Countries (NICs) and the world's third largest producer of semiconductors.

discussed to analyse the problems associated with reforms. The successes and the failures of the reform initiatives and the means for improving the reform process will also be examined.

The research is based on a longitudinal comparative analysis of public enterprise reform in Iran and Malaysia. The comparative analysis takes into account the cultural, economic, managerial, political and social objectives specified prior to the reforms and those established in the Constitution of each country.

Reform modalities include divestiture and non-divestiture alternatives. Privatisation, for example, includes public offering of shares, private sale of shares, sales of government or public assets (divestiture), as well as the reorganisation of an enterprise into separate entities and management or employee buy out. It seems that privatisation through the sale of assets or shares to a single private buyer is often the preferred alternative for weak or poorly performing enterprises, while other alternatives which aim to enhance the performance of PEs such as corporatisation and marketisation (non-divestiture) may be used in preparation for future privatisation.

Nevertheless, it seems that privatisation in the form of a divestiture of assets is considered to be the main reform strategy for PEs, especially in those countries that are the recipients of advice from the World Bank and the IMF.

The analysis is based primarily on the privatisation policies in Iran and Malaysia, however, other reform alternatives are also addressed in order to examine the range of effective strategies for public enterprise reform.

The work is based on primary and secondary data. Primary data is collected from both government documents and interviews. Relevant government documents, policy papers and official statements of individuals and organisations responsible for the formulation and implementation of the privatisation program provide part of the primary data. The organisations in Iran include: the Tehran Stock Exchange, the Secretariat of Privatisation in the Department of PEs (Bongah-hay-e-Eghtesadi), Department of Economic Survey in the Central Bank, the College of Economic and Finance Affairs affiliated to the Ministry of Economic and Finance Affairs, the Plan and Budget Organisation (PBO), the Iran National Industries Organisation (INIO), the Industrial Development and Renovation Organisation (IDRO), the Iran Chamber of Commerce, Industries and Mines, the Islamic Consultative Assembly (Parliament), the Faculty of Public and Business Administration of Tehran University and the Department of Economics of the University of Kerman.

Interviews were conducted with a number of officials serving in key positions in PEs, in ministries with policy-formulation involvement, committees responsible for the formulation and implementation of privatisation policy and for reform of organisational design in Iran and Malaysia. The interview schedule was constructed to cover key and representative PEs in each country. An attempt was made to seek individuals in those enterprises whose positions or knowledge is sufficiently broad to be representative. The list of interviewees is shown in Appendix A. During the interviews, issues pertinent to public sector problems, privatisation policies and strategies adopted to implement such policies were addressed.

The research used questionnaires with major issues/themes as a complementary method of data collection. The questions varied according to the interviewee's position and their area of responsibility. The interviewees consented to either be quoted if necessary or to have the gist of their responses used as primary sources of data.

Reliability of the findings is addressed by obtaining multiple data from multiple perspectives. In the cases where it was necessary to choose more than one interviewee to ensure a diversity of perspectives, more interviewees were chosen. Direct observation of a number of PEs as a client, an executive staff member (county governor), lecturer at Kerman University and as a researcher during my visit to Iran, have been factors which have helped to enhance the testing of the research ideas. To get a more comprehensive view of the problem, attempts have been made to obtain the views of various professional bodies such as the Iran Chamber of Commerce and the PBO.

In Malaysia, data has been elicited in the form of a) a registered document of the Malaysian Government, and b) interviews conducted with authorised people. In respect of public enterprise reform in Malaysia, reports such as those of the Modernisation and Management Planning Unit (MAMPU), the privatisation sector of the economic Planning Unit (EPU), and seminar reports on privatisation are some important sources of secondary data. The list of organisations which provided primary data in Malaysia is shown in Appendix B.

The main sources of secondary data have been the Constitutions of both countries, statutes, books, journals, published monographs and government documents and reports from each country. The list of organisations which provided the sources of secondary data in Iran is shown in Appendix C. The list of questions in shown in Appendix D.

On the basis of data collected through primary and secondary sources, the study examines the rationale, strategies, and outcomes of public enterprise reform in Iran and Malaysia. The analysis of effectiveness, for example, is based on the degree of success in achieving the stated objectives. The anticipated outcome from a program of privatisation is greater efficiency, although this goal may be pursued at the expense of equity and social objectives. The ideal is reform that is both efficient and equitable.

The substantive issues examined in this research are of importance to policy-makers in Malaysia and Iran who are concerned with public enterprise reform. In addition, there are insights for international agencies such as the World Bank and IMF, private entrepreneurs and the public. The subject matter and approach also provide an opportunity to undertake a limited comparative study in public administration. The following paragraphs describe the organisation of the thesis.

Organisation of the Thesis

The thesis is divided into five chapters with each chapter encompassing a number of sections.

The components of Chapter One are overview, definition of the problem, objectives of the study, research questions, significance of the study, methodology and organisation of the study.

Chapter Two encompasses theories and principles of PE reform including privatisation. This includes theories and principles concerning socio-economic factors involved in privatisation programs, the role of PEs, reform motives, privatisation policy-making, implementation of reform, and evaluation of privatisation. Theories concerning reform initiatives other than privatisation are also included.

Chapter Three examines Malaysian PE reform, and Chapter Four covers Iranian PE reform. Each chapter is divided into seven sections in order to assist the comparative analysis. Section One includes a general background of the social, economic, political and cultural environments within which the country's public enterprises operate. Section Two comprises an analytical description of factors involving the emergence of public enterprise in each country. The structure, function, responsibility, performance and evolution of these establishments are examined in this section.

Section Three is an overview of privatisation motives. It comprises the rationale, effective driving factors, and objectives of privatisation of public enterprises (PEs). The managerial, economic, social, and political factors are examined in this section. This section also analyses external factors influencing privatisation motivation.

Section Four examines privatisation policy-making. It reviews policies concerning foreign participation, private sector, capital market, modalities for privatisation, and privatisation safeguards.

Section Five deals with privatisation implementation. It includes the administrative structure of privatisation, appropriate modalities for privatisation, privatisation alternatives, and privatisation practice. The freeing of government and administrative machinery of certain responsibilities and obligations (government-centred justification); the various opportunities which reform initiatives can open up for organisations in the private sector (business-centred justification); the potential benefit of the reforms to both individual and community (public-centred justification); the benefit to the managers and staff of reforms such as privatisation (employee-centred justification) are also analysed in this section.

Section Six encompasses evaluation of privatisation. In this section privatisation results and problems are analysed. Privatisation results include performance improvement, financial gains, reduction in the administrative burden of the government, and economic and efficiency gains. Privatisation problems include structural problems and subsidiary problems. Managerial problems and legal obstacles are examined as examples of structural problems. Social and economic problems which privatisation may create are examined as subsidiary problems. The section also includes an evaluation of the safety clauses concerned with workers, consumers, social equity and the public interest.

Section Seven examines applying effective reform alternatives other than privatisation. In this section alternatives such as administrative and managerial reform initiatives are examined. The rationale for administrative and managerial reform, the administrative process and the system of accountability in these countries are also analysed.

Chapter Five presents the overall findings and conclusions of the study. It summarises the results of the study, draws conclusions and makes recommendations, where appropriate.

CHAPTER 2

PUBLIC ENTERPRISE REFORM: THEORIES AND PRINCIPLES

Privatisation in a broad sense involves not only divestiture and sale of government assets, but a gradual reduction in the interventionist role played by the public sector. An important feature of privatisation is the diversity of rationale for its implementation in various countries. Pressures for privatisation come from different sectors in different countries. These pressures may be external and/or ideological, such as prescriptions concerning adjustment policy from the IMF; or internal, such as low economic growth or inefficiencies in industry; or even the rise of new pressure groups within a country. In each of these circumstances the forms of privatisation and the instruments employed differ greatly.

In many developing countries, privatisation comprises a significant part of the new adjustment program prescribed by the World Bank. Pressures from the World Bank, the IMF and other creditors have forced governments to look for short-term answers such as quick divestiture. On the other hand, internal pressures arising from fiscal deficits and balance of payments (BOP) deficits have driven them to search for ways that will ensure a more long-term adjustment (Gouri et al., 1991:5). Therefore, a close look is needed at economic and social development priorities, and at readjustments in the basic relationship between the state and the market.

Privatisation has been considered as a response to both state failure in economic activities as well as market failures (Gouri et al., 1991:9). As a result, privatisation is no longer confined to the narrow area of the sale of PEs. It includes any reduction of state activity, and provides an alternative to the separation of the state and the market-place.

Policies for the reduction of state activity can range from complete ownership transfer, to joint ventures with public and private sector involvement, or providing greater autonomy to the existing PEs. Emphasis has shifted to finding ways of incorporating efficiency, as defined in the context of each country. Policy-makers are seeking to adjust this policy to other conflicting objectives such as ensuring distributional equity. Therefore, the range of possibilities, situations and alternatives in respect to privatisation is large.

1 Socio-Political and Economic Environment

In order to have a realistic understanding of the implementation of reform in PEs and privatisation, the particular political and economic system must be kept in perspective. The rationale is that the potential capacity of a society in terms of its ability to attain a given set of objectives deserves additional consideration. Le Grand (1990:557) maintains that constraints on physical resources may affect a society's ability to achieve its objectives. Other decisive factors include the nature of a society's economic system - whether it is predominantly capitalist, collectivist, mixed, or whatever - and the psychological characteristics of its citizens - whether they are individualistic or cooperative, materialistic and so on. For example, the policies to achieve economic growth in a competitive market economy full of individualistic materialists would be different from those encountered in a cooperative economy managed by and for strict humanitarians.

Critics have pointed out that reforms such as structural adjustment and privatisation are purely economics focused and often disregard social aspects (Piam, 1994:197). Since there are practical and important differences in the structure and organisation of national economies, it would be unwise to assume that the intellectual construct appropriate for an understanding of the United Kingdom situation, for example, is equally appropriate for the development of privatisation policy elsewhere (Wiseman, 1991:258). This suggests that developing countries which see privatisation as a stimulus to economic growth may subsequently find that the means to deal with the practical difficulties - laws and requisite institutions - for the necessary transfers of resources do not exist (Wiseman, 1991:259).

Privatisation programs usually follow two general aims: improvement of performance of the PEs and/or restructuring of market mechanisms to reduce the role of government in the economy. Privatisation may also be required to enhance "people's capitalism" with advantages for consumers as well as tax relief. For example, one aim of privatisation in the United Kingdom was to reduce the level of taxes, while in Iran this has not been an objective of privatisation.

Therefore, each developing country should follow a privatisation strategy that is designed to meet its own objectives and based on the characteristics of social-political and economic environment. These characteristics are different to those of the developed countries. In some developed countries such as Japan, for example, there are more than twenty complete industrial chains. The point is that governments in Japan applied interventionist policies when they were completing their industry chains and their economic success was due, it has been argued, to the policy of intervention in those periods (Shams, 1993:2). The Japanese government's role in the period of modernisation was based on long-term vision and quick responses to immediate conditions (Stretton and Orchard, 1994:116).

Economic policies in developing countries may produce adverse results if liberalisation through reduction of the role of governments is based on outside models. Careful attention is needed, therefore, to maintain the degree of stability of the social-political and economic environments of these countries.

Economic growth in itself is no guarantee of improved standards of living in a developing country. The United Nations Development Plan (UNDP) has shown categorically that an improvement in economic indicators does not automatically transfer to the population. On the contrary, in developing countries in the 1980s, GDP growth and improved macro-economic balances were frequently accompanied by a serious deterioration in the social condition of the majority of the population (Kliksberg, 1994:186). Unfair distribution of income, deficiencies in the role of the state and lack of coordination between economic and social policies have attributed to the social failures in societies.

Within the context of political economy, some important factors that influence PEs and their reform include the following:

(i) the ideology and culture of the country as to the role of government and the individual;

(ii) the political environment within which these enterprises operate;

(iii) the historical processes of industrialisation;

(iv) the expectations and political influence of different stakeholders, workers, controllers, consumers, and the orientation of managers (Habir, 1991:66-70).

Developing countries differ from one another in significant ways - in material endowment, in socio-cultural and economic conditions as well as in other respects. Even in the same country, the PE sector can differ in its composition, while facing certain common problems. Some major variables that cause differences within the public enterprise sector include:

(i the structure of the markets in which PEs operate;

(ii) the degree of professionalism of the managers;

(iii) the interplay between the PEs;

(iv) their controllers in the government; and

(v) their size and their strategic importance to the country (Wiseman, 1991:259).

Technology, law, culture, politics, and the international economy have great influence on the performance of PEs at the micro and macro level. Changes in these areas, the most important being political, are reflected in the PEs' structure, behaviour, development and performance. The response of PEs to the continuous interactions of these influences, must be taken into consideration.

All of this means that a blueprint approach in dealing with PEs is not suitable. To study PEs for the purposes of reform, a study of the socio-political and economic environment which have had an influence on the creation of the PEs, and their continued influence on their performance also needs to be taken into consideration. To convey a better idea of the factors influencing their operation the following section examines the role and structure of PEs.

2 The Role and Structure of Public Enterprises

PEs are included in the broader area of the public sector and four classes of functions may be targeted. These functions are as providers, producers, facilitators, welfare and regulators of society (Thynne, 1989:7-8; Gouri et al., 1991:35).[1]

Based on this classification, it could be argued that Australia, for example, has shifted from a facilitator to a welfare state, while Korea has shifted from a regulator to a facilitator state and Malaysia has moved towards the role of facilitator taking a big jump from the producer state.

Public provision of goods and services includes "public goods" - those consumed by the whole community - such as defence, law and order, environmental matters, and most roads, streets, etc. Public provision may also extend to services such as health, education and public utilities such as water and electricity, which are also capable of market provision.

The second function relates to the production of goods and services for sale or as a basis for another business transaction. This kind of involvement is

[1]– Rumpf (1994:84) refers to Lowi (1972, 298-310) and three types or arenas of *distributive, regulatory* and *re-distributive* policy of governments which are differentiated in terms of the coercion they involved, and the fourth arena of *constituent* policy which is relatively uncoercive and suggested by Woodside (1986:778).

normally found in the financial, industrial, and trade areas, and is used as the means of generating capital for investment in the development of a country.

The involvement as a facilitator includes functions such as providing subsidies, grants, loans, tax concessions and other incentives for special groups. A regulatory involvement is described as the permitting or the imposition of a variety of limits on the provision, production or consumption of goods and services by private sector organisations, individuals, groups and other community organisations. For example, regulatory involvement includes licensing, registration, certification mechanisms, price and profit controls, and establishing standards, all of which require some form of monitoring and execution.

The role of the state in developing countries is a combination of a regulator in a free enterprise system, as the provider of public and merit goods, and the state's role in a system of government ownership of the means of production of goods and services.

2.1 The Role of Public Enterprises
(Rationale for their Establishment)

The state plays a central role in the politics and economics of development in Third World countries as well as developed ones (Toh, 1991:11). The economic role of the state ranges from minimal to major in different countries. The United States of America, for example, has a relatively small public sector and limited union membership and power (Toh, 1991:15; Stretton, 1994:70). The role of the state is seen in the implementation of anti-trust laws. The state has also pursued the role of protecting the interests of local industries unable to compete with foreign industries, through the imposition of both tariff and non-tariff barriers. In Britain, this role of the state is performed by the Monopolies and Mergers Commissions and one of their duties is investigating unfair trading practices of large firms (Toh, 1991:13).

A common reason may exist for government intervention in the establishment of PEs in developing and developed countries. For example in Japan, as a developed country, market failure or a lack of trust in the market is a reason for government intervention. According to Okimoto (1990:12) in the view of Japanese officials, the "pure" market is flawed by several shortcomings:

> ...imperfect information, narrow, short-term pursuit of instrumental gain; primacy of individual company interests over collective interests; "free ride" approach to public good; opportunistic behaviour; scant spirit of co-operation; structural change and social dislocations; potential subordination to foreign commercial interests; and inattention to national goals.

In developing societies, the state usually acts as an agent of development and may have to intervene to accomplish it. It is recognised that the market mechanism cannot be relied on to create the required increase in growth rates to meet rising development expectations. Thus, the state often steps in directly to mobilise and allocate resources for production, especially in industries where both entry cost and risks are high, and there may be significant external benefits (Toh, 1991:15).

Every developing country, irrespective of ideology, has found it necessary to establish PEs in order to meet the requirements of its development program. Many developing nations believe that rapid economic growth, to implement social and economic policies, can be achieved with public enterprise devices (Hope, 1982:72). In other words, governments have had to energise the engines of growth in the economy and had to provide the devices for achieving their political, economic, social and historical purposes (Hill et al., 1989:3).

Many factors have been cited for the creation of PEs in developing countries, and they need to be analysed (Gouri et al., 1991:12; Fischer, 1988:47; Mohammad Khan and Quamrul Alam, 1986:115; Shirley and Nellis, 1991:1; Prager, 1992; Hughes, 1992:4; World Bank, 1992:3; Sikorski, 1993:26 and De Walle, 1989:602f.). These factors are: social and equity factors; economic factors; developmental and national factors; and managerial and political factors. Table 2.1 shows the role of the PEs and the rationale for their establishment.

2.1.1 Social Factors

Significant social benefits are expected to be derived from the creation of PEs in developing countries. Often, public ownership is argued to be essential to the attainment of a number of social policy aims (Hemming and Mansoor, 1988:3). Furthermore, the social goals of public ownership take on particular significance in developing countries, where unemployment and inequality are more readily associated with political instability (Hemming and Mansoor, 1988:4).

Social and equity objectives of PEs (non-commercial) include the promotion of regional development, job creation, and income redistribution. They also include pricing goods and services below market prices (even below costs), locating plants in uneconomic areas, or keeping uneconomic facilities open (Shirley and Nellis, 1991:17; Adam et al., 1992:24). In these circumstances, PEs become key instruments for the allocation of benefits to favoured groups.

Table 2.1: The Role of PEs and Factors for their Establishment.

No.	Social and Equity Factors
1	to fulfil equity, ethnic or other social concerns;
2	to stimulate indigenous private sector;
3	to get multilateral and bilateral aid;
4	to empower economically weak segments of the population;
5	to develop backward or depressed areas;
6	to distribute income and wealth in a just manner;
7	to respond to the pressure from socialist ideology;
8	to balance or replace a weak or ideologically unacceptable private sector; and
9	to balance social and commercial costs and benefits

No.	Economic Factors
1	to follow social democratic movements and Keynesian economic ideas;
2	to exploit profit from scarce resources such as oil and coal;
3	to preserve declining industries;
4	to cross-subsidise downstream industries;
5	to boost exports, decrease imports, and improve the balance of payments;
6	to promote investment and saving;
7	to create sufficient capital markets;
8	to earn income from revenue-earning enterprises;
9	to rectify trade dependency;
10	to gain access to commercial credits;
11	to fill entrepreneurial gaps; and
12	to rectify market failure.

No.	Development and National Factors
1	to allocate scarce resources for development purposes;
2	to exert control over major natural monopolies and natural resources;
3	to prioritise development of utilities, infrastructure, and promotional agencies;
4	to transfer technology to strategic firms in mining, telecommunication, transport, and heavy industry;
5	to foster high risk and high technology industries; and
6	to promote national security and national prestige.

No.	Managerial and Political Factors
1	to facilitate centralised long-term economic planning;
2	to achieve economic sovereignty;
3	to control corrupt units;
4	to transfer assets to an identified elite class of people;
5	to apply colonial experience;
6	to create ownership where right to property is non-existent;
7	to create responsibility and accountability to clients;
8	to promote political and ideological principles such as redistribution of wealth; and
9	to control strategic industries.

Source: Adapted from Gouri et al., 1991:12; Fischer,1988:47; Mohammad Khan and Quamrul Alam, 1985:115; Shirley and Nellis, 1991:1; Prager,1992; Hughes, 1992:4; World Bank, 1992:3; Sikorski, 1993:26 and De Walle, 1989:602-3.

The role of PEs, keeping social and equity factors in perspective, was significant in the economy of Malaysia. Economic policies were devised which took into account specific interests of indigenous Malays (Bumiputra) and increased state involvement in economic policy-making after the implementation of the new economic policy (NEP) in 1971 (Gouri et al., 1991:15).

2.1.2 Economic Factors

During the past century, PEs have developed along with the expansion of the state. The rationale and objectives for greater government involvement in the economy were: macro-economic stabilisation and realisation of a certain level of economic growth; achievement of "fair and just" distribution of income and wealth among the socio-economic groups of society; and acquisition, allocation, and efficient use of scarce resources (Ng and Wagner, 1991:3).

In the developed industrial capitalist economies of Europe and North America, the growth of the public sector has been largely associated with the welfare state, especially under the influence of social democratic movements and Keynesian economic ideas. However, in the Third World, the public sector was developed under populist national movements (e.g. Sukarno's Indonesia, and Nasser's Egypt) as well as by statist capitalist governments, using state intervention and planning to achieve rapid economic growth in favour of the ruling interests (e.g. Suharto's Indonesia, Marcos' Philippines, Malaysia under the NEP, South Korea, and Kenya) (Jomo, 1989d:124). In these countries, PEs have invested in the areas of core sectors; natural monopolies; utilities; public goods;

merit goods or essential services; infrastructure; mining; non-core sector with economies of scale; equity; and revenue generation (Gouri et al., 1991:16).

The economic reasons for the establishment of PEs are pertinent to the major structural changes which are required in developing countries. These changes need large and long-term investments. Therefore, very few private investors are able to respond adequately. This has led to the establishment of PEs in basic and heavy industries and for the manufacture of complex and intermediate goods whose resource requirements are very large and profitability is low, at least in the short run.

Market Failure

The inability of markets to achieve distributional objectives is a source of market failure in the standard sense (Hemming and Mansoor, 1988:3). Market failure may occur in a number of circumstances where favourable outcomes can not be guaranteed.

The relevant types of market failure fall into three categories: situations in which competitive order does not exist; situations in which it exists but competition is not achieved; and circumstances in which competition is achieved but not efficiency (Bishop and Kay, 1990:246). In each case, government intervention to regulate the effects of market failure is appropriate.

The first area is natural monopolies where this is the most efficient means of production. They have been common in public utilities which involve distribution networks such as gas, electricity, water, railways and some telecommunication networks. Provision by a single supplier (PE) has been viewed as the most efficient means in these sectors to avoid wasteful duplication.

Therefore, competition in these activities would appear to conflict directly with the achievement of an efficient provision of output.

Besides, some of these industries display the characteristics of a "contestable" monopoly, of replacing an inefficient natural monopoly with a more efficient one, particularly where technological development has taken place. In some utility industries technological change enables the entry of new network providers who have lower costs and who are able to supply a superior service (Littlechild, 1992:39).

However, an important reason for the emergence of the PE sector in developing nations has been the inadequacy of the private sector in initiating economic and developmental activities. Private enterprises in these countries have often been inadequate because they have not taken any initiative in the area of industrialisation. This has led governments to direct and to play an active part in achieving economic development goals. Even in an industrialised and developed country, such as Japan, there is a belief that "certain outcomes cannot be achieved by relying solely on the invisible hand of Adam Smith's market" (Okimoto, 1990:9). Therefore the Japanese government has adopted its own set of industrial policies for economic growth.

The second area of market failure occurs where a potentially efficient competitive market is under utilised and an optimum level of efficiency is not achieved. An example is where vertical integration between generation and distribution in electricity supply allows a company to use its monopoly power to undermine competition (Bishop and Kay, 1990: 247).

The third area of market failure is where a competitive market exists, but it is not the most efficient solution. Two principal issues to be considered here are externalities or social aspects of markets and equal bargaining power of parties to market transactions. Externalities arise where the production or consumption of a commodity has effects which extend beyond those which are directly concerned with production or consumption. Thus, for example, it is often argued that the provision of utility services in rural areas provides benefits which are greater than the amount which the purchasers of these services are willing to pay. Buyers and sellers of commodity or services must have all information available to them to look after their interests, and avoid any disadvantage due to lack of information.

As a result, regulatory intervention would appear to offer a way of overcoming this particular form of market failure (Bishop and Kay, 1990:248; Hemming and Mansoor, 1988). This regulatory intervention can be exercised through regulatory controls, legal restraints, taxes, transfers, and subsidies (Cook and Kirkpatrick, 1988:6f.).

Market Failure and Public Interest

The public interest includes provisions for many individual interests in the society. These provisions encompass: safety measures for the protection of the general public; protection of consumers against unreasonable charges; safeguards for those who subscribe capital; a requirement that all potential customers within reach of the relevant facilities be served; and prescription of service quality standards (Wettenhall, 1988:45).

Public utilities which require regulation in the public interest, are the basic or infrastructure industries such as power, light, water supply, transport, and communication, on which all other industries and services depend for their existence. They are fundamental to the economy, but often monopolistic because of the high capital cost of technology.

However, PEs are established to pursue and protect the public interest. The argument is that the marketplace has neither the willingness nor the capacity to do anything other than be self-interested, profit maximising and possibly anti-consumer. The market provides for private enterprise freedom to service profitable areas and to put aside the others. Profitability is the dominant concept, and the group of public interest questions involving issues such as public accountability, equity and consistency in service development, as Wettenhall (1988:47) believes, *"comes in a very poor second"*. In this view, the public interest is not represented by the self-interest of private enterprises who want to *"capitalise profits and socialise losses"*.

The point about PEs is that the more efficient and profit-making they become, the more they attract the "privateers". Selling productive PEs can sometimes amount to the *"squandering of public assets"* (Wettenhall, 1988:48).

Nevertheless, the matter of public interest can not be dismissed easily. According to Wettenhall (1988:47), some interests are more enduring than others and they stand in need of identification and protection. Governments still have the power, through regulatory mechanism, to do those things that are necessary for the public interest.

2.1.3. Political Factors

The role of PEs in the economy of a country depends basically on the economic and political system. In countries with inequitable distribution of income, wealth and opportunity, the state may seek an expanded role of direct participation through PEs. This is especially so when the economically undeveloped group is an indigenous community which provides state elites with their electoral support.[2] In these circumstances, governments will pursue policies that will help them to retain or enlarge their political base while weakening their political opponents.

The original motives for the creation of PEs are considered to have explanatory value, and the United Kingdom is a classic case (Sikorski, 1993:25-6). A major political focus initially was the redistribution of wealth. This objective was achieved by nationalising industries to promote the general economic welfare of the poor.

Another reason for the establishment of PEs can be constitutional obligations. The legislature and constitutional law give governments the power or obligation to undertake the responsibility of managing a range of economic activities. For example, in Iran Article 44 of the Constitution prescribes that strategic economic activities are under the control and ownership of the government.[3] Similar requirements exist in the constitutions of other developing countries such as Indonesia (see Mardjana, 1992:189).

The extent of success of some PEs in achieving their stated objectives has, however, resulted in positive or negative responses to these normative rates. The

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[2]- For example, see social-political factors in Chapter Three, Malaysia.

[3]- This is explained in Chapter Four, Section One.

world-wide debate about privatisation and the impact of the IMF's structural adjustment policies have combined in different ways to encourage some governments to initiate privatisation and the restructuring of their PEs (Gouri et al., 1991:19). In addition, the failure of some of these enterprises and consequent fiscal crises has strengthened these pressures and encouraged many governments to wind up some PEs or to divest them to the private sector.

2.2 Analysis of Reform of Public Enterprises

One reason for the initiation of reform of PEs is the shortcomings of some of them. The argument is that PEs seldom are permitted to take advantage of a competitive, profit-maximising market environment: they are constrained by non-commercial objectives; they operate in non-competitive markets; their management is more bureaucratic than entrepreneurial, impeded by government intervention in details of management, lacking incentives to improve performance, and without accountability for results (Shirley and Nellis, 1991:6; Cook and Kirkpatrick, 1988:19).

However, the performance of PEs varies widely among countries, depending on control measures, orientation and attitudes. In countries where they are managed on a commercial basis, their performance has often been commendable, while in countries where PEs are run with inadequate attention to profitability, cost control or efficiency, they are frequently faced with deficits, overstaffing, and dependence on domestic or foreign credit (Ng and Wagner, 1989; Toh, 1992:44).

The difficulties of PE analysis often stem from an ideological tendency to prefer private to public enterprise. This ideological tendency supports the view that the centuries old experiment of free enterprise should not be undermined by any justification of creeping socialism. According to Sikorski (1993:18), such criticisms are often made in certain contexts, especially when the rationale derived from Western culture dominates other judgments.

Public enterprises are perceived widely in the context of monopoly or at least oligopoly and operating in non-competitive environments. The assumption also extends to government bureaucracies, openly subsidised, established for political or social service, etc. However, the aim here is looking for truths which are relevant to PEs that are created for open competition and national profit (Sikorski, 1993:24). These are PEs which have been established for national interest rather than for government interest (except as a shareholder) or political benefit.

Part of the explanation for cost inefficiency of PEs involves the problem of multiple enterprise goals arising from management's profit goals and national policy goals. The objectives of PEs may be formed by a complex arrangement of pressures including government agencies involved in controlling the enterprises; other interest groups such as political parties, consumers, regional or ethnic groups and managers and workforce within the enterprise.

The special managerial problems of accountability in PEs are derived from the fact that their objectives are a blend of public and private sector objectives.

They are government owned and responsible to both their own management and boards of directors, and to a minister while usually not funded by government (Hughes, 1992:8). While PEs are subject to varying degrees of political influence, they are often required to meet objectives that are in the public interest as opposed to maximising profit.

In summary, PEs are devices of the public sector, fulfilling a role as provider, producer, facilitator, or regulator. PEs have been created for the fulfilment of social, economic, political and managerial objectives. Trends towards reform of PEs stem from regulatory or government failure. The principal - agent argument points to the possibility that private property rights and the profit incentive of private ownership will make their enterprises profitable and efficient except when owners are not managers. Furthermore, the fact that the role of control is more significant than ownership in enhancing performance of enterprises undermines the theory of government failure. Finally, PEs were created for special objectives, which need to be taken into consideration while reforming PEs.

3 Reform Motives

The motivation for privatisation and the pressure to re-define the boundaries of state activity usually involves a mixture of factors. These factors can be classified into two areas: internal and external. Internal factors comprise financial, economic, managerial and political factors. External factors encompass international financial institutions, international investors, and the ideological move to the right. The next section examines the motives for reform and the interactions between internal and external factors.

3.1 Internal Factors

3.1.1 Financial Pressures

Financial aspects are usually related to two indicators, namely the fiscal deficit, and the balance of payments deficit. Both industrial and developing countries with heavy debt burdens may consider privatisation as a quick fix to reduce public debt by disposing of enterprises (Jones, 1991:40). Three considerations are involved in financial issues for PEs: general shortage of funds experienced by the exchequer; shortage of funds faced by PEs; and surplus generation by PEs for investment. The argument is that only the first consideration, reduction in government expenditure, requires divestiture of PEs (Gouri et al., 1991:23). Otherwise, pressure to change the role of the state may not extend to the sale of PEs.

The fiscal objective is in terms of maximising returns to government and ensuring minimisation of losses even if this implies capitalisation of the future flow of income (Reddy, 1991:224). PE deficits are financed either by borrowing from domestic and international financial markets or by central government transfers. When PEs borrow from the central bank there is an immediate impact on domestic credit and money supply. Where transfers from government are used, the overall public sector deficit is increased. Foreign borrowing also raises the debt ratio. Some developing countries relieve the burden on the state budget, by allowing PEs to raise funds for investment and working capital directly from the domestic commercial bank sector on preferential terms (Cook and Kirkpatrick, 1988:14-15).

However, a solution may lie in the restructuring of PEs rather than in selling them. Furthermore, if the basic problem originates from anywhere else, a financial solution may only be temporary (Gouri et al., 1991:23).

Sales of Assets for Reducing Debt

Many sales programs are focused on the sales of assets to reduce foreign or domestic debts. However, while sales may have short-term revenue effects, long-term net fiscal benefits are hardly assured. For example, if the sale price of a profitable firm plus the present value of future tax revenues is less than the present value of the net future income stream under state ownership, this worsens the government's financial position (Shirley and Nellis, 1991:58). This means, therefore, that the following equation needs to be established to produce a positive financial position after the sale of assets:

Sales price of assets + Present value of future tax revenue > or = Net future income under state ownership

Privatisation of unprofitable PEs eliminates the fiscal drain on the government, but it can also leave the economy worse off if extensive concessions are granted to the buyer. Alternatively, as Jones (1991:40) asserts, if the sale of PE assets can be made attractive to small investors, this will broaden share ownership and may promote the development of domestic capital markets (as in the United Kingdom).

Pitfalls Associated with Asset Sales

Raising of revenues from the sale of assets to finance debts has a potential problem of how to utilise the proceeds. Therefore, prior to the sale of public assets, the following problems must be understood:

Firstly, the impact of asset sales on the overall deficit may be insignificant as these changes do not take into account the effects of such sales on the net worth of government (Mansoor, 1988:180). Therefore, changes in overall deficits do not accurately reflect changes in the fiscal situation. Proceeds from privatisation are usually insignificant in relieving the overall deficit, thus they are used to pay the outstanding debts of PEs, or to provide support for the privatisation program itself.[4]

Secondly, asset sales provide a one-off reduction of the overall deficit, particularly if the market price is not less than the income that would have been collected by the government. The counterpart to this initial reduction of the deficit is larger deficits in future years, reflecting the loss of revenue in the form of decreased profits of profitable enterprises. This is while the entire proceeds from the sale are used to finance a temporary increase in current expenditure or a temporary reduction in taxation (or both). These large future deficits would be

[4]– An example of this has been privatisation in Iran. See Chapter Four, Section 5.

exactly offset only if the government applies the proceeds from sale either to purchasing other financial assets or to retiring an equivalent amount of outstanding debt (Mansoor, 1988:180-2; Cook and Kirkpatrick, 1988:21).

Thirdly, the notion is misleading that privatisation without changes in performance offers permanent financial dividends to the budget where enterprises are heavily subsidised. Such dividends will only emerge if the enterprise can be run more efficiently in the private sector (Mansoor, 1988:184). The point is that mostly successful PEs are sold, leaving the government with unprofitable PEs. In the long-term these sales can hardly be considered beneficial (Gouri et al., 1991:56). Financial gains can also arise from reduction in budgetary support to PEs.

Fourthly, the financial effects of assets sales are more obvious than the fiscal impact. To the extent that sale revenues go beyond the sacrificed income in the year of sale, the initial impact is beneficial if the sale revenues are not spent. However, gross future financing needs, excluding the interest income resulting from the return on sale revenues invested in suitable financial assets, would be greater (Mansoor, 1988:185).

Fifthly, the tax flow to the government will be unaffected if the performance is unchanged by the change in ownership. It is expected that the tax receipts would be increased after privatisation but at the cost of a lower market price. A transfer of ownership that leaves income streams unaffected cannot generate greater income. However, the distribution of that income between taxes, dividends and other transfers may change following the transfer in ownership (Mansoor, 1988:186).

Sixthly, uncertainty and imperfect capital markets will affect asset prices. Expected income and attitudes to risk of various agents need to be considered for asset prices and governments may have to sell assets at a discount. Other uncertainties such as future changes in the regulation of prices, markets (including labour) and profits will produce a greater discount (Mansoor, 1988:186). Therefore, the expected future income stream would be lower than the situation before the sale of assets.

Finally, when governments offer assets for sale, they do not know the confidence price of the private sector. Thus, some assets may be overpriced while others are underpriced.[5] Large financial losses occur with underpriced sales (Mansoor, 1988:167).

In many developing countries financial deficits will contribute to inflation and balance of payments difficulties. The financial benefit of divestiture to the private sector may do little to improve the economic performance of the enterprise if it simply transfers the ownership to the private sector. Also if market protection is offered as an incentive, the potential economic gains from increased competition are sacrificed for budgetary gains (Cook and Kirkpatrick, 1988:30).

Sale of Assets and the Balance of Payments

The argument that privatisation will reduce budget deficits by generating receipts and relieving the government of having to invest in PEs, would also reduce foreign debt is flawed and not based on economic realities (see for example, Hughes and Emy, 1992; Riston, 1991:20f.). The total level of expenditure within

[5]– For example, see the case of privatisation in Iran.

a country is conducted either by consumers, investors, the government or by foreigners. This expenditure is made in exchange for goods and services that have been manufactured locally or abroad.

Therefore: $$P+M= C+I+X+G \qquad (1)$$

where: P = domestic production; M = imports; C = consumption; I = investment; X = exports; and G = government spending.

On the other hand, all the national income is either consumed, saved or taxed.

Hence, $$Y= C+S+T \qquad (2)$$

where: Y = income; C = consumption; S = saving; and T = tax.

In economics, domestic production equals domestic (national) income. Hence, equation (1) can be re-written as:

$$P= C+I+G+ (X-M)$$

Since Y= P, Then, $$C+S+T= C+I+G+ (X-M) \quad (3)$$

and $$(T-G)+ (S-I)= (X-M) \quad (4)$$

The fourth equation demonstrates the source of the two deficits view of the balance of trade. A trade deficit will equal the sum of an imbalance in tax and government spending and of private savings and investment. If government spends money on public enterprise, then G increases. Privatisation as a solution means the private sector will spend the money instead, increasing I (to the same extent as the avoided increase in G) and therefore increasing the trade deficit. It is the act of spending which adversely affects the trade balance. It makes no difference who does that spending.

This illustration is also true in the case of borrowing, whether conducted domestically or overseas. Both will increase the level of foreign debt. The reason is the limitation of the pool of domestic savings. Again, it is the act of spending, not who does that spending, that impacts on foreign debt.[6]

The sale of a public sector asset to the private sector cannot, of itself, affect the current account or the balance of payments. Private and public sectors have simply exchanged assets, and this alone cannot influence economic activity. But if privatisation raises the overall productivity of the economy, net exports should increase. Furthermore, the real economy would be further affected if savings and investment are adjusted in response to privatisation (crowding out). Unless privatisation programs are large, the impact of asset sales on the current account is likely to be only marginal (Hemming and Mansoor, 1988:18). To emphasise the point, consider the case where the private sector sells bonds to purchase privatisation equity, whilst the government uses the sales proceeds to retire outstanding bond liabilities. The transaction involves a change only in the composition of the sectors' net wealth and the fiscal impact is neutral (Adam et al. 1992:9).

The Role of Government Intervention in Financial Markets

Financial markets are vital to a country's economic activities. Kane (1993:173) refers to Stiglitz's study concerning the important role of government in the

[6]– However, in developing countries domestic borrowing affects only an increase in prices and inflation, but may not have very much impact on increase in foreign debts. An example of this situation is Iran, during 1981-89, which had domestic borrowing without affecting foreign debts. That argument can be true only if the government liberalises the exchange rate and devaluates the domestic currency through financial liberalisation.

economic life of a country and specifically on financial markets during liberalisation. In this period, the state does have a key role to play and various forms of government intervention can be beneficial and even welfare enhancing. According to Stiglitz (Kane, 1993:173), for financial markets:

> ...the impetus for liberalisation is not based on a sound economic understanding either of how financial markets work or of the potential scope for government intervention, but on an ideological commitment to markets grounded in neither economic theory nor fact.

The reason is that this commitment is not appropriate to financial markets, not only because financial markets are more often confronted with failure than other markets, but also because government regulation can make them function better and also improve the overall performance of the economy. Stiglitz adds that capital markets serve as the "brain of the entire economic system" (ibid., p.173). If they do not perform this function well, the performance of the entire economic system can be affected.

In economic theory, competitive markets are efficient because information is perfect, i.e. information cannot be changed by individual actions taken by participants in the market. In reality, however, information is not perfect, and definitely not in markets where risk is an inherent element, as in financial markets.[7] This fact provides a rationale for government intervention.

According to Stiglitz (Kane, 1993:173), government intervention in financial markets can take several forms. For developing countries, the most important action has been the creation of financial institutions that can provide funds for long-term investment. Government intervention can also be seen as

[7]– For example, see the case of Iran, Chapter Four, Section 6.

pursuing "social" objectives, such as ensuring competition, directing resource allocation, and encouraging growth. Caution is needed to deal with these PEs at the time of privatisation and liberalisation of the economy.

3.1.2 Economic Factors

There are also economic pressures behind changes to the role of the state. According to Reddy (1991:224), the origins of the pressures are twofold: the efficiency dimension and the economic growth rate, that is mainly projected in the industrial growth rate.

It is argued that competition creates efficiency and that state controls, by preventing competition, promote inefficiency. Theoretically, the strength of markets has always been based on competition and efficiency, but it has two weaknesses. First, markets in developing countries may not be always favourable to introducing competitive conditions because of either (i) small domestic markets, (ii) predominance of international cartels, or (iii) influence of the local business community on the government. Secondly, competition in the marketplace does not necessarily suggest only private sector ownership, as no amount of ownership changes would improve the initial situation. Instead, the linkage is "between competition and efficiency" (Gouri et al, 1991:23).

Reddy (1991:224), therefore, asserts that commercial objectives suggest generating profits and obtaining surpluses from commercial operations, which may or may not require the transfer of ownership.

3.1.3 Managerial Factors

Managerial factors are those related to the establishment of an appropriate environment of contentment for managers, workforce, and consumers. The problem is that some high-level PE managers can misuse their positions to patronise key appointments and to benefit from corruption (Toh, 1992:60).

Managerial weaknesses may become the origin of political problems as the government has the final obligation to respond to the community. In such cases, there is a need for structural reform of PE management to improve efficiency and to enhance accountability. An important aspect of this restructuring is the development of sound auditing and the monitoring of PEs. It is obvious that improvement in the internal management of the PE sector offers an important means of improving economic efficiency and performance. Public sector reform, rather than privatisation, is the major focus of public enterprise policy in many developing countries (Cook and Kirkpatrick, 1988:32f.).

Hemming and Mansoor (1988:6) argue that earlier efforts involving statutory and administrative measures were judged to be unsuccessful. On the other hand, Gouri et al. (1991:27) maintain that structural reforms seem to have positive effects. In South Korea, for example, structural reforms produced profits for the PEs. Commander and Killick (1988:106) assert that South Korea, and before it Japan, are examples of countries in which public enterprise played a key role in the earlier phase of industrialisation. Bhatt (1990:198) however, refers to the key element of developing an enterprise ideology that motivates the individual and groups within the enterprise. Commitment, a sense of belonging, and identification are easier to ensure through an enterprise ideology. Effectiveness, efficiency and profits are, then, by-products of the motivation provided by the enterprise ideology.

Governments have an option of choosing managerial reform initiatives in PEs to enhance the efficiency and quality of their services. For example, Australian governments have used private consultants, to establish greater political control over the management of PEs by direct involvement in the appointment of chairpersons and "Board of Directors" of PEs (Mascarenhas, 1993:322). Problems in managerial coordination can be addressed and there need be no detriment to the public interest when such managerial reforms are implemented.

3.1.4 Political Factors

Politicians' decisions as to economic policy to some extent reflect the existing balance of political forces. These decisions, however, have economic consequences that effect not only resource allocation and growth but also the balance of macro-economic policies (Krueger, 1993:138). Economic success promotes support for a government, while economic failure may erode and threaten the power of the government. With economic failure the change in political equilibrium can bring about an intensification of controls and intervention, with still more political consequences (Krueger, 1993:139). Privatisation, as an economic decision, is no exception.

There may be political benefit from economic reform and privatisation, in particular, in electoral advantage to a government by those voters who gain shares in the newly privatised companies (Connoly, 1992:379). The political pay-offs from privatisation, however, may be strategic as well as electoral. Privatisation may also be pursued for pragmatic, tactical or systematic purposes. A pragmatic approach is concerned only with the relative efficiency of the public or private sector to deliver the results. This is the usual traditional approach of economists and administrators. A tactical approach uses privatisation to pursue specific political or economic goals such as pleasing the party faithful or raising funds quickly to reduce a budget deficit. In the UK, for example, reducing trade union power, permanently overturning socialism in British public policy, and popular capitalism were political objectives that the Thatcher Government followed through privatisation (see Ernst, 1994:72; see also Malaysia, Chapter Three, Section 3). A systemic approach aims at making *a regime change* which will shift the whole system towards a market economy and away from reliance upon government (Self, 1993:60 quoting from Henig et al. 1988).

A change of ownership is assumed to lessen the scope for political intervention in the operation of PEs. As a result, the enterprise's objective is simplified, complex networks of malfunctional bureaucratic controls are reduced, and interference in operating decisions is lessened. It is noted, however, that application of these remedies is not conditional on privatisation in the form of selling public assets to the private sector. Internal reform of the PE may be an alternative option for realising the same gains. The key factor in determining the efficiency of an enterprise, is not whether it is publicly or privately owned, but how it is managed (Cook and Kirkpatrick, 1988:19).

On the other hand, a question arises about the relationship between economic policies and the type of government. Myrdal (1968) first raised this question in the context of the *soft* states and *hard* states. In his analysis, only hard states (e.g. South Korea and Taiwan, which were identified as dictatorial) could undertake the necessary economic policies to achieve very rapid economic growth. More recently, the question has arisen as to whether satisfactory policy reform can be undertaken in democratic societies (Krueger, 1993:139; see also Stretton and Orchard, 1994:69)..

From the point of view of public choice theorists, economic growth demands a hard state. For example, Olson's theory contends that Japan and Germany were able to achieve economic miracles, after World War II, due to having strong leaders to break the unions and other self-defences of labour and thus allow free market forces to work (Stretton and Orchard, 1994:68f.). However, some effective factors such as hard work, scientific and technical record, unusually intense motivation and substantial international aid which contributed to German and Japanese economic miracles are reasons which have not been considered in Olson's theory.

3.2 External Factors

3.2.1 Pressures from IMF and the World Bank

External pressure for privatisation has a significant role for many countries, especially developing economies. Three types of external pressures are identified: (i) IMF structural adjustment policies; (ii) pressure from foreign investors, such as distinguished institutions - World Bank, IMF, and the Asian Development Bank - and other development financing agencies; and (iii) export obligations. The influence of international financial institutions is evident in most developing economies. Many of these nations, encouraged by IMF and the World Bank, are actively involved in privatisation as a device to reform statutory and other PEs

(Bishop and Kay, 1990:241). Ramourti (1992:235) found that the privatiser countries had higher external debt than non-privatisers. Active privatiser countries were also more dependent on both IMF and the World Bank than non-privatisers.

Mascarenhas (1993:320) has stated that the trend toward globalisation of the economy is associated with the free flow of international capital. In keeping with this trend, a powerful role is played by international agencies such as the OECD, IMF, the World Bank and *a chain of think tanks* which have extended their influence across countries. They seek to apply concepts of property rights based on the principal-agent theory of the firm to the public sector.

The very fact that reforms are normatively sanctioned increases the likelihood of their adoption (DiMiggio and Powell, 1991:65). As a result, many countries have adopted economic liberalisation and deregulation of the economy; reorganised public services to make them efficient and more accountable; and adopted privatisation to bring about more market-oriented approaches such as user-pays, contracting out and selling assets.

Structural Adjustment

In those countries relying on IMF/ World Bank structural adjustment loans, the most common externally imposed requirement is that the public sector play a reduced role. However, they may sometimes support public enterprise reform (Prager, 1992:301). To finance new investments in PEs, an impressive change in performance is imperative. The World Bank is among the first lenders to assert a new policy concerning PE reform, specifically privatisation. Associated with this policy, the new focus is usually on broad macro-economic and sector-wide policies and a new form of lending called "adjustment lending" (Alexander, 1990:196).

The types of enterprise reforms supported under these programs fall into three general categories:

> ... change to the policy framework governing enterprise operations; change to the institutional framework; and change to the size and nature of government holdings in enterprises (Alexander, 1990:198).

On the other hand, structural adjustment loans frequently support privatisation by:

> ... helping to develop strategies, classify candidates for sale, establish time bound implementation plans, and develop an appropriate supervisory/ institutional framework. The Bank also supports financial and managerial restructuring of the enterprises before the sale (World Bank, 1992:13-14).

Privatisation has become an important part of the package of adjustment programs. Correcting exchange rates, low and negative interest rates, removing excessive protection, price controls, subsidies and other distortions all form part of an adjustment program (World Bank, 1991:25). Under these policies, loans, investments and aid are made conditional on the design and implementation of these structural adjustment programs. In such cases, governments pursue privatisation in order to have access to donor assistance, and to ensure that aid allocations are not threatened.

Structural adjustment programs are associated with the aid policies of the World Bank, IMF and the US Agency for International Development (USAID). Pressure is applied to developing countries by these international lender and donor organisations to pursue structural adjustment programs as a package of economic reforms (Ramourti, 1992:228). These programs include:

> Trade liberalisation (moving away from licenses and quantitative restrictions on imports, to reducing the scope and size of tariffs); getting domestic prices in line with world market prices, improving revenues by widening tax bases and reforming the administration of taxes; diminishing government deficit by lowering public expenditure, especially subsidies (Bienen and Waterbury, 1989:621).

Trade liberalisation has been supported by the World Bank as a central element of an adjustment program, and this has met substantial criticism on both economic and political economy grounds (Corbo and Fischer, 1991:11f.). However, free trade has been used as a rule of thumb, not a reliable rule. It causes increases in imports rather than increases in exports. Increasing exports is a time-consuming program which needs other provisions rather than the free trade prescription of the World Bank. Serven and Solimano (1991:11) refer to Rodnick's argument that a weak link exists between trade liberalisation and growth both at an analytical and empirical level.[8] The World Bank's support is also considered to prolong dependence on imports in borrower countries (Corbo and Fischer, 1991:20).

Based on this program, the World Bank pushes governments to prioritise expenditures and to devise more effective mechanisms for channelling domestic supplementary resources to aid-financed projects (World Bank, 1991:8). This program is carried out as part of the strategy for reduction of government deficit and reduction of government intervention in the economy. The World Bank and IMF adjustment lending attempts to bind government policy actions (Adam et al., 1992:61).

Restructuring of PEs is also suggested through the provision of sector-specific aid by the World Bank. In some instances the World Bank's aid package comes tied to economic management. Nellis and Kikeri (1989:664-5) assert that a prime objective of the Bank's involvement is the promotion of economic efficiency. They explain that in the context of overall PE reform, the Bank views privatisation "not as an end in itself, but as one of many means to help

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[8]– The impacts of trade liberalisation are depicted in the case of Iran in Chapter Four, Section 6.

governments increase the efficiency of both government and business." They maintain that privatisation has been supported as a device for efficiency improvement.

Nonetheless, the Bank has taken on additional responsibilities to add to its earlier institutional development activities. Recently, the World Bank has shown concern about government issues and clarifying the institutions, including the rules and regulations that govern society. The challenge for the Bank and its borrowers is to utilise methods that are both technically sound and politically and bureaucratically feasible. The Bank has come to the conclusion that PE performance could be improved without changing ownership, by "commercialisation" of PEs (World Bank, 1991:23). At the same time they do not accept the PE sector as an efficient system capable of improving its own performance. They believe that the policies needed for this purpose are difficult to implement and hard to maintain (World Bank, 1991:22). Therefore, their principal message is that *"the state should manage less but manage better."* (World Bank, 1991:2)

Good performances, in the view of World Bank, are few in number despite the existence of some PEs which perform well in every developing country. Factors outside the managers' control are cited as reasons for weak performance of PEs. Some examples of these factors have been identified as "political interference in day-to-day management of the company, improper pricing, credit and labour policies, and the failure to impose hard budget constraint" (World Bank, 1991:22).

The reforms prescribed by the World Banks in the PE area are:

(i) rationalising the size of the public enterprise sector, by liquidating companies that are not viable and privatising those that are certainly better managed under private ownership;

(ii) improving the market environment in the framework of adjustment operations such as correcting an overvalued exchange rate, excessive low and negative interest rates, excessive protection, price controls and subsidies; and supporting price liberalisation and ending monopoly rights; and

(iii) rationalisation of the relations between government and PEs, by freedom of action where it is demanded and removing limits on managerial freedom of action where they are not justified (World Bank, 1991:24-26).

Prescriptions concerning civil service reform are also delivered by the World Bank to borrower countries. These prescriptions are based on the concept that in developing countries civil services are larger than the countries need. Therefore, a planned reduction in government staff is prescribed. This program includes:

(i) employment reform, by enforcement of a retirement age, regularising civil service employment, and recruitment freezes;

(ii) payment reform, through wage freezes, review and restructuring of government wage policies, expansion of the wage structure between the top and the bottom levels of civil services;

(iii) long-term reform in civil service management by establishing a linking system between personnel and financial management; competence testing; incentive schemes to attract skilled or retain professional civil servants; and

(iv) formulating and implementing personnel policies (World Bank, 1991:14-18).

The Impact of Structural Adjustment Reform

A study of the conditions attached to loans provides a useful check on the consistency between the ideas which the World Bank advocates and the policy reforms which are actually attempted in developing countries. Subsequent loans, often in the form of sectoral adjustment loans, focus more on structural adjustment measures. Among these measures are tax reforms; the restructuring of public expenditures; measures to increase the efficiency or to support the privatisation of PEs; trade reform; and financial market reforms, and other sectoral reforms (Corbo and Fischer, 1991:6; World Bank, 1991:25).

In a study of twenty one developing countries, Mosley (1988:129-34) reports that requests for deregulation, removal of price controls, reduction in subsidy or more general financial restructuring of PEs are common. Mosley, reports, however, that these proposals have often met with an implementation failure. This results from either the lack of administrative capacity within government to carry out the reforms, or lack of political willingness to confront those interests who will be opposed to it (Ibid., p.135). However, the lack of political willingness outweighs the other reasons. Mosley then proposes that any reduction in subsidy or increase in price of the output of PEs hurts all consumers of that output. Any increase in competition for, or privatisation in the form of selling assets of, PEs reduces the government's ability to use those enterprises as an instrument of motivation and employment creation.

Corbo and Fischer (1991:24) assert that some short-term social costs are inevitable when an economy has to adjust to adverse external shocks or the effects of previous mismanagement, and that adjustment lending was not associated with an increase in the overall misery of the poor who are at a low level of support. De Walle (1989:606) also argues that there are few reasons to believe that privatisation will necessarily create greater inequities or increases in poverty, but if it does the adverse consequences can be compensated for by other policy instruments. Here, an empirical question concerns whether policy-makers engaged in privatisation campaigns have used these instruments to compensate the poor when the need arises.

It seems IMF structural adjustment policies are biased against PEs in developing countries. Sri Lanka and Philippines are two examples of this position. Sri Lanka is an IMF test case which has moved from high state involvement to substantial market orientation. Gouri et al. (1991:31) maintain that in Sri Lanka, of the four pressures - financial, economic, managerial and external - the impact of the IMF structural adjustment policies has been the greatest. In response to the traditional structural adjustment program, the government has undertaken large scale privatisation of PEs.

Sri Lanka's gains are assessed in terms of relatively modest financial gains. Efficiency and economic growth have not responded to a shift from state activity to a market orientation. At the same time, trade dependence has increased considerably. Negative social effects have also emerged due to an emphasis on the alleviation of financial burden at the cost of equity. In other words, low positive gains are outweighed by high negative effects (Gouri et al., 1991:49f.).

The Philippines is another example of a country subjected to these pressures with similar disappointing outcomes. For example, pressures from IMF and foreign investors did not permit the Philippines government the option of using safety clauses, to protect workers and consumers from the negative effects of structural adjustment policies. The low positive gains in the two extreme cases of Sri Lanka and Philippines have been outweighed by the high negative effects. The same situation was reported with regard to Indonesia, which implemented pro-market policies including privatisation and deregulation under pressure from the World Bank and IMF. These steps were conditions for obtaining further financing from these international organisations (Mardjana, 1992: 199).

With respect to Bangladesh, the main effects of the policy taken by the regimes in the post-1975 period, as Quamrul Alam (1989:54, 67) stated, were to hand over industrial units, banks, insurance companies, etc. to the private sector and to help the Bengali rich to accumulate capital.

As a result, governments who did not want to be seen as giving way to outside pressure in their policy-making and fully commit themselves to what may appear to them as the new order imposed by the lending agencies (Cowan, 1990:20; Cook and Kirkpatrick, 1988:30).[9] In the case of Sierra Leone, for example, the government opposed turning to the World Bank for assistance in privatisation because it resented the conditionality accompanying the assistance and

[9]– For example, see the case of Iran.

because it questioned whether the Bank would be able to provide the kind of business advice that was needed (Cowan, 1990:21).

The conditions required by these agencies are problematic and often lack consideration of the socio-political and economic sensitivities of developing countries. The conditions offered are based on the assumption that the market is competitive and elimination of political intervention will create a competitive atmosphere for improving efficiency. Each developing country has to confront its specific circumstances and a blanket approach is unsuitable.

For example, a common prescription of the IMF is devaluation of the domestic currency in order to reduce imports and increase exports and consequently reduce trade deficits (World Bank, 1991:25). However, devaluation will result in increasing exports only if the elasticity of foreign demand for internal products is high enough.[10] This is rarely achievable for the products of developing countries because the prices of these commodities are mostly determined in world markets (Emad, 1993:29).

There has been cultural and political inconvenience for the borrower countries implementing the World Bank prescription. The result as the World Bank (1991:31) acknowledges is that:

> ... neither the recipients nor the providers of technical assistance, a principal instrument of public sector management reform, have been satisfied with its result.

[10]– The impact of devaluation of the domestic currency in Iran is explained in Chapter Four, Section 6.

To remove the political problem and to improve its impact on governments the solution adopted by the World Bank is that:

> ... the Bank should develop explicit technical assistance strategies that complement its policy reform agenda and should adapt the mix of bank instruments to the degree of government commitment of PSM (public sector management) reform (World Bank, 1991:31).

When pressures originate from internal factors, the government has greater freedom in fixing the problem, but external pressures do not allow for such freedom because they indicate the perception of international financial institutions.

3.2.2 Ideological Factors

Privatisation has long been encouraged by USAID for ideological reasons and picked up by the World Bank and IMF in the 1980s (Ramourti, 1992:228). The IMF, for instance, was no longer content merely with eliminating government subsidies to PEs or raising their prices but actively sought to transfer their ownership to the private sector. The World Bank, which used to be concerned with the soundness of individual projects in the 1960s and 1970s, became concerned with broad economic policies and the question of ownership in the 1980s, especially in the context of structural adjustment loans. Both international agencies shifted towards privatisation because of pressure from the conservative governments of industrialised countries such as the United Kingdom and the United States (Ramourti, 1992:228).

The election of Margaret Thatcher (1979) and Ronald Reagan (1980) led to what is now regarded as the conservatism of the 1980s, bringing on pressure for reform of the public sector and what was referred to as the "new public management" (Mascarenhas, 1993:319f.). The neo-conservative philosophy favours a market-oriented approach to public sector management in line with right-wing economic thinking (e.g. monetarism and supply-side economics).[11]

Promotion of privatisation by powerful international agencies such as the World Bank and the Asian Development Bank is often part of a larger package favouring private capitalist interests (Jomo, 1989:124). Pressure for implementation of privatisation in developing countries may be due, in part, to the opportunities which such a program provides for industrialised countries such as the UK and the USA.

Privatisation tends to create predictable opportunities for international business managers and multi-national companies (MNCs). Three types of opportunities can be accounted for as follows:

(i) Opportunities which arise from the privatisation transaction itself. Multi-national investment bankers are often required to help governments set prices and find prospective buyers for PEs, including foreign investors. Multi-national firms with a world wide experience base tend to have an advantage over purely national companies as evidenced by the take over of dozens of hotels in developing countries.

(ii) Opportunities for MNCs exists when PEs are being privatised, particularly when the domestic private sector lacks the capital or the technology (or both) to take over complex, capital-intensive PEs.

11– Supply-side economics was introduced against the demand-driven model during the tenure of the Presidents of USA before Reagan. Demand-driven models were aimed at stimulating consumption while providing little or no incentive for investment or productivity. Consumption was to be kept high to reach full employment assuming that investment, productivity and total capacity would all take care of themselves. Supply-side economics deals with those factors affecting the productive capacity of the economy. Most of the emphasis of supply-side economics under the Reagan administration has focused on tax cuts, while the desired end was higher productivity which makes for rapid growth and lower inflation (Evans, 1983).

(iii) The third set of opportunities created by privatisation consists of possibilities for foreign portfolio investment by individuals, firms, and institutional investors (Ramourti, 1992: 243- 245).

Ideological pressure for privatisation may also be directed by the advocates of market forces inside developing countries. Gouri et al. (1991:26) maintain that the emergence of a class of entrepreneurs created the pressure to remove the obstacles built by state controls. These are groups such as importers and commission agents whose main source of income is derived from licenses rather than from industrial activity. Furthermore, the World Bank works through technocrats and a chain of think tanks within the governments with whom it deals who may be persuaded by the offer of concessional finance to confront vested interests (Mascarenhas, 1993:320; Mosley, 1988:135).[12] Special factors which reduced the Bank's bargaining power or which made it difficult for recipient governments to implement liberalising measures, are cases where the World Bank has not realised this hope (Mosley, 1988:135-137).

In market ideology, equity dimensions of state policy are subordinated to the larger quest for economic efficiency. An equity ideology of social distribution of assets and the participation of labour and consumers as shareholders, are however matters for equity consideration in privatisation policies.

Nevertheless, Commander and Killick (1988:117) argue that privatisation programs are evidence of a value shift among the electorates and governments of many major Western countries and that the idea has been exported to developing countries, both ideologically and within bilateral assistance. Commander and

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[12]– See the role of technocrats in Iran, Chapter Four, Section 6.

Killick propose that it places less weight on distributional concerns and carries no concerns about its consequences for PEs. However, efficiency objectives cannot be viewed separately from the values of the society and the relative importance attached to the social goals.[13]

The new market ideology utilises pragmatic reasons for privatisation while it tends towards a *systematic* belief in the typical superiority of private provision. Self (1993:61) states that:

> The *efficiency* argument is used to stress cost comparisons and service to consumers and to underplay questions about equity, social policy and basic responsibility of government.

The important purpose of "reducing the state" was a radical shift from a public service culture whose purpose was to promote public welfare to an enterprise culture based on efficiency and economy. In the ideological climate in which privatisation is carried out, there may be a tendency to underestimate negative distributional consequences. Gouri et al. (1991:67) suggest that privatisation in the final analysis is an ideological issue, "The issue is to sell or not to sell".

Public Choice Theory

Public choice theory is the foundation for market ideology. It focuses on self-interested motivation and on individual and group gains and losses from government activity (Stretton and Orchard, 1994:41). The theory presumes that man is self-centred, rational, a utility maximiser and as in the writings of James Buchanan uses methodical individualism as his *modus operandi* or building block (Hosseini, 1990:168).

13- See the case of Iran and the emphasis on social justice in the letter of the Leader, Chapter Four, Section 5.

Public choice theory provides the mechanism for the application of neo-classical economics to political science (Hosseini, 1990:169; Pincus, 1989:200). The theory is based on the theories of the pre-eminent classical economist, Adam Smith, who asserted that selfish rational individuals would in a competitive market interact so as to produce an efficient allocation of economic resources (as though by an invisible hand).

However, the neo-classical micro-economists such as Pigou and his followers came to a contrary conclusion. The Keynesian welfare state stressed the limitation and failure of market economics and the beneficial capacity of the state for promoting both social welfare and economic prosperity. Furthermore, it was proven that selfish rational individuals can, without coordination, cause an inefficient allocation of resources (Pincus, 1989:196; Self, 1993:56).

Nonetheless, the public choice theory continues to be applied to political processes and events for ideological reasons (Pincus, 1989:193). Table 2.2 depicts the components of public choice theory. Since 1971 the basic ideas have been refined, elaborated, applied and tested in many cases of politics in the United States (Stretton and Orchard, 1994: 26, 41).

Table 2.2: Public Choice Theory and its Components.

1-	Public Choice
1-1	Individual Self-Interest
1-2	Interest-Group
1-3	Private interest
1-4	Collective action
1-5	Government (regulatory) failure
1-6	Private property right

Source: Adapted from Pincus, 1989: 193-205; Hosseini, 1990:179-180.

The new ideology argues the general advantages of markets and failures of politics.

The major application of public choice theory is in the theory of "interest group activity". This indicates that "interest group" has a large incentive to contribute to the lobby or to do lobbying itself when there is likely to be a significant difference in positive outcome (Pincus, 1989:200).

It is argued that pressure groups apply a variety of techniques and strategies to influence the policy-making process. Mathews (1988:149) maintains that most of the pressure groups in the United States testify at hearings, contact officials directly, enter into coalitions with other groups, attempt to shape the formulation and implementation of policy, talk with journalists, inspire letter writing campaigns, and mount grass-roots lobbying campaigns. The pressure groups use other techniques such as advertisements in the media about their positions on given issues, contribute work or personnel to electoral campaigns, and make public endorsement of candidates for office.

An approach which substantiates the importance of interest group activity is the "private interest model". The model makes full use of the observation that individuals tend to favour their own narrow interests at the most opportune time. It warns people to be sceptical of claims made by politicians or bureaucrats that they are only concerned with the welfare of others and motivated by the "public interest" (Pincus, 1989:201).

Individuals need collective action, and the state is a necessary mechanism for such action. A central problem for public choice theory, however, is to determine how the individual preferences of the members of a society are to be translated into collective political decisions (Self, 1993:48; Paul, 1991:6).

James Buchanan's views are associated with the individual's capacity for attending to his own interests and engaging in mutually beneficial trade with others, whether in the market or the political area. From his point of view:

> Political economy should mean, not devices for adding up performance, but the study of the appropriate rules for regulating these exchanges and thereby facilitating the individual's pursuit of his or her ends (Self, 1993:51f.).

Public choice theorists view the political process as less responsive to individual wants and more exposed to the self-regarding exploitations of its principal actors or participants. In accordance with this theory, bureaucrats and politicians can and do manipulate the political process for personal gain at the public expense (Self, 1993:53-58; Ott and Hartley, 1992:15).

The government is seen as nothing more than the vehicle which allows such collective action to take place, and this makes the state into something that is constructed by men, an artifact (Hosseini, 1990:169f.). Buchanan suggests that the role of government is to establish a *moral order* or constitutional agreement for lawful transactions, which helps the market function, and to provide necessary public services (Self, 1993:52). Public choice ideology offers a theory of governmental-political failure in response to the theory of market failure that emerged from the theoretical welfare economics of the 1950s.

Government (Regulatory) Failure and Private Property Right

Public choice theory leads to the theory of government failure which indicates that governments fail to achieve economic efficiency through PEs. The theory supplies one answer to the problem of government (regulatory) failure. The answer it suggests relies on the exercise by individuals of their private property right (Pincus, 1989:205).

With respect to enterprise management, the theory of private property right indicates that private owners are enthusiastic to have successful enterprises, which helps them take desired actions. Owners are presumed to provide incentive for management. They have means such as dismissal or persuasion, instruments to use to their advantage (Ott and Hartley, 1992:15; Sikorski, 1993:23). On the basis of the theory, an organisation may be viewed as a team of service or product suppliers with contracts established and monitored by the management. When management prevents sluggishness in the team, the result is high productivity and low costs.

Private property right is the framework for the liberals' belief in a theory of public choice. They believe that the government should assist in development and protection of a system of private property right (Pincus, 1989:205). The principles of private property underlie the economic approaches of the concepts of the rights of the individuals, whereas the principles of equal basic entitlements form the social aspects of the concepts. Indeed, it is not being suggested that all economists would subscribe to the former position (Self, 1993:246).[14]

[14]- Modern theories of the rights of property go back to John Locke in the seventeenth century. Locke believed that an individual was entitled to receive the protection of the state for his person and property. He contended that a property owner was entitled to as much of the fruits of his labour as he could reasonably enjoy, and no more, and he lamented that the invention of money enabled individuals to acquire much more wealth than they could reasonably require (Self, 1993:247).

Public Choice Theory and Privatisation

The advocates of privatisation in the form of sales of public assets to the private sector adhere to the theory of private ownership. They argue that the advantage of the sale method of privatisation is to transfer property rights to profit-oriented owners who push their companies to perform better, at lower cost, and to pay more attention to the needs and demands of clients (Kikeri et al., 1992:48).[15] This is based on the assumption that the private enterprise needs to perform efficiently to remain in business.

A further argument is that the change in ownership will impose the discipline of private capital markets on the enterprise, resulting in improved productive efficiency. While this argument may be important in industrial countries, it has limited relevance to developing countries. Cook and Kirkpatrick (1988:19-20) maintain that in many of these countries the capital market is typically underdeveloped and privatisation normally involves the sale of the enterprise to individual purchasers or the introduction of private capital in a joint venture. Even for an industrialised monopoly, the capital market may only impose an incentive to lower costs in order to improve profit rather than to benefit consumers through lower prices (Peacock, 1984; Cook and Kirkpatrick, 1988:20).

Any effect of government, based on public choice theory, is expected to be motivated by the desire for re-election. Furthermore, citizens are seen as consumers and as small shareholders. Such analysis relies on scepticism. Sikorski

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[15]- See the case of Iran; the advocates of the privatisation program in the form of selling public assets to the private sector adhere to this argument.

expresses the view that this sort of belief is not relevant for Asian countries. He states:

> We assume government does nothing but scrape for votes, and that citizens promote only their immediate selfish interests. It is unfortunately, a solid premise in the West, but may be less so in parts of Asia (Sikorski 1993:21).

Privatisation is the reflection of property rights and the theory of government failure from the view point of public choice theorists.

3.3 Coping with Internal and External Pressures

Governments usually come to the conclusion that privatisation is an appropriate reaction to internal and external pressures on an economy. "The form and nature of privatisation depend, however, on the types of pressures exerted on an economy and the consequent process of adjustment" (Gouri, 1991b:115).

A horizontal linkage of internal and external pressures occurs by means of the channels of international finance and investment. For developing economies fiscal crunch and a deficit in the balance of payments (BOP) have often been the joint triggers for privatisation together with the external pressures applied by the condition of loans and aid from the World Bank and IMF (Gouri, 1991b:117). This linkage becomes reinforced with pressures from foreign investors and their relationship with supportive local industrialists and technocrats.[16] Ramourti (1992:236, 241) in his research has concluded that:

(i) The short-term factors, especially external financial dependence are associated with privatisation.

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[16]– See the case of Iran, Chapter Four, Section 6.

(ii) Privatisation seems less likely if those deficits can be financed by domestic rather than external borrowing.

(iii) The greater a country's dependence on the World Bank, the greater is the likelihood of privatisation.

Economies which prefer to tackle long-term problems invariably choose modalities of privatisation that are less severe and take a step-by-step approach to transform the existing structure. However, external pressures, which arise mostly because of short-term financial difficulties, tend to establish radical privatisation measures using divestiture modalities in a short-term period (see Table 2.3). Economies responsive to external pressures were oriented more towards privatisation programs suggested by the IMF. This was evident in the economy of Sri Lanka and the Philippines in which state (regulatory) failures were replaced by market failures as described earlier. Excessive emphasis on efficiency without concern about equity only uncovered the inherent immaturity of their privatisation programs (Gouri, 1991b:119).

Table 2.3: Time Dimension of Pressures for Privatisation of PEs.

Time dimension:	Modality selected:
Long term perception:	
Efficiency problem	1-Liberalisation 2-PE reform
Moribund industry	3-Non-divestiture options
Short-term perception:	
Fiscal crunch	
Balance of payment deficit	1-divestiture options

Source: Gouri, 1991b:118.

Responding to internal pressure and developing a privatisation policy to overcome the long-term constraints in the economy brings more success and prevents pitfalls. China and India are examples of this type of privatisation policy: "The modalities of privatisation included liberalisation, public enterprise restructuring, and non-divestiture options" (Gouri, 1991b:119). The choice of modalities was based on an understanding that both the market and the state had limitations. Privatisation must necessarily aim towards correction of both types of failure, so long as external pressures allow sufficient freedom for developing local privatisation policies.

In summary, internal and external factors have been advanced as privatisation motives. Internal factors include financial, economic, and managerial pressures, while external factors include pressures from international agencies such as the World Bank, IMF, USAID and ideological pressures. Financial pressures for privatisation are more common than other internal factors. This makes a link between internal and external pressures. There are pitfalls in the relationship between financial problems and the option of sales of public assets to the private sector, which demand caution in considering this option as a final solution. External pressures are accompanied by ideological considerations. Prescriptions such as trade liberalisation may become an element for an increase in imports of borrower countries, and have a negative effect on the balance of payments (BOP). The international agencies such as the IMF are only content with reforms in the form of transferring ownership to the private sector. This may be because of the pressures from the conservative governments of industrial countries such as the UK and the USA to take advantage of available opportunities to make profit from investment in other countries. Successful privatisation demands contributions towards correction of both market failure and government failure. The next section examines the privatisation policies.

4 Privatisation Policies

There is no such thing as "no policy" in what governments do. If they do not do something, following due deliberation, that is a policy, and if they do, that is also a policy. Good economic policies enhance growth, while poor policies slow it down, while very poor policies can set development back by decades (Dornbush, 1993:1).

It is apparent that for policy-making, a conscious design with attention to principles should produce better alternatives than no design at all. Besides, there is the possibility of biases with unconscious design which may affect the quality of decisions. Rumpf (1994:57) refers to Linder and Peters (1990:304) who contend that the first bias is instrument bias, a tendency to link problems with certain solutions. A narrow conception of the best solution often creates a policy problem. The other bias involves a presumption of particular actors. Here design choices are pre-judged by an earlier preference for a particular institutional or organisational design feature (Rumpf, 1994:58).

Policies are dependent on the policy-making process and the current ideas that are prevalent in the community, or the interest group. Policies, as Bruton et al. (1992:13) maintain, do not arise simply from a model or from a theoretical argument, nor are they simply derived from the experience of other countries. A correct policy is a feasible policy, which depends, in part, on the policy-making process.

A correct policy-making process demands consideration of objectives for which policies are made. Bruton et al. (1992:13) maintain that an "objective function" of policy-makers should exist before the search for policy. The national objectives are found during the policy search process. This is particularly evident in those countries where ethnic, religious, regional or other divisions in the population complicate the notion of the national policy and the notion of equity.

In developing countries, many features of market systems were imposed by colonial powers. Many more features such as privatisation were pushed by advisers, aid donors, and so forth on societies that have not experienced this evolutionary process. Indeed, it is difficult for them to understand arguments that depend primarily on the working of the market (Bruton et al., 1992:14).

4.1 Policy-Making Process in Privatisation

Policy-making is always a difficult task in all countries and more so in the developing areas. Rumpf (1994:80) refers to Simeon's statement (1976:550) that policy-making is a matter of choices, rather than a matter of problem solving.[17] It is a choice between alternatives uses for limited resources, on the one hand, and different goals and objectives, on the other hand, which cannot easily be weighed against each other.

Understanding the process of formulation of policies involves understanding of how linkages among values, problems, and instruments are made (Rumpf, 1994:67). Public policies emerge through a process of interaction of ideas, motives, options, programs and implementation actions. Many countries deal with

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[17]– See also Kingdon, 1984.

specific policies through a series of different obvious decisions which define the direction of the policy over a period of time (Sankar, 1991:201). Most of the developing countries have been reticent in defining and openly spelling out policy in the area of PE reform and privatisation.

Three broad groups are involved in the policy formulation process in most countries (Sankar, 1991:201). First are political executives, or those who take the responsibility for a policy. They hold themselves accountable for its outcomes through the cabinet and Parliament. They are the most important group. Second are bureaucrats functioning as the support group for the policies proposed by the political executive. The third group comprises professional policy consultants who provide, in specific sectors or issues, policy prescriptions and alternatives based on professional analysis.

The political executives are highly visible, but usually have short-time horizons. They have to fulfil promises made or implement new policies and programs to further their political interests and maintain their power.

The bureaucracy may have no strong desire to upset or modify a system within which it has achieved security. The bureaucratic policy-makers often prefer evolutionary strategies, those which brings slow changes *"without upsetting the apple cart"* (Sankar, 1991:202). Therefore, some countries involve external professional policy analysts in policy-making efforts.

Professional policy-makers come with technical competence in analysis and formulation of proposals. But, they often lack an understanding of the environment in which the policies have to be implemented, thus bringing about results which may be contradictory to what is desired (Sankar, 1991:201). Policy-makers from each group deal with privatisation in a different manner.

To achieve the objectives set out during a privatisation policy process, there is a need to examine the appropriate modalities of privatisation. Selecting the appropriate tool in the policy-making process depends on the knowledge of the government's tool-set. Selecting the right tool also appears to be a matter of faith and politics rather than certainty (Rumpf, 1994:56). The modalities of economic, financial, commercial, legal and public relations aspects have to be fully addressed. Therefore, "the art of selling policy must be fully backed up by the science of modalities of privatisation" (Sankar, 1992:208). The next paragraphs will examine the choice of instruments and modalities of privatisation based on macro and micro policy-making.

4.1.1 Macro-Privatisation

Macro-privatisation puts into practice the ideology and policy framework which influences the new boundaries of the state and the market. Two types of macro-privatisation are depicted in terms of policy-making: (i) privatisation or sale of assets and (ii) liberalisation (Gouri et al. 1991:41). The division is purely an ideological one and depends on the rate of movement from a producer state or regulator state.[18]

Macro-privatisation includes reduction in executive ownership (e.g. China), deregulation (e.g. China and India) and sale of government assets (e.g. Australia) (Gouri et al. 1991:42). Privatisation through the sale of assets is a response to a policy of general reduction of state involvement in all areas of activity.

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[18]– Professor David Corbett also suggests terms such as *minimalist state*, *care-taker state* and *watchdog state*.

The Sale of Assets and Change of the Ownership Structure of PEs

The sale of assets involves diversification of ownership in favour of private enterprise. Modalities of ownership structure can be described as divestiture of assets and people's capitalism, re-privatisation, rolling privatisation and liberalisation.

Divestiture implies sale of shares, transferring the ownership as well as controlling interest from the public sector to the private sector (e.g. Malaysia) (Prager, 1991:312). The means of divestment of companies include:

(i) management buy-out: selling to existing staff of the organisation, who become the owners after arranging external finance for their bid;

(ii) selling to the original promoters of privatisation (organisers or financiers): selling shares without involving any new party and adding to the number of shareholders;

(iii) negotiated sale: selling shares of divested companies with a negotiable price involving only one new party;

(iv) selective tender - open bidding from a chosen, nominated group of tenders;

(v) secondary offer: offering either to existing shareholders or to the public at large; and

(vi) listing: adding a new entity to the stock market and allowing investors to purchase new shares (Thynne, 1989:38).

The above discussion is categorised in Table 2.4.

Table 2.4: Modes and Features of Divestiture of PEs.

Mode	New party	New shareholder
Management buy-out	_	_
Original promoter	_	_
Negotiated sale	+	_
Selective tender	+	+
Secondary offer	+	+
Listing	+	+

People's Capitalism, popular capitalism, and/or people's share program (PSP) is the modality of wide distribution of shares of PEs to the people. This modality can reduce conflict between consumers, labour, managers and shareholders of a newly privatised company. Such a conflict often emerges after privatisation, when shareholders want a good dividend from a privatised company and consumers want the charges or tariffs to be as low as possible. Thynne (1989:41) argues that where all consumers are shareholders the conflict is minimal because what one gains as a consumer one loses as a shareholder and vice versa. The World Bank (1992:24) suggests that strong private management and control are necessary to avoid a reduction in management performance in developing countries. Experience has shown that PSP serves as a suitable device for income redistribution, to consumers, staff and managers, and creates a strong management and control system.

Income redistribution is the most common reason for PSP. For example, the equity issue was very strong in the recent South Korean privatisation program (Song, 1991:181). In South Korea, privatisation was essentially seen as a means of equitable distribution of company shares to low-income groups on a preferential basis. This was due to the concern of policy-makers regarding the people's perception of their rights as owners of successful PEs (Sankar, 1992:206). The point is that those PEs selected for privatisation through the PSP were not the troubled ones, but the ones showing a large financial profit. Most of the seven PEs designated for privatisation through the PSP were monopolistic (Song, 1991:183-4).

In PSP, the proportion of shares sold to individual buyers may help the government to have final control. For example, in South Korea, the maximum proportion of shares to be sold to the public and workers was 49 per cent, so that the government maintained control (Song, 1991:183, 189). In order to provide financial assistance to those people who were eligible but lacked the funds to invest in the PSP, the People's Share Trust Fund was set up. Those shares purchased with financial assistance from the People's Share Trust Fund may not be resold for at least three years (Song, 1991:184). Many governments (Nigeria, Jamaica, Chile, France, and the United Kingdom, for example) see wide share distribution as an important benefit of privatisation in spite of the tendency of share distribution to reconcentrate over time (World Bank, 1992:24). Therefore, Thynne (1991:45) suggests the possibility of divestiture often being viewed as more of an exercise in "*publicisation*" than *privatisation*.

Re-Privatisation implies essentially handing over an enterprise which was originally in the private sector but was brought into the public sector for some reason. In essence, this is also divestiture but in some cases the original owners may have a priority or first right of refusal [19] (e.g. the Philippines).

Rolling Privatisation implies creating shares in the public sector, but transferring them to the private sector over a period of time. It is not undertaken with the primary aim of reducing the presence of the public sector, but rather seeks to use the public sector as an instrument for developing private enterprise itself. The hybrids in the United Kingdom and the joint ventures in developing countries illustrate this type of halfway house (e.g. Thailand) (Reddy, 1991:223).

Liberalisation

Liberalisation refers to the removal or relaxation of statutory barriers against the development of market competition. It has the same meaning as deregulation. For any PE, it is also related to the relaxation of governmental rules and regulations to increase the flexibility of its operations (Dhiratayakinant, 1991:254). Liberalisation is a more gradual shift from producer state to regulator state and then onto a facilitator state on a longer time scale. It refers to deregulation and freeing of the economy. Licensing and other forms of control (price and administrative) differentiates these economies from their predecessors.

Liberalisation is considered to reduce government expenses by allowing private sector participation and eliminating expenditures such as investment in new plant and equipment. In the framework of liberalisation certain goods and services are provided, produced or consumed in the public and private sectors (Thynne, 1989:55). Liberalisation is an alternative which helps increase the degree of

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[19]– Re-privatisation in Iran was used to give shares back to the previous owners of some nationalised enterprises. Re-privatisation was also used in some instances in the Philippines.

competition in the public enterprise. It directly or indirectly raises the probability of achieving greater efficiency by abolishing or relaxing existing laws and regulations which place obstacles on the management of a PE which wishes to take *privatisation action*. More specifically, in liberalisation policy, there is no regulation that requires a submission for approval by the supervising ministry. Therefore the management of a public enterprise, on its own initiative, can privatise its activities in a manner that maximises the benefit earned by the PE (Dhiratayakinant, 1991:263).

Liberalisation policies fall into three categories: first, it is associated with promoting competition by attracting new participants into the market and restructuring existing companies into more competitive units (Bishop and Kay, 1990:250). It is also associated with market prices and the introduction of market competition. Such action is termed *marketisation* and is a feature of a regulator state and a facilitator state. The second modality of liberalisation is divestiture or transfer of ownership from the public sector to the private sector (Gouri et al., 1991:42). The third modality includes measures under which areas exclusively reserved for PE investment are opened to private sector participation.

Three advantages are expected from restructuring. First, by reducing the size of the firms it will facilitate acquisition or reorganisation if performance is inadequate. Secondly, it will facilitate the generation of comparative information by which shareholders can assess performance such as in a separately owned gas distribution network. Thirdly, the regulatory authority can make comparative assessments in determining the proper regulatory formula (Bishop and Kay, 1990:252).

4.1.2 Micro-Privatisation

Micro-privatisation is pertinent to the operational activity of PEs towards achieving efficiency at the enterprise level. Micro-privatisation is aimed at:

(i) better performance of PEs to generate economic efficiency; and

(ii) resource mobilisation and generation of financial surplus (Gouri et al. 1991:45-6).

Micro-privatisation, therefore, takes the ideology of privatisation into account. However, Toh (1992:57) asserts that selection of the enterprises for reform should be based on an order determined by widespread public recognition of the enterprise's eligibility for privatisation, political insensitivity and its record of profitability.

The Structure of Policy Guidelines

The starting point for privatisation is the financial performance of a PE and its correlation with the environment in which it is placed. PEs are divided into financially successful and financially unsuccessful enterprises. They could also be divided into those functioning in a competitive environment and those in a non-competitive environment (Table 2.5).

Table 2.5: PEs in Different Environments.

Competition/ Viability *	Financially successful	Financially unsuccessful
Competitive environment	AA	AB
Non-competitive environment	BA	BB

Source: Gouri et al., 1991:62.
* This expression has been added to the original pattern.

Four conditions are depicted in this respect as follows:

AA Financially successful in a competitive environment.

BA Financially successful in a non-competitive environment.

AB Financially unsuccessful in a competitive environment.

BB Financially unsuccessful in a non-competitive environment.

The sale of assets in quadrant BA could result in strengthening the monopolistic market structure. Therefore, built-in safeguards are needed to compensate for the consequences of privatisation. The most difficult to sell are the PEs in quadrant BB. PEs in the competitive quadrant (AA) are those which face competition, and more often international competition. Examples of PEs in these quadrants are airlines and engineering industries. PEs in the non-competitive quadrants are those which are categorised as natural monopolies and utilities.

PEs in a Competitive Environment (AA and AB)

A privatisation program for the restructuring of PEs in a competitive environment requires two major policy reforms to strengthen their ability to face competition (Gouri, 1991:62). The first policy is giving complete autonomy to management to take timely decisions and actions. The second reform initiative involves allowing management to set the prices of their products based on scientific criteria. The distancing of PEs from government is also significant. Distancing includes the following:

(a) Government distancing or cold privatisation,[20] i.e. to distance a PE from the government with clear objectives to ensure that, where possible, the public enterprise relates to the market and simulates the behaviour of the private sector (e.g. India)(Reddy, 1991:222). This can be achieved by leasing out which could involve letting out or sub-contracting to private entrepreneurs a part or full product process or enterprise giving the lessee the right of ownership and management during the lease.

(b) Management distancing can be attempted through contracting. Management can be contracted out to a private group without shifting the ownership from the government, or through the government drawing up a contract with the existing management.

In both cases a formal contract known as a Memorandum of Understanding (MOU) needs to be signed. The MOU should determine: (i) the minimum expected rate of return on capital; (ii) the product mix; (iii) diversification and modernisation schemes; (iv) market strategy; and (v) technology plan. The MOU includes the criteria for evaluation of the enterprise, which would consist of a number of non-financial indicators as well as financial indicators (Gouri et al., 1991:63).

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[20]– Cold privatisation refers to making public systems behave as private enterprises by:

(a) Giving financial autonomy to seek financial assistance directly from the bank/capital market;
(b) Giving autonomy to make investment decisions;
(c) Entering into a Memorandum of Understanding (MOU) for providing freedom to fix prices, output etc;
(d) Making subsidies explicit and exhibiting an arms-length relationship;
(e) Having recourse to corporatisation, i.e., converting a departmental enterprise into a corporate entity to ensure distancing (Sankar and Reddy, 1991:550).

Unprofitable PEs (quadrant AB) in the competitive environment require close analysis as to the causes of their inefficiency. Intensive studies reveal that such PEs sustain losses due to wrong decisions on technology, location, product mix and demand at the time of project planning (Gouri, 1991:64). Mergers as an action plan for reconstruction could be attempted here.

(c) Ownership distancing and sale of assets in PEs to the private sector. Ownership distancing of competitive PEs has two limitations. First, if the PE is financially successful, then privatisation terminates an important source of revenue for the government. If the enterprise is sustaining losses, privatisation becomes a difficult solution. In this case, the PE needs to be restructured before privatisation. Developing shareholding by selling shares to the public is a solution which encourages private entrepreneurs or even ordinary people to become "joint partners" in the venture. Table 2.6 summarises the above discussion.

Table 2.6: Restructuring of PEs in a Competitive Environments.

No.	Type of Restructuring:	Instrument:
1-	Government Distancing	Leasing, Management Autonomy
2-	Management Distancing	Contracting Out (with MOU)
3-	Ownership Distancing	Selling Shares or Assets to the Public

Adapted from Gouri et al., 1991: pp.62-64.

PEs in a Non-Competitive Environment (BA and BB)

PEs operating in a non-competitive environment include very large firms involving heavy investments in such sectors as steel, coal, non-ferrous metals, power and defence (Gouri et al., 1991:65). Others may be promotional agencies which are executive arms of various departments of government. These areas have been historically reserved for PEs based on socio-economic grounds and where government control was required. The rationale for PEs in a non-competitive environment has been the social obligations of these enterprises. Thus, evaluation and ranking of PEs demands modification of their structure. This restructuring of PEs enables identification of social objectives and organisational provisions for meeting social obligations.

In view of their monopolistic position these PEs require constant attention and monitoring by the government. To facilitate autonomy, MOUs or contracts between enterprise and government would have to:

(i) specify clearly the objectives of the government;
(ii) outline strategies and the decision-making process; and
(iii) devise measurable monetary and non-monetary performance indicators (Gouri et al., 1991:64).

Setting up a holding company has also been suggested as a major structural reform. This company would be an umbrella organisation for a number of industries having similar or complementary lines of production. This often has advantages of cross-subsidisation between firms; ability to compete in the international market; and more effective use of scarce managerial resources (Gouri et al., 1991:65).

4.1.3 PEs and Equity Issues

Four divisions can be considered for PEs with respect to distributional equity and economic success in the efficiency area. These criteria combine both the economic and financial concepts of efficiency, as well as an equity obligation considered necessary for evaluating PEs (Table 2.7).

Table 2.7: Restructuring of PEs for the Aims of Distribution of Equity and Efficiency.

Equity obligation/ viability	Economically successful	Economically unsuccessful
Good distribution of equity	A	B
Poor Distribution of equity	C	D

Source: Gouri et al., 1991:63.

Quadrant A represents the efficient PE in all respects. Any reconstruction of such PEs could be derived from the earlier analysis of PEs in a competitive environment.

Quadrant B represents PEs where social obligations have dominated other considerations. In this category, the major reform concerns the pricing policy, where *long-term marginal cost* should be the norm (Gouri et al., 1991:66). The argument is that PEs in this category may use social obligations as a cover for their inefficiencies.

Quadrant C represents PEs in the minority, which rate high on economic performance but poor on social obligation. Their poor rating for equity may be due to the fact that they are purely money-makers such as hotels. They need not be in the public sector.

PEs in quadrant D rate poorly on both considerations. These are usually PEs in utilities and infrastructural activities. It has often been observed that these PEs have heavy social obligations but, owing to organisational and management deficiencies, are unable to effectively perform them. An improvement in their performance may require any of the following measures or a combination of them:

(i) introducing competition either through dividing the enterprise into smaller units or by allowing private sector participation;

(ii) contracting-out a part of service to the private sector;

(iii) effective monitoring of the social obligations; and

(iv) a more rational price policy (tariff structure responsive to market signals).

Equity in the Context of PEs

Equity has been considered as a major reason for setting up PEs. The assumption was that "public sector provision of goods and services offers a better guarantee of meeting equity expectation" (Wanasinghe, 1991:124). These reflect beliefs that PEs, under public ownership, are better suited to the satisfaction of equity demands.

Governments have also preferred to depend on PEs as reliable instruments for achieving equity goals, because they are under the direct control and management of the government and tend to be directly accountable for the achievement of equity goals. Therefore, any action for divestiture of PEs has generated considerable emotion and feeling of insecurity over equity considerations. This is a reality with which policy-makers have to struggle (Wanasinghe, 1991:124).

Equity goals have often been advanced in the developed countries as well as developing ones in Asia and the Pacific (Wanasinghe, 1991:123). These countries with a variety of political, social and economic systems have one thing in common - a subscription to equity as a key community goal, which is a general expectation of society.

Experience in Asia and the Pacific reveals that a number of societies are involved in a debate on the issue of minimising the concentration of economic power and encouraging its wider distribution. In this debate, the social consensus has increasingly moved towards an expectation that the privatisation of PEs would also serve the objective of wider distribution of economic power rather than its concentration (Wanasinghe, 1991:126). Consumer groups, political parties, trade unions, sub-national regional groups and the like have constantly brought up, from their respective points of view, issues related to equity considerations.

This context of public expectation suggests that equity considerations need to be a basic element in any privatisation exercise: "Equity can neither be ignored nor left to be realised as a by-product of privatisation" (Wanasinghe, 1991:124). This is especially so in countries that have emphasised the redistributive role of the state in pursuit of social justice and have criticised the inability of the private sector to serve those goals.[21] They will find it difficult to reduce state intervention and to privatise without calling the legitimacy of the regime into question (Bienen and Waterbury, 1989:623f.). Any privatisation program or project would need to be clearly perceived by the public as not only *not threatening,* but in fact, *ensuring* equity. Otherwise, it is likely to meet public resistance. Therefore, in discussing privatisation of PEs it is relevant to examine the issues which relate to the trade-off between equity and efficiency in the planning and implementation of privatisation.

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21 – For example see the case of Iran.

Trade-Off Between Equity and Efficiency

If equity judgments are appropriate in a particular context, then it is usually suggested that optimality be thought about in two-dimensional ways. One dimension is *efficiency* and the other is *equity*. If both are socially desirable goals, then a *trade-off* of one against the other has to be made (Williams, 1993:68; Le Grand, 1990:555).

Examples of equity concerns are:

(i) provision of consumers' service and uniform access to services and goods at an affordable price;

(ii) assurance that the interests of marginal consumers will be protected under privatisation, for example unprofitable rural transportation; and

(iii) maintenance of the quality standards of goods and services provided by privatised PEs.[22]

Theoretically, there is the possibility of allocating resources in either a fully efficient or a fully equitable way. In practice what usually occurs is a variety of combinations and degrees of efficiency. The trade-off between the values (equity and social values) and efficiency (in a form of production) can be illustrated in a diagram. There are two objectives, I and II, movement towards each of which can be measured by an index, XI and XII. The convex lines, W1, W2, and W3, are indifference or welfare contours for the policy-makers or evaluators which connect points relating to all the combinations of I and II in the appropriate individual's perception (Le Grand, 1990:554-559). Therefore, each contour corresponds to a

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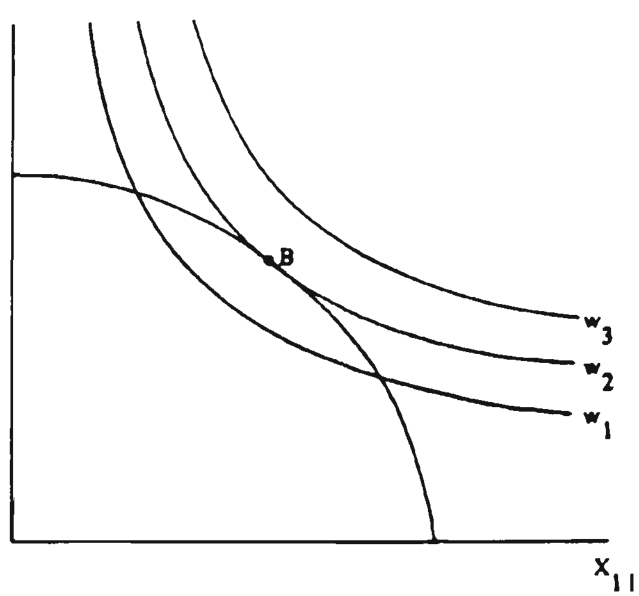
[22]- These provisions are part of what has been described as the public interest by Wettenhall (1988:45).

particular level of social welfare. The convexity of the slope represents the likelihood that the closer the society is to the attainment of one objective, the more it will be prepared to sacrifice the other. The concave line in the diagram refers to the society's productive capacity in terms of its objectives. The slope of this line thus represents the (production) trade-off. Point B - at which the objective possibility frontier is touching the welfare contour W2 - represents the "best" combination of the two objectives for the society concerned. At B the slope of the objective possibility frontier is equal to the slope of the relevant contour welfare (W2), so at this point (but at this point only) the trade-offs are numerically equal, "but equality does not imply identity" (Le Grand, 1990:559).

Figure 2.1 Trade-Off Between Equity Values and Efficiency.



Source: Le Grand, 1990:557.

The magnitude of the value trade-off can be established by reference to personal or social values (equity), and that of the efficiency (production) trade-off, by reference to empirical observation. Le Grand (1990:559) gives the following definition for the efficient allocation of resources:

> An allocation of resources is efficient if it is impossible to move towards the attainment of one social objective without moving away from the attainment of another objective.

The result of this argument may be that the trade-off between efficiency and equity in the context of social security such as an *unemployment benefit system* may cause a decrease in attempts of people to seek work. In the case of a state pension, it may lower the rate of economic growth:

> The system of state pensions may reduce the incentive of individuals to save to provide for their old age; unless this is offset by an increased propensity of the state to save, then this will result in smaller aggregate saving, smaller investment, and, hence, a lower rate of economic growth (Le Grand, 1990:561).

The last point that Le Grand (1993:566) asserts is that "it is conventional in economics to treat efficiency, in contrast to equity, as a concept that is relatively unproblematic."

The Methods for Equity-Efficiency Trade-Off

There is some difficulty with formulation of the trade-off in equity judgment. Many economists simply advocate displaying the gains and losses, from distributional issues, to different individuals or groups. Then, they leave the matter there for the policy-makers (and/or to their voters) to sort out. Others view distributive justice as too complex a task to be left entirely to the chance and informal methods of assessment usually used by policy-makers, and recommend that it should remain within the analyst's decision and authority. Finally, there is a view that indicates equity issues are more likely to be followed through, explicitly and systematically, if the analyst deals with them and a fuller discussion occurs at all stages in a study (Williams, 1993:69).

The decision about what to include and what to exclude and the decisions about which valuation method to employ must not be regarded simply as technical matters for the experts to decide on. The reason is that they are also matters on which a judgment has to be made about what is (politically) appropriate or inappropriate in the particular context of the study. But this political judgment should not be subjective, or presented without argument or justification. Ideally it should be both explicit and systematic about the factors involved in the particular choice under investigation (Williams, 1993:73-4). Cost-benefit analysis (CBA) is a measure to help ensure that the value of additional things that are provided by some projects is greater than the value of the things that have to be sacrificed (Williams, 1993:77).

4.1.4 Cost-Benefit Analysis and Equity Aspects

The pure version of cost-benefit analysis aims to help decision-makers by carefully analysing all relevant costs and benefits so as to express them in terms of money. For this purpose, the following procedure may be applied:

> Socially acceptable money valuations such as past behaviour and present preferences are expressed in the common language of money. The costs and benefits are to be wrapped up in an overall cost-benefit ratio. This monetised summation, or in the case of alternatives, series of summations would determine the decision-makers' choice (Boswell, 1976:174).

National income and consumption have three dimensions: (a) quantity, (b) distribution, and (c) modes of distribution. The factors determining the first dimension are concerned with efficiency. The other two dimensions are more concerned with the concept of equity. In CBA only the quantity dimension is usually considered, so that the concept of efficiency is separated from that of equity. Therefore, CBA does not consider the role of equity and distribution of wealth and thus they are not included as objectives in allocative efficiency:

> The role of CBA as an instrument for improving allocative efficiency is based on the hypothesis that distribution objectives and allocation objectives can be kept distinct (Battiato, 1993:30).

A modified principle of CBA suggests that projects can be justified if estimate of total benefit exceeds that of total losses, even if compensation to the costs was not actually paid (Self, 1993:246). According to Battiato this method makes it possible to determine the cost and the consequence of redistribution of income and reduction in the loss of welfare to a minimum.

> By keeping the objectives of allocative efficiency distinct from those of equity, it is possible to establish how much a project contributes to the increase in social welfare, in terms both of an increase in the flow of goods and services available and of a redistribution of income (Battiato, 1993:33).

In summary, policy-making for reform in PEs is an essential and difficult task. A comprehensive study of the objectives of reform is suggested for this reason. Selecting the appropriate tools for achieving the objectives of reform is the next step. A variety of modalities could be assigned for different objectives. Different structures, obligations, and objectives for PEs demand different modalities. Managerial, efficiency, financial and distributive objectives need their own specific modalities. Therefore the government's knowledge of these modalities is needed as well as the selection of the right modalities. For example, divestiture of assets is merely one of the numerous modalities of privatisation policy. The trade-off between efficiency and equity is suggested as a vital element to be considered in policy-making for privatisation. This trade-off is best based on the realities of local political judgments. The restructuring of PEs and managerial reform can provide an appropriate measure for reform in PEs without transferring the ownership to the private sector. However, the emphasis of international agencies is on modalities of divestiture and sale of PEs to the private sector. The next section examines theories about privatisation implementation.

5 Implementation of Reform

Three different problems endanger any reform program. These are: implementation failure; failure emanating from policy design; and policy failure (Rumpf (1994:46). Implementation failure occurs when a reasonable and potentially effective policy is undermined or sabotaged during implementation. Policy design is the second cause of failure. "This results from the failure of those who make policy to formulate a program which has any possibility of being successful." Thirdly, there can be policy failures. In these situations, a program may or may not achieve its goals, but unexpected side-effects impact negatively upon other social values.

Effective implementation of programs depends on six conditions (Ryan, 1995:71-72). These are:

(i) the clarity and consistency of program objectives;

(ii) the extent to which assumptions underlying the programs are valid, especially with respect to cause and effect;

(iii) the extent to which the implementation structure support the achievement of objectives;

(iv) the commitment and management skills of implementation officials and agencies;

(v) the commitment and active support of organised interest groups, the public, politicians and/or senior officials; and

(vi) the condition that changes do not frustrate program objectives, negate causal theory, or diminish political support.

Implementation of reform in PEs and privatisation depends on a number of key requirements. These are: (i) clarity of objectives; (ii) choice of appropriate instruments; (iii) development of market structures; (iv) careful planning with built-in safety clauses; and (v) monitoring impact (Gouri et al., 1991:54; Reddy, 1991:219-223; Dhiratayakinant, 1991:260-265). This section examines the above factors after an initial discussion of the institutional arrangements needed for a privatisation program.

Institutional Arrangements

Institutional arrangements focus on employing and creating a management group and involving professional advisers. Professional advisers may come as members of the Board of Directors or as outside consultants. Outside consultants have an important role in the formulation of support systems for reform policy implementation. Establishing the administrative arrangements for privatisation is an even more extensive task than establishing its legal framework.

New laws usually have to be passed to enable privatisation to be implemented (Enick Nasir Zihni, 1992:3). If the need for legal changes is ignored or the time needed for such changes is under-estimated, then implementation may face considerable problems. Any reform measures should be within the Constitution and legal framework.

Action Plan

For classifying appropriate enterprises and their required reform an action plan is created. An action plan illustrates the process and program of privatisation without involving the final decisions about political details. Before taking any action, governments tend to classify enterprises as "strategic" or "essential" and "non-strategic" or "inessential". Economic analysis, on the other hand, usually attempts to divide enterprises into "viable," "potentially viable," or "non-viable". Shirley and Nellis (1991:19) illustrate a classification and action plan adopted by the Somalian government (Table 2.8).

Table 2.8: A Type of Action Plan

Category:	Action:
Essential/strategic, viable	Retain
Essential/strategic, non-viable	Retain, take specific steps to improve
Non-essential/non-strategic, viable	Divestment in whole or in part to the private sector
Non-essential/non-strategic, non-viable	Liquidation

Source: Shirley and Nellis, 1991:20

5.1 Clarity of Objectives

Clarity of objectives is an important feature of any successful reform including privatisation experiment (Gouri et al., 1991:54). Clarity is necessary in terms of defining the end goal, whether it is to be financial gains, enhancement of efficiency, or greater equity in distribution. These three objectives can even be combined, but with clear balance. Other objectives may include reduction in the administrative burdens of government and the creation of a market orientation.

5.2 Choice of Appropriate Instruments

Instruments for privatisation need to be carefully examined and chosen. There is a relationship between the objectives of reform of PEs and the modalities to be selected to achieve those objectives. The important guideline is to consider each modality alternatively in terms of its compatibility with or implications for the economy and society.

The choice of instruments should be made only after the study of various cases. For example, Gouri et al. (1991:54) assert that the central concern of Thailand was to emphasise the effective use of various instruments of privatisation other than divestiture. The principal objective was attainment of both financial and efficiency goals. The choice of non-divestiture modalities becomes a matter of crucial importance when further divestiture is not feasible. The appropriate modality, then, is the one which is relevant to the objectives of a reform initiative.

Three instruments can be used for micro-privatisation. These instruments are instruments for efficiency and better performance, instruments for financial gains, and instruments for equity. Efficiency and performance can be improved through liberalisation, marketisation, divestiture, sub-contracting, capital market involvement and leasing (Gouri et al., 1991:46). These instruments aim at introducing competition and providing greater managerial and entrepreneurial autonomy.

The main instruments of privatisation for financial gain are the sale of assets, divestiture, sub-contracting and capital market involvement. The instruments of privatisation for equity could encompass the preferential sale of shares and public sale of assets as people's capitalism. Appropriate modalities of privatisation for each objective have been suggested by Reddy (1991:219) and Gouri (1991a:80). (For example, see Table 2.9).

Table 2.9: Ranking of Preferences for Privatisation Instruments.

Objectives Instruments	Liberalisation	Marketisation	Divestiture*	Leasing	Sale**
Financial	No	No	Partial	Partial	Yes
Efficiency	Yes	Yes	Yes	Yes	No
Equity	No	No	Yes	Yes	No
Administrative	Yes	Yes	Yes	No	Yes
Ideology	Partial	No	Yes	Yes	Yes

Source: Gouri et al., 1991:55; Reddy, 1991:219.
* Divestiture refers to the sale of shares.
** Sale refers to the sale of assets.

5.2.1 Modalities for Financial Gains

Immediate financial gains can be attained from the sale of assets. However, gains from the sale of assets have to be balanced against expenditures which arise in preparing the enterprise for privatisation.[23]

PEs may continue to have ownership and competent control through application of modalities for privatisation for the objective of financial gains. For example, modalities such as contracting-out, franchising, leasing, liberalisation and Build-Operate-Transfer (BOT) are alternatives to divestiture and joint venture, which may improve the internal operation of PEs and produce financial gains (Gouri, 1991a:83; Reddy, 1991:223; Dhiratayakinant, 1991:260-5).

Contracting-Out involves private production of final goods and services on behalf of a PE which must still pay for the production. Contracting-out can also

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23- See the cases of Iran and Malaysia in which a proportion of privatisation proceeds are allocated to preparing other PEs for privatisation.

involve production of intermediate products as well as the turnover of PE management to a private contractor (Dhiratayakinant, 1991:254).

Contracting-out of some PE functions to a private enterprise through competitive bidding is the most common modality of privatisation practised so far (Reddy, 1991:223; Alford and O'Neill, 1994). It has been used widely in the provision of local public services such as refuse collection, catering, cleaning and laundering in hospitals (Hemming and Mansoor, 1988:15). Furthermore, as these are considered less newsworthy services, they can be an integral component of an established program of privatisation as they are in Singapore (Thynne, 1989:52). When the decision is such that all mandatory and subsidiary outputs are to remain in the hands of the PE, all stages of the production process or only those parts of the production process that can be performed efficiently need be carried out in-house.

The common provisions that contracting bring about are often less permanent with the advantage of solving performance problems of PEs without a change in public ownership. With this alternative, production lies in private hands, however decision-making about the parameters of the service to be provided remains with the government. Prager (1992:312) argues that "depending on the precise arrangement of the contract, this technique may be no less efficient than private ownership." In China, for example, the system of contracting has been successful, with many enterprises having achieved better economic benefits (Dongpu 1991:268). The contracting system, in China, means not only employing private contractors for supplying various goods and services needed by PEs, but also contracting the managerial right of the whole enterprise.

Franchising is legally permitting or granting the right to private entrepreneurs to operate a business or to carry out an activity, while withdrawing the public enterprise from provision and the production of the franchised service (Dhiratayakinant, 1991:254). It is an attempt to introduce an element of competition to markets which are unavoidably monopolistic through setting up competition for the market rather than in the market (Bishop and Kay, 1990:252). Franchising, in other words, involves inviting the private sector to compete for the right to operate a monopoly (Hemming and Mansoor, 1988:15).

Franchises may have two forms: *concession* and *affremage*. In concession, the private company constructs the facilities with its own capital, and maintains and operates the system. Under affremage, the cost of construction is borne by government while the private company manages and maintains it (Veljanovski, 1992:49; Kikeri, 1992:48).

Franchising relieves pressures on the PE and the government to mobilise additional financial resources. Franchising helps the PE focus on the remaining operation while providing a certain degree of financial leverage for it to improve the operation of the remaining activities (Dhiratayakinant, 1991:261). It also enables provision of needed new services for an ever-expanding economy. Franchising permits the PE and/or the government to exert some control over the franchisees in a way that protects or increases consumer welfare. By applying franchising, it is easy to compare the quality of output of a regional network and to see how well (or badly) they are delivering what they are contracted to produce. Productive and allocative efficiency can be enhanced in cases where franchises awarded are based on price and service offered rather than on payments made by the franchisee to the government.

Leasing is a temporary turning over of PE assets (land, factory, building) to a private undertaking for a fee (Dhiratayakinant, 1991:254). Leasing is applicable when the PE considers it has idle properties, for example vacant land, unused manufacturing plants, office buildings or idle machinery and equipment. This modality can be carried out by itself or together with other forms of privatisation such as liquidation and franchising. This is an efficient method for generating more income without enlargement of the managerial capacity of the PE (Dhiratayakinant, 1991:161).

Leases transfer greater management responsibility to the private sector. They also provide greater incentives to reduce costs and maintain the long-term value of the assets because the private party assumes the commercial risk of operation and maintenance and pays a performance-based fee to the government (World Bank, 1992: 26). In this method, while ownership remains with the government, control is privatised.

User-charges are introduced as an alternative to the financing of the public provision of selected goods and services out of tax revenue (Thynne, 1989:55, Emmy and Hughes, 1992:444). The users of community services provided under contract may also pay a fee directly to the private enterprise concerned, subject to any limits or conditions which a government decides to impose (Mohammad Ariff, 1991:92).

Build-Operate-Transfer (BOT)

BOT schemes have been used increasingly by governments as a form of non-debt financing of public sector activities through which private contractors finance the construction of capital assets (usually roads), the cost of which is recovered through user-fees. The asset ownership and control revert to the public sector following a pay-back period during which the private sector operator earns the revenue from the asset (Adam et al., 1992:7-8; PMP, 1991:23).

The BOT method is applicable in privatising new projects such as roads and water supply projects. Under this method, the private sector constructs the facility using its own funds, operates it for a period known as a concession period and transfer it to the government at the end of that period.

The Build-Operate (BO) method is similar to the BOT method except that the former does not involve the transfer of facilities to the government. Both methods will be accompanied normally by a grant of licence and/or concession (PMP, 1991:24).

5.2.2 Modalities for Restructuring Public Enterprises (The Aim of Efficiency)

One aim of PE restructuring is to make PEs efficient in terms of the total combination of financial, economic and social efficiency. A central focus of restructuring of PEs is to introduce competition, either through simulation or stimulation of the market for achieving efficiency (Gouri, 1991a:99).

Restructuring can be done through:

> ... rationalising production, increasing prices, improving productivity through staff reductions, tightening up controls, better management of stocks and inputs, reconstitution of working capital, recapitalisation and debt re-financing, improvement to billing and collection systems and procedures, plus internal and external audits (Alexander, 1990:200).

The above framework suggests selecting a suitable modality for the privatisation of a specific activity within an enterprise.

Ownership Transfer: Divestiture

Under ownership transfer, there are different modalities of sale of PEs such as: (i) to a single party, (ii) to the public and (iii) to workers of the enterprise. The first alternative has provoked a general reaction against privatisation. This reaction is first based on the fear of foreign ownership because of the financially weak potential of the domestic private sector. Secondly, there is a fear of replacement of a PE monopoly by a private enterprise monopoly (Gouri, 1991b:245). *Partial divestiture* through equity dilution may present a more acceptable reform. Dilution of equity may be to the public or even to the lower income category of people, as in the Republic of South Korea; to workers; and joint ventures between public and private sectors. In partial divestiture, governments continue to retain a controlling stake. This reform instrument seeks to ensure transparency and accountability of PEs. This advantage is strengthened by public/worker involvement in the functioning of PEs.

For PEs which have low social obligations and low viability, divestiture or sale is the best alternative. In PEs of a competitive nature, retention of efficient PEs makes sense even if their social commitments are low. But for PEs where social commitment is high, the question of divestiture does not arise. Instead, the efficiency of PEs can be promoted by *non-divestiture* options (Gouri, 1991b:247).

If the tendency is towards monopolistic structures, then privatisation serves no purpose. Ownership transfer of PEs to the private sector, in this situation, is not only unlikely to improve efficiency but may result in a concentration of economic power, especially of MNCs. The question is whether a change of ownership really resolves performance problems when social objectives or external factors prevent a competitive market structure. In these circumstances it is difficult to implement complete privatisation.

Modalities for Managerial Restructuring of Public Enterprises

Managerial restructuring is complementary to market development of PEs. Managerial privatisation implies that while ownership may continue within a public system, the board of directors may be backed with the known expertise of the private sector, or there can even be a formal managerial contract under which a private enterprise is placed in charge of the operations and takes the risks and rewards for such operations (Reddy, 1991:222).

In the past twenty years all developing countries have adopted reform programs to remedy PE problems without ownership transfer. Recent assessments of PEs reform reveal that some performance improvements have indeed taken place (World Bank, 1992:4-5). In China, for example, the introduction of a *responsibility system* led to performance improvements in at least some public industrial firms. *Total Factor Productivity* (TFP) in Chinese PEs rose at a respectable 3 per cent per annum between 1984 and 1988 (World Bank, 1992:5). However, it is argued that there are problems in managerial reform initiatives in PEs. These are:

(i) often, well-designed programs fall short in implementation;

(ii) performance improves only when the full package is put in place, and the coordination of numerous reforms is difficult; and

(iii) performance improvements have proven difficult to sustain once the factors and pressures that encouraged the reforms disappear (World Bank, 1992:4).

An important aspect of PE restructuring is the need to provide transparency and accountability in their activities. This clearly highlights their viability as well as achievement of social objectives. To improve the efficiency of PEs, a holistic measure capable of assessing the social, economic, and commercial objectives is needed. Financial criteria are only able to evaluate the commercial objectives. Economic measures of efficiency such as TFP assess efficiency in resource allocation. On the other hand, social objectives of PEs require a blend of economic and non-economic criteria. Thus, on this fundamental basis it is possible to develop a framework for restructuring of PEs through non-divestiture options (Gouri, 1991b:243-4). Major management transfer options can be non-divestiture options, sub-contracting and leasing. Creation of a competitive environment, corporatisation, commercialisation and BOT are other modalities to secure the objectives of managerial enhancement.

Competition Enhancement

Managerial restructuring of PEs is aimed at enhancing or maintaining the efficiency of PEs by emphasising the "enterprise" without sacrificing the "public". However, when efficiency in industry and PEs is the stated objective, it is linked directly to competition and its creation.

Competition needs to be encouraged as a central point of restructuring. It refers to an increase in the number of suppliers in the same product line, the existence of close substitutes and the threats of new suppliers or new substitutes. PEs can be categorised according to the market structure. They can broadly be divided into those which function in a competitive market structure and those in a monopolistic market structure. Competitive market structures include:

(i) those PEs in which competition with the domestic private sector exists;

(ii) those PEs in which competition is international;

(iii) those PEs in which competition is between different units of the PE family (yardstick competition); and

(iv) those PEs exposed to a potential or contestable market structure (Gouri, 1991c:247).

They can also be sub-divided based on social and external objectives. The combination of three dimensions of market structure, efficiency or viability and equity creates a basis for choosing an effective modality (Gouri, 1991a:100). Restructuring PEs for efficiency purposes can be envisaged in the format given in Table 2.10.

Table 2.10: PE Restructuring, Aim of Efficiency.

Ownership Transfer	Management Transfer	Marketisation
Total Divestiture to: 1 Private Sector 2 General Public Partial Dilution of Equity to: 1 General Public 2 Workers 3 Joint Ventures	Partial Transfer of Control on the Basis of Equity: 1 Joint Ventures 2 Changed Participation of Board of Directors Total Transfer: 1 Sub-Contracting 2 Leasing 3 Franchising	1 Distancing 2 Freedom in Transfer of Control - Pricing - Investment - Hiring - Financial 3 Liberalisation and Deregulation of Rules (Cumbersome Ineffective Controls)

Source: Gouri, 1991a:100.

Corporatisation

Corporatisation refers to legislation that changes the legal status of PEs to that of a limited liability company. However, under corporatisation, the shares in the enterprise are still fully or predominantly owned by the government (Toh, 1992:46). It is also associated with creating institutions which emphasise the commercial or enterprise sector versus the government departmental approach to the activities of the public sector. Corporatisation is the first step towards privatisation. It allows authorities greater freedom to operate as business organisations and aims to make assets more suitable for sale to the private sector (Rimmer 1991:140).

Commercialisation and Marketisation

Commercialisation refers to the introduction of commercial (marketplace) criteria as guidelines to decision-making in existing government departments and agencies.

Marketisation is a part of PE restructuring. The most important and the basic condition of marketisation is the distancing of PEs from government. Freedom in pricing, investment, financial activity and personnel policies constitute the essence of marketisation. However, freedom does not mean license or irresponsibility. Marketisation needs to be supported by management reforms. Accountability and transparency provide the required checks and balances (Gouri, 1991b:246).

The critical element of reform in PEs is the move to market pricing where competition is possible, or the development of criteria for monopoly tariffs where competition is not possible. Rules for setting monopoly tariffs at the equivalent level of efficiency prices (prices equal to the economic cost of the last unit sold plus a mark-up to clear the market) are devised (Shirley and Nellis, 1991:10-11).

5.2.3 Modalities for Equity Options

The objective of equity can be divided into two aspects. The first aspect is based on the identification of special groups and focusing attention on them, as happened with divestiture in Malaysia through participation of Bumiputras and in South Korea through the PSP program. The second aspect looks at equity as part of the larger outcome arising from efficiency. When the emphasis is on equity, care is demanded in selecting the modality of privatisation. Thus, privatisation for a reduction of the administrative burden and for ideological purposes is easier to achieve than privatisation for equity improvement (Gouri et al., 1991:57). Privatisation is said to aim at efficiency while public ownership ensures the appreciation of equity. Therefore, by designing "non-divestiture" modalities of privatisation, two aspects are settled. The application of non-divestiture options enables government to insure equity measures and social objectives. Meanwhile, efficiency is enhanced through the establishment of a competitive environment. Therefore, contracting-out, managerial contracting, franchising and liberalisation are included among the modalities to achieve equity objectives (Wanasinghe, 1991:129; Gouri, 1991a:92).

The selection of modalities depends on a proper assessment of equity concerns. Equity is part of the socio-economic dimension of an economy and thus requires careful planning at the three levels of policy making, program, and operations level. The government has an unavoidable responsibility to ensure, in advance, that sufficient regulatory mechanisms are established. Such responsibility inevitably becomes an essential element in any privatisation program (Wanasinghe, 1991:130; Ernst, 1994:115).

Considering the market structure, efficiency obligations and social obligations of PEs, some appropriate modalities are suggested in Table 2.11.

Table 2.11 Differentiation of Privatisation.

No.	Market structure	Efficiency obligation	Social obligation	Privatisation option
1	Competitive	High	Low	Create further competition
2	Competitive	High	High	Non-divestiture options: a: Management transfer b: Marketisation
3	Competitive	Low	Low	Divestiture
4	Competitive	Low	High	Non-divestiture options: a: dilution of equity b: sub-contracting etc.
5	Monopoly	High	Low	Create competition and increase scope for marketisation
6	Monopoly	Low	Low	Divestiture
7	Monopoly	Low	High	Create competition either contestable or by splitting enterprise into different units
8	Monopoly	High	High	Regulate with divestiture option or dilution of equity

Source: Gouri, 1991a:103; 1991b:248.

5.3 Development of Market Structure

Preparation for effective privatisation requires the existence of well-developed capital markets and a supply of local entrepreneurs who are able and willing to participate in the sale process. The reluctance of governments to sell assets to foreign investors is also a reason for reliance on the domestic capital market.

However, capital markets in developing countries are typically weak and unable to help in the transfer of PEs to the private sector. They were not established for the task of privatisation. Public ownership of the large natural monopolies was due originally to the inability or incompetence of the private sector to undertake such large investments (De Walle, 1989:608).

The development of an effective capital market demands an understanding of the requirements of the private sector, the process of flotation of shares, the capacity of such markets and their ability to attract capital investment, and the protection requirements for small investors. The timing of issue flotation is extremely significant. The equity dimension of administrative arrangements for privatisation requires the identification of potential buyers from the lower income section of the people, as in the South Korean case of asset distribution, and the identification of potential buyers from the private sector (Gouri, 1991a:106). This also requires an assessment of the technical and management capability of various firms in the private sector. The financial viability of new partners is also important.

5.3.1 The Domestic Private Sector

Domestic entrepreneurial participation is crucial for the economy of a country. The private sector is an alternative to foreign participation, as it reduces the risk of entry of foreign MNCs which can undermine competition in the market and adversely affect the economy. For example, according to Gouri et al. (1991:56), in the case of privatisation and foreign participation in the Philippines "instead of financial inflows, privatisation resulted in outflows over a period of time through payment of royalty etc."

Some prominent successful economies have established organisations to coordinate the private sector and to direct their objectives towards the aims of the national policies of the government. These organisations have acted as a solution for government failure as well as market failures. One of these organisations is the Ministry of International Trade and Industry (*MITI*) in Japan. MITI is the central headquarters for *Japan Incorporated* and MITI bureaucrats are the visible hands of the government. *Japan Incorporated* calls up the image of a state which is distrustful of *laissez faire* capitalism and reliant on centralised planning and control (Okimoto, 1990; Jomo, 1993:10). MITI has been given the opportunity to advise on a very broad range of policy measures, fine-tuned to meet the needs of specific industries, without having to utilise costly and inefficient measures that undermine industrial competitiveness. MITI intervenes when necessary and provides a structure for government coordination.

In South Korea, large private companies (*chaebols*) and a substantial PE sector dominate the manufacturing sector. But the chaebol is closely controlled by the state, having been facilitated by high debt-equity ratios permitted by the state (Jomo, 1993:309). *Malaysia Incorporated* has also made an effort to co-ordinate the private sector's interests with the government's aims in Malaysia.[24]

5.3.2 Foreign Participation

Sensitivity about foreign ownership exists in all countries, developing as well as the developed ones. Ownership by foreigners and non-resident nationals is often forbidden or unacceptable in many developing countries. Foreign participation on the other hand, is either totally prohibited or confined to some sectors only. These restrictions have also been found in developed as well as developing countries. For example, Japan does not allow foreign purchases of shares in the Japan

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[24]– *Malaysia Incorporated* is discussed in Chapter Three Section 4.

telecommunication company, NTT. Britain, France, Portugal and South Korea also imposed restrictions on foreign ownership (see Hemming and Mansoor, 1988:11; Wiltshire, 1986:354; Cowan, 1990:26 and Jomo, 1993:308).

Governments are sometimes reluctant to transfer control over assets to foreign investors, for political and social reasons. This is especially so for those assets which are considered to be of strategic importance. The Mexican Constitution, for example, requires strategic industries to be state owned and their sale to the private sector is forbidden (Cowan, 1990:26)[25]. In spite of increases in foreign direct investment since the mid-1980s, foreign investment accounts for only 10 per cent of all private investment in 40 developing countries (World Bank, 1992:36).

Many developing countries wish to limit participation of particular groups of shareholders and exclude potential buyers, in order to avoid the concentration of economic power in a few hands. For example, in Malaysia the total percentage of foreigners may not exceed 20 per cent of the total paid up capital of a company. Malaysian Airlines (MAS), as Enick Nasir Zihni (1992:12) states, "could have fallen into foreign control if no restriction on ownership was imposed."

5.4 Careful Planning with Built-in Safety Clauses for Privatisation

Privatisation as a reform policy for PEs is a discouraging option as it impacts on different areas of the economy and society. Furthermore, market failures, which were a reason for the creation of PEs, may be ignored in a disorganised process of

[25]– See also the case of Iran.

privatisation. Built-in safety clauses, however, can assure the community that their expectation will be met after privatisation. Gouri et al. (1991:59) believe that successful case studies (South Korea and Malaysia) reveal that careful planning involves designing built-in safety clauses. The World Bank (1992:29-32) suggests that an appropriate regulatory framework be established to protect consumer welfare and labour concerns instead of merely increasing revenue by selling into an unregulated market.

5.4.1 Planning to Meet Equity Concerns

In developing countries, equity is seen as the essential driving force for reform. The implication is that measures such as raising wages to at least the poverty line is a requirement for raising the efficiency and effectiveness of the public sector (Holmes, 1992:476). Thus benchmarks need to be clearly defined at the early stages of planning for privatisation.

In planning for privatisation, objectives involving equity expectations have to be determined. These objectives also need be considered as part of policy planning and operational planning. Policy planning relates to the introduction of privatisation as an element of economic restructuring of society. It sets the minimum standards, norms, and objectives to be satisfied in any specific act of privatisation.

Operational planning would concentrate on planning at the enterprise level in implementing a certain privatisation exercise. Operational planning here would enable equity guidelines and standards depicted in the policy and the program plans to be transformed into operational realities.

Equity concerns need to be focused centrally at all three levels of decision-making, programming and operations, if equity expectations are to be met. In the first level, equity becomes an integral element in the approaches to and modalities of privatisation. In the second level, equity concerns need to be spelled out specifically in respect to each sector or type of enterprise. In the third level, specific equity considerations should be set out as well as modalities pertinent to achievement of those considerations and the relevance of a particular approach to individual cases of privatisation evaluated in terms of equity concerns. The equity standards and the system for evaluation of the process are to be defined. No country can merely borrow or copy the action steps of another (Wanasinghe, 1991:132-3).

Labour Concerns of Privatisation

Workers are wary of privatisation. Labour's fears of privatisation arise for the following reasons:

(i) loss of jobs, since privatisation is connected to cost-effectiveness;

(ii) protection of benefits already gained;

(iii) effects of privatisation on unionisation and workers organisation (Gouri, 1991a:95).

They fear dismissal either before or after the sale. For example, sale of assets have been accompanied by downsizing of the workforce in countries such as Tunisia, Mexico, Argentina, New Zealand, Japan, and the United Kingdom among others. Therefore workers and labour unions are among the most direct opponents of privatisation, causing governments to delay or postpone privatisation (as in Thailand, Sri Lanka, Bangladesh, and India) (World Bank, 1992:31; Wanasinghe, 1991:128). Therefore, during the transition to privatisation, the workforce may create a considerable degree of conflict.

While programs of privatisation seek to promote competition, improve efficiency and increase productivity, at the same time, there is a concern to safeguard the conditions of work enjoyed by the workforce before privatisation. These should be safeguarded even though they may impede the achievement of efficiency objectives (Wanasinghe, 1991:128). The resolution of these contradictions is a major challenge in any privatisation effort.

In the absence of social security, the impacts of privatisation and rationalisation, as perceived by labour, have to be justly faced and equitable solutions have to be designed (Sankar, 1991:204). There is no choice but to deal with this issue as it is *the equity issue* in many countries. Gouri (1991a:92, 96) suggests a safety net to prevent a forceful representation of labour's interests:
"the issue here is not merely labour's equity but the social justice of a people's democracy through privatisation."

Consumer Concerns

Privatisation has also to be concerned about consumer rights. As citizens, consumers have the right to demand safe and equitable services for public and merit goods such as electricity, transport, education and health services. These rights need not always have legal endorsement, but policy-makers, especially politicians, are concerned more with potential political issues than with mere legalistic structures (Gouri, 1991a:105).

With respect to consumers of goods and services, the public interest concern about PE reform can be answered by:

1) Ensuring that no segment of the relevant customer public is disadvantaged in terms of access to the goods and services provided by the particular enterprise. Equity of access to all consumers is a basic expectation from PEs.

2) Maintenance of a safety net beneath the economically weaker division of society. This can be fulfilled by direct subsidies or cross-subsidisation of services and activities within a PE.

3) A high standard of quality of goods and services provided by the PEs should be available to the consumer (Wanasinghe, 1991:127f.).

Any change in the role of PEs tends to be measured against these benchmarks.

5.5 Monitoring the Impact of Privatisation

Privatisation initiatives with different modalities are being carried out in different countries, whereas assessment of their immediate impact may be neglected. Monitoring the effects of privatisation is important for the following reasons:

(i) involvement of certain social objectives and equity considerations for low income groups in the privatisation program, which demands close monitoring of the results obtained in those areas of concern;

(ii) determining whether efficiency objectives are being met;

(iii) evaluating performance at a central level to assist planning and implementation of subsequent privatisation efforts;

(iv) reviewing mechanisms in certain modalities of privatisation such as contracting out services for the public; and

(v) developing new management information systems for PEs that undertake reforms and restructuring (Gouri et al., 1991:58-60).

Effective monitoring of privatisation programs may not be sufficiently considered during privatisation efforts. This may be because of a focus on privatisation as an end, not a means to national objectives, and/or lack of a feeling of responsibility after privatisation and the transfer of activities or assets to the private sector. According to Sharif (1993:55), no attempt was made to gather even elementary data on the fate of the enterprises privatised between 1977 and 1990 in Bangladesh. Meanwhile, 53 per cent of these enterprises had been closed down and many of them which were in operation were working at less than satisfactory levels.

Another reason for the lack of monitoring of the privatised enterprises may arise from the reduction of the role of government after privatisation. For example, in Britain as Wiltshire (1986:344f.) notes once the privatisation process has occurred, the Public Accounts Committee is virtually unable to monitor the performance of the new enterprises and the same is true for Parliament. In these circumstances the British Parliament has terminated its responsibility as custodian of the public interests.

On the other hand, South Korea is one of those countries in which efforts have been made in monitoring privatisation programs to obtain a continuous assessment of privatised enterprises. The high-powered Management Evaluation Council was established, with the task of setting down the guidelines for the evaluation of restructured PEs (Gouri et al., 1991:60). The performance evaluation task force under the guidance of the Council and with necessary professional and technical resources evaluates the various PEs every year. A major emphasis is placed on an evaluation of the specific achievements of the management, and particularly the achievement of results, including pre-tax profit and interest earned.

In conclusion, in order to implement an effective privatisation program appropriate institutional arrangements must be in place. An administrative and legal system for implementing privatisation is suggested which would provide technical advice using consulting groups and accounting firms. These provisions are required to ease the way for better implementation of privatisation and to make it more attractive to the people. Objectives of privatisation need to be clear and well explained. These objectives identify the specific modality to be applied. The market structure needs to be developed and the extent of foreign participation defined. Built-in safety clauses need to be established to protect consumers, labourers, managers and the whole community. This is especially important as a means to prevent social and political problems which may cause the implementation to fail. Equity considerations too are important objectives of state activity and for the setting up of PEs. Equity cannot be ignored or left to be realised as the by-product of privatisation. It should not be sacrificed for the aim of efficiency, but a trade-off can be established. Careful planning is needed to make privatisation acceptable to the different interest groups, as is establishment of a monitoring system to modify and evaluate the process of privatisation. The next section examines the evaluation of privatisation.

6 EVALUATION OF PRIVATISATION

The privatisation process needs to be evaluated for its relevant gains and problems. Without evaluation, damage may occur to the national economy and its resources. The positive effects of privatisation are said to be financial gains, efficiency, economic growth and equity.

Equity attainment is viewed from two angles:

(i) the benefit from direct equity-oriented programs, as in South Korea and Malaysia; and

(ii) better distribution of increased gains from efficiency measures.

Under this second heading, equity is an essential part of efficiency (Gouri et al. 1991:47).

The problems of privatisation may be those which emanate from lack of properly thought out policy and/or the implementation of privatisation. These problems have been discussed here as structural as well as consequence problems.

6.1 Evaluation of Privatisation Results

6.1.1 Evaluation of Financial Gains

Financial gains from privatisation are associated with reducing the personnel and financial administrative burden of government. Privatisation may increase the revenue base and reduce the budget deficits.

Financial measurements for the evaluation of the results are financial statements in annual reports and indicators such as rate of return, which consists of return on assets (ROA) and return on equity (ROE). The profitability of privatised enterprises is also considered as one of the measurements of national financial gains. However, any study should include other measures such as the enhancement of performance and competition.

Profitability is a financial measurement which does not necessarily measure performance improvements. For example, profit can be obtained by increasing prices in a monopoly situation, or by collusion among producers. In the absence of competition, profitability can be achieved without efficient operation. By raising prices it is quite possible to gain profits and improve financial performance, yet decrease efficiency (World Bank, 1991:26; Porter, 1983:30). Increased profitability with regards to enhanced performance can only be considered where a competitive situation exists.[26]

6.1.2 Efficiency Gains

Efficiency may be gained in different ways. The products or outputs might be produced with minimum feasible resources or without waste (technical efficiency, or x-efficiency), or at minimum cost (productive efficiency). They may also be produced in quantities that match consumer preferences (allocative efficiency) (Bibby, 1992:11; Fischer, 1988:47; Jackson and Palmer, 1988:197; Connolly and Stark, 1992:376).

Technical efficiency embraces the notion of the minimisation of waste of scarce factors. It involves operating on, rather than above, the relevant isoquant. The concept of efficiency is the maximisation of output from any given quantities of the factors of production, or the minimisation of the quantity of factor inputs used to produce any given quantity of output (Bibby, 1992:10; Pruger, 1991:10f.).

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[26]- See "Pitfalls Associated with Asset Sales" (Chapter 2, Section 3.1.1).

Productive efficiency is pertinent to minimising the cost of producing any given level of output. In other words, it is associated with maximising the level of output for any given level of cost. This is done by adjusting factor inputs in response to a change in factor price.

Allocative efficiency is defined as output maximisation with less than equal rise in cost. On the other hand, if cost reduction is accompanied by more than equal reduction in the quality or quantity of the results, inefficiency will increase. Therefore, allocative efficiency is assessed according to the net benefits flowing to or from the economy as a result of the investments in and operation of an enterprise (Nellis and Kikeri, 1989:660; Habir, 1991:63). Allocative efficiency corresponds to the tastes and preference of consumers and takes into account the demand and the supply curves. This suggests that allocative efficiency is a perfect efficiency and is based on consumer benefit as it sets the prices at a level equal to marginal costs (see also Hammond et al., 1986:249-54).

Another type of efficiency is dynamic efficiency, that is the rate at which and the extent to which opportunities are taken up to innovate and to enhance and upgrade a service. (Ergas et al., 1989:39). Dynamic efficiency involves:

> ... exploiting fully and in a timely manner opportunities to enhance the range, quality and grade of service both by implementing new techniques and through improved marketing and product differentiation.

The costs of failing to do so are opportunity (rather than out of pocket) costs[27],

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[27]- Opportunity cost is the value of the opportunity sacrificed, or the benefit forgone, as a result of not employing something in its best alternative use as seen by decision-makers and/or society. It is something which exists in the mind of the decision-maker before the flow begins. This implies that the cost involved in a particular decision loses its significance with the making of a decision because the decision displaces the alternative course of action (Boswell, 1976:76-77).

but they are as real as those arising from other inefficiencies - and in technologically progressive industries will often be greater (Ergas et al., 1989:63). Opportunity costs are measured not in absolute terms, but by reference to foregone alternatives (Nellis and Kikeri, 1989: 660). Table 2.12 illustrates the above discussion.

Supply curves are drawn on the basis of cost minimisation. They involve the idea of productive efficiency. In this way full allocative efficiency automatically implies productive and technical efficiency. However, in a monopoly situation technical and productive efficiency may be satisfied, but allocative efficiency may not (Bibby, 1992:10).

Table 2.13: Types of Efficiency and its Measures

EFFICIENCY	*VALUE FOR MONEY*	PROFESSIONAL VIEW
Productive efficiency	*Economy, Productivity= I/I**	Cost minimisation
Technical or X efficiency	*Efficiency= Y/I*	Waste minimisation
Allocative efficiency	*Effectiveness= Y/Y**	Objective achievement
Dynamic efficiency	*Opportunity*	Opportunity cost

Y= Actual Output; Y*= Planned Output; I= Actual Input ; I*= Planned Input

Efficiency and Competition

There is a strong relationship between the idea of competition and the idea of allocative efficiency. Competitive markets tend to produce efficient outcomes. Shirley and Nellis (1991:7) assert that any enterprise, public or private, operates more efficiently when faced with a competitive market. The incentive of competition pushes firms to develop their marketing skills, pay attention to service, keep up technologically, and control costs.

The role of competitive pressures, as a stimulus to efficiency, is to force an enterprise either to adapt or to cease operation (Prager, 1992:309). When the performance of an enterprise is being evaluated, opportunity cost could be a relevant consideration. If resources are not providing adequate return, then the transferring of the enterprise to the best alternative should take place to provide a net gain.

However, an important point here is that results depend on competition rather than simply the private market. A private monopoly will not generally achieve full allocative efficiency. In a monopoly situation, the monopolist will produce less than the allocatively efficient quantity, while having incentives to minimise the cost (and achieve productive and technical efficiency) to maximise profits (Bibby, 1992:10). Even in markets that are relatively efficient, there may be externalities and barriers to full allocative efficiency.

Regulation is required when a public monopoly is transferred to the private sector. Private providers may reduce or eliminate competition, as competition is not in the best interest of a private provider. Therefore, there is no reason to expect private providers to sustain that competition (Halachmi and Holzer, 1993:36). As a result, the privatised monopoly will have to accept the domination of regulations as a substitute for competition (Hemming and Mansoor, 1988:12). The force of competition should provide the incentive for enterprises to seek out opportunities to increase both productive and allocative efficiency.

6.1.3 Privatisation, Efficiency and Competition

It is obvious that privatisation does not always result in competition. Johnson and Rix (1991:41) point to their experience that the basis for improving efficiency is "better control of these enterprises and better production, distribution and end-use information as the basis for making better decisions about them." Increased efficiency which may follow privatisation stems from a consequent increase in competition rather than from a change in ownership. This suggests that the scope for enhancing efficiency through privatisation may be limited by the extent to which markets can be made more competitive (Hemming and Mansoor, 1988:14; De Walle, 1989:605).

Changing ownership in developing countries is not sufficient or even necessary for enhancing the performance of PEs, nor does competition and regulation policy necessarily guarantee the economic efficiency of a privatised enterprise. Therefore, if the social cost of regulation of a private sector industry outweighs the internal and allocative efficiency gains from privatisation, then it is not obvious that privatisation should be undertaken (Adam et al., 1992:18f.). Both public and private enterprises can operate with equal inefficiency (Prager, 1992:307). In fact, relative efficiency between the two types of ownership depends on the respective costs/benefits ratio so that no absolute judgment is possible.

The main contention of the proponents of privatisation is that it enhances productive and allocative efficiency. Private enterprises are presumed to be more efficient than public enterprises for two reasons. First, their competitive environment improves performance; and secondly, the profit motive encourages their efficiency (Riston, 1991:21).

The critical assumption of the privatisation debate stems from the equation of private ownership with a higher level of managerial supervision resulting in more commercial and more timely financial decisions. This results from the more single-minded profit maximisation objective of private ownership which leads to a higher level of monitoring of management performance, and the institution of more effective forms of incentives. Adam et al. (1992:13) maintain that managerial efficiency can be more directly related to enterprise performance when the owners pursue narrower objectives, thus more efficiency-enhancing contracts can be established.

In relation to the profit motive argument, its pertinence appears to be a matter of faith rather than a matter of fact. In the private sector, owners will be the shareholders and creditors, while the government and the electorates will be the owners in the public sector. It is most reasonable to believe that employees will look after themselves first, while earning enough surplus to keep the owners off their backs (Adam et al., 1992:14; Riston (1992:21).

Privatisation, on its own, is not the entire answer for efficiency enhancement. Improving enterprise efficiency can be achieved by more clearly defining and separating the role of governments, establishing precise and measurable objectives for enterprises, granting them freedom of action and managerial autonomy, yet reinforcing a system of accountability (Alexander, 1990:205). Ownership by itself is rarely the dominant determinant of performance. The influence of the regulatory and competitive environment greatly over-rides the impact of ownership on enterprise performance (Adam et al., 1992:28; De Walle, 1989:605).

6.2 Evaluation of Privatisation Problems

The negative effects of privatisation are more indirect and difficult to quantify, which partly explains their neglect in privatisation programs. For developing economies, as Gouri et al. (1991:47) state:

> the dimension of trade dependence, the entry of multi-national corporations, foreign investment, political instability and social consequences can outweigh the positive gains of privatisation.

Privatisation can be a source of anxiety for the management and employees of target companies. Selling assets at a discounted price will result in complaints by taxpayers. To counter this concern it may be appropriate to adopt a policy favouring small investors (Thynne, 1989:37-8). The distributional consequence of privatisation has also been criticised, where it is a case of transferring the ownership of substantial assets to a select section of the population for less than their true value (Ernst, 1994:1090).

The political and social problems after privatisation are of particular concern in developing countries. For example, the outcome of the Mexican privatisation program has been to concentrate wealth in the hands of a few industrialists close to the government, some with foreign partners. This top-down approach, which is seen as reinforcing the hold of political elites on economic power, has been strongly criticised for making a small group of super-rich industrialists (Brummer, *The Age*, 22 April 1994:21). Privatisation in Mexico has widened the gap between the ruling elites and the lower strata of society despite pious descriptions of the social safety net to be built from the proceeds and budget savings. Bangladesh had similar experiences (Adam et al., 1992:86).

Privatisation has been accompanied by political and social effects in countries which have undertaken radical economic reform within an ideological framework. Gouri et al. (1991:49) assert that the influence of Western countries through foreign investment has had profound social effects.

Privatisation under the external pressure of the World Bank and IMF has often not been effective in small countries. This was discussed earlier in the cases of Sri Lanka and the Philippines where low gains from privatisation have been offset by high negative effects. Malaysia has been fortunate as the IMF pressure has been less strong than in other countries (Gouri et al. 1991:52).

Large countries in responding to internal pressure have been relatively more successful in their attempts towards liberalisation. Gouri et al. (1991:53) point to examples of the large economies of China and India in which efforts to respond to internal pressures allowed for greater freedom of action. The large size of these two economies, of course, permitted greater flexibility. Nonetheless, India and China, which have been relatively successful in their internal policy of liberalisation, are also bearing its negative impacts. These effects are the outcome of a society in transition (Gouri et al. 1991).

Privatisation in many developing countries has failed to meet expectations. The argument for privatisation cannot be simply transferred from industrialised to developing countries. It needs to be adapted to its specific economic environment (Adam et al. 1992:3).

Many reforms required of borrowers by the World Bank were difficult to implement and harder to sustain in both industrialised and developing countries.

Pakistan and Senegal are examples where economic performance has deteriorated instead of improving (World Bank, 1992:v).

Some other problems experienced by ex-socialist countries are:

(i) the legal basis for private ownership is unclear or rudimentary, and the claimants to property rights are numerous and are competing;

(ii) the elaborate auditing, consulting and financial mechanism for preparing a firm for sale must be built from scratch or imported (at high cost);

(iii) the wealth of the domestic population is illiquid, capital markets are virtually non-existent, the banking and credit system may be in desperate shape, and the only domestic buyers are distrusted Nomenklaturas[28]; and

(iv) the vested interests arrayed against privatisation are powerful (World Bank, 1992:43).

Moreover the politicians are afraid of the collapse of much of the industrial base, increasing unemployment, inequities in the distribution of property, and serious socio-political trouble. The costs of inaction and delay are very great, because enterprises receive neither central commands nor adequate market signals. This lack of direction is the worst possible situation (World Bank, 1992:44-45).

Stretton (1987:32) points to the possible consequences of a poorly managed privatisation program. He says that the plan may be simple: spending eight or ten years selling the saleable parts of the PEs for cash, and using most of the cash to cut taxation or avoid taxation increases. The consequence is that the assets will be gone and the prudent leaders will retire. The next government will have to:

(i) cut services or increase taxes to replace the annual cash from asset sales;

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[28]- Members of former elite under communist rule.

(ii) cut services or increase taxes to replace the revenue which the profitable enterprises used to earn for the government;

(iii) increase taxes to pay additional bureaucrats to regulate the new privatised monopolies;

(iv) cope with worse balances of trade and payments as the privatised companies may be enthusiastic to buy from foreign suppliers instead of domestic ones;

(v) cope with a balance of payments problem as foreign shareholders of the sold enterprises transfer their profits to other countries;

(vi) increase taxes or public debt to buy back any of the sold enterprises it proves desirable to return to public ownership;

(vii) either cope with the inflationary and balance of payments effects of trebled or quadrupled foreign debt, if the buyers are financed by foreign borrowing; or

(vii) cope with the social, economic and export competitive effects of a decade of massive national disinvestment (Stretton, 1987:33f.).

Although different factors are involved in developed and developing countries as motivations for privatisation, some similarities exist in consequent problems. For example, in developing countries tax reduction following privatisation is not the reason for privatisation, as it was in UK.[29] Nonetheless, a privatisation program does give additional concessions to buyers of enterprises.

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[29]- In Iran, for example, businessmen readily benefit from tax avoidance schemes and the extent of tax is not comparable with that in developed and even other developing countries.

Dependence on exports of raw material, and the higher profitability of distributive and service activities rather than productive activities, are among the economic problems of developing countries which need to be considered and resolved before creating the additional problems engendered by a privatisation program. Without the establishment of prerequisites, privatisation alone, as McDonald (1993:59) asserts, is "like throwing a person into the water and calling it a swimming lesson". Prudent policy-making requires that a privatisation program targets the resolution of these problems.

6.3 Gradual Reform Versus a "Big Rush"

There is an argument that rapid privatisation prevents the realisation of the specified economic objectives. Kane (1993:173) refers to McKinnon's comparative study of liberalisation undertaken by China in the late 1970s with that undertaken by the former Soviet Union in the late 1980s and early 1990s. During 1989-92, the rapid liberalisation undertaken by Russia as well as by most of the other Eastern European countries has been associated, in almost all cases, with sharp decreases in output, accompanied by high and unstable inflation. In contrast, output in China rose sharply after 1978, and throughout the early 1980s, with low inflation. McKinnon asserted that the reason was that the central government continued to support much of the state-owned industry through low-cost bank loans and other subsidies, with the soft budget constraints that such subsidisation implied and in the absence of competition from a hard budget private sector.

McKinnon argues that the Chinese authorities rightly decided to retain price controls to fix producer prices. Once the cash-constrained private sector became large enough to compete with the old public sector in product markets, the government could relax prices (Kane, 1993:175). Since the government was leaning on the state banking system as a crutch to cover its own fiscal deficits, liberalisation has not extended to the banking system in China. If the government were to throw away the crutch, it would be met with an inflationary explosion of the sort that overwhelmed the former Soviet Union.[30]

In South Korea, the strength of intervention in the financial market by the government was recognised by the World Bank as a key instrument in the government's industrial policy in the 1960s and 1970s. The South Korean government adopted a system of multiple exchange rates with a system of multiple interest rates. Interest rates were controlled and were kept low during most of this period (Jomo, 1993:308).

Adam et al. (1992:4) assert that attempts to carry out rapid privatisation can be counter-productive. This is especially so in smaller developing countries. Speed in selling is seldom contributory to the realisation of the potential of privatisation. Therefore, in practice, implementing this type of privatisation policy has rarely conformed to the expectation of the creditors (Adam et al., 1992:24, 65).

According to Gouri et al. (1991:52), "small economies who have embarked on rapid privatisation under IMF pressure have gained only marginally". In Bangladesh, for example, the government's policy is an example of rapid privatisation. The government responded to the pressures from donor agencies like the World Bank/IMF by rapid privatisation and liberalisation. In this "forced

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30- See Iran's experience of financial and price liberalisation in Chapter Three, Section 6.3.

privatisation" effort, many industries were privatised as quickly as possible without considering future effects on the industries concerned and on the overall economy (Sharif, 1993:54). These agencies did not even consider the country-specific factors such as the readiness of the economy and the viability of the policy. The whole privatisation theme and the World Bank/IMF-sponsored policy imperatives were accepted as axiomatic without any attempt to refine or modify these policy prescriptions.

In summary, privatisation is potentially accompanied by positive results as well as problems. Financial and efficiency gains are the stated aims of privatisation, which are achieved through the reduction of the administrative burden of government. However, these financial gains and the income tax gained from privatised enterprise may turn out to be negative as the potential future earnings of the government are reduced by more than these gains. Profitability cannot be applied as a measure of efficiency only when a competitive environment is dominant. Privatisation, however, does not always lead to competition. Efficiency gains can be obtained by utilising a minimal quantity of resources, by minimising cost or improving quality. Changing ownership is not a sufficient or necessary factor for enhancing PEs performance in developing countries, as privatisation does not always lead to more competition. Thus, when a public monopoly is transferred to the private sector the privatised monopoly has to accept regulations as a substitute for competition. The performance of an enterprise may be influenced more by the managerial capability of the enterprise than the form of ownership.

The negative effects of privatisation are mostly indirect or side-effect problems rather than direct or stemming from implementation failure. Legal and administrative problems and weaknesses in economic management may lead to privatisation failure. Workers, consumers, and the under-privileged may lose from privatisation. Distribution consequences of privatisation, social problems, collusion among the purchasers of assets, and increases in the cost of living can be the consequences of a poorly established and disorganised privatisation program. Governments have a responsibility to consider privatisation procedures in a comprehensive policy-making program. Otherwise, it may be better not to enter a privatisation program. The next section examines administrative and managerial reform in PEs.

7 Reform Other than Privatisation:
Accountability and Managerial Reform in Public Enterprises

It is frequently argued that PEs need a more powerful managerial and administrative discipline than they customarily have. One of the reasons for the privatisation of PEs emanates from this argument. However, it is mostly accepted that the inefficiency and mismanagement of some PEs is not inherently characteristic of these organisations. PEs can be involved in structural, managerial and administrative reform to enhance their efficiency and improve their productivity.

Managerial reform is especially crucial in the privatisation process for financial and economic reasons as some PEs remain in the control of government through partial privatisation. They need managerial reform to achieve the predicted economic and social objectives. The management guidelines that a state undergoing reform should follow:

(i) concentration on implementing a public policy process covering formulation, monitoring, assessment and feedback;

(ii) decentralisation of the state's activities;

(iii) development of a "network" state instead of a "pyramid" state;

(iv) development of capacities for inter-governmental administration;

(v) a flexible organisational model;

(vi) a new public management style (an active management style);

(vii) reassessment of the staff and focusing on the citizen (a system of priority on the distribution of profit to staff, client and shareholders);

(viii) a public corporate culture; and

(ix) recovering credibility of the public sector (which has been eroded by inefficiency and the ideologies that tended to associate the public sector directly with inefficiency (Kliksberg, 1994:188-191).

Managerial and administrative reform, therefore, seems to be necessary for the following reasons:

(i) to provide an alternative to privatisation policy;

(ii) as a new system for implementing the state's new role;

(iii) as a device for improving efficiency and effectiveness of PEs which remain under the control of government; and

(iv) as a requirement for those PEs which are to be transferred to the private sector and need to make managerial changes to change unprofitable enterprises to profit-making ones.

This section examines accountability and managerial reform in PEs and deals with the methods of improving accountability and thus the efficiency and effectiveness of PEs.

The discussion has been focused to illustrate the characteristics and the quality of monitoring and accountability of public enterprises. Administrative reform and its impact on the improvement of the efficiency of various large PEs are also examined.

The principles and theories of public enterprise management have been used when discussing these topics. This should lead to a greater understanding of the principles of different types of accountability and monitoring which can be applied in PEs.

7.1 Accountability and Managerial Reform in Public Enterprises

The concept of accountability implies responsibility to some higher authority, which has the power to demand and force a change in behaviour. The concept of public accountability is used for:

> ... the obligations of persons/authorities entrusted with public resources to report on the management of such resources and be answerable for the fiscal, managerial and program responsibilities which are conferred (Hill e t al. 1989:6).

7.1.1 The Rationale for Monitoring and Accountability

Accountability is a fundamental prerequisite for avoiding abuse of delegated powers; for ensuring that power is directed towards the achievement of broadly accepted national goals; and for ensuring that this is done with the greatest possible degree of efficiency, effectiveness, integrity and care (Forrest, 1983:82; Foley, 1982:26; Gould, 1991:473f.).

While entrepreneurship calls for autonomy, a personal vision of the future, privacy and risk-taking behaviour demands accountability under democratic administration, national participation, open policy-making processes and supervision of operation. Democratic stewardship is concerned with the reasonable use of public trust to achieve both long and short-term goals consistent with a concept of the public interest (Bellon and Goerl, 1991:130-132; Paul 1991:9).

The objective of accountability and monitoring is performance improvement. Accountability and monitoring performance help managers optimise the efficiency of scarce resources by applying necessary and suitable adjustments. From this perspective, according to Cutt (1977:333), accountability entails confirming and verifying that scarce resources have been used in the manner specified. Lack of accountability may cause inefficiency and wastage of resources.

7.2 The Types of Accountability

Accountability is a means of examining the performance of PEs as well as other government institutions. Increasing attention has been given to raising the quality and quantity of public services by reforms in PEs directed at achieving greater efficiency and effectiveness.

Administrative reform in PEs usually involves three strands: reform for a more efficient administration; reform for a more democratic administration; and reform for a more equitable administration (Wilenski, 1986). In this regard Paul (1991:7) points to three types of accountability, viz. professional accountability, democratic accountability and legal accountability. Professional accountability refers to the experts who are guided by their professional norms to be accountable for the service they provide. Criteria of accountability here are influenced by the norms internally agreed upon by professionals acting on behalf of the public (Paul, 1991:8). Democratic accountability refers to the accountability of government (ministers, the bureaucracy and its constituent parts) to the political leadership of the country for its actions and performance. Legal accountability is associated with the public's rights to seek information from government, and the right to sue individual civil servants and public agencies in law courts to make them liable for violations of the public interest (Paul, 1991:9). Except for legal accountability, the primary focus of accountability has been on internal means of control.

Accountability for prudent financial management, for efficiency and for effectiveness can be achieved by reforms other than changing the ownership of PEs. Three types of accountability - financial accountability, efficiency accountability and effectiveness accountability - are explained here.

7.2.1 Financial Accountability

The first level of accountability is financial or fiscal accountability. It is defined in terms of the actual expenditure of funds and procedures by which that expenditure is accounted for. It is also called ex-post auditing. That, according to Cutt (1977:334), is monitoring after concluding the activity. Financial accountability is concerned with inputs such as money allocated or collected rather than with outputs or performance. It deals more with procedure than "value for money" (Cole, 1988:226; Scambler, 1992:5). Indicators for financial accountability include measures for financial performance of PEs. For example, financial statements in annual reports include profit and loss; balance sheet; funds flow; bills, etc.

Financial performance of the government can be addressed in a number of ways. One way is to look at aggregate outcomes in terms of receipts, outlays and budget deficits or surpluses. Another way is to look at the impact of government policies on the overall growth rate of the economy and on the rate of return on investment (ROI) in the private sector.

For PEs matters are somewhat simpler. Financial performance is usually assessed by looking at the financial results of the enterprise. These measures usually include Return on Assets (ROA) and Return on Equity (ROE) or returns on capital. These measures are then compared with returns elsewhere in the economy (EPAC, No.44, October 1990:68). The operating environment also usually needs to be taken into account.

Profitability is one of the indicators for the evaluation of financial performance of PEs. Profitability may not be a primary aim of public enterprise. However, some commentators regard profitability as being just as important as it is in the private sector. Success or failure, in their view, is measured in profit terms (Ramanadam, 1984:160). Efficiency demands regaining full costs with a reasonable amount of profit in a competitive environment.

On the other hand, the profitability measure is not sufficient for evaluation of performance. Profitability is only one criterion used for evaluating public enterprises. It is an unreliable measure of the efficiency dimensions of public ownership. Efficient firms are profitable, but so may be inefficient ones. This occurs where PEs or private firms, for that matter, control the market, so that they dominate the supply and thus the pricing of their output. Therefore, profitability may mask inefficiency (Prager, 1992:305, 316; Porter, 1983:30).[31]

Competition pressures may force an enterprise to either adapt or stop the operation. Opportunity cost could be a relevant cost when evaluating the performance of PEs and decision-making about their transformation to the best alternative (Prager, 1992:309).[32]

Performance indicators, based on the objectives, are instruments for achieving accountability. Publication of objectives, operational performance targets, and reporting of outcomes are seen as powerful instruments to better accountability (Scambler, 1992:6). Other accountability mechanisms include questions in parliament, scrutiny by the auditor general, public meetings, parliamentary committees, expert ministerial advisers, and publication of ministerial directions.

7.2.2 Efficiency Accountability

The second level of accountability is "efficiency accountability" and is achieved by monitoring performance management and operational efficiency measures.

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[31]- See Section 6, for explanation.

[32]- See also Section 6.

As stated in the previous section, public enterprise outputs, as well as private sector outputs might be produced with minimum feasible quantities of resources or without waste (technical efficiency, or x-efficiency), at minimum cost (productive efficiency) and in quantities that match consumer preferences (allocative efficiency) (Bibby, 1992:11; Fischer, 1988:47; Jackson and Palmer, 1988:197; Connolly and Stark, 1992:376).

In the public sector, different expressions are chosen for efficiency improvement. Three elements of value for money are as follows:

(i) Economy, which is concerned with minimisation of the cost of resources obtained or used, having considered an appropriate quality.

(ii) Efficiency is concerned with the relationship between the output of goods and the resources used to produce them. How is the maximum output achieved for a given input, or minimum input used for a given output?

(iii) Effectiveness is concerned with the relation between the expected result and the actual results of projects, that is, the extent of success achieved by the outputs of goods, services or other results in attaining policy objectives (Bibby, 1992:11; Reid, 1992: 84; and Jackson and Palmer, 1988:207).

These three aspects of "value for money" are the same as the three aspects of efficiency.[33] Economy is the same as productive efficiency or cost minimisation. Efficiency is the same as technical efficiency, x-efficiency, or waste minimisation. Effectiveness is the same as allocative efficiency, or the economist's view of matching output to choices of consumers. Dynamic efficiency is pertinent to the rate at which and the extent to which opportunities are taken up to innovate and to

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[33]- See Section 6 for explanation.

enhance and upgrade services. Table 2.12 illustrates the different types of efficiency measures.

Efficiency is an important criterion in public sector activity, especially in circumstances of greater demand and less resources. However, efficiency considerations should not outweigh criteria such as equity, freedom and security (PSMI, 1991:132). Efficiency is not an end in itself, but needs to be related to the achievement of desired outcomes such as equity.

Efficiency accountability is difficult to pursue in large segments of PEs - especially in those which do not produce physical outputs of any kind, or at least physical outputs which are directly related to the organisation in question. However, in the performance-oriented phase of budgetary evolution, input expenditure is specifically related to outputs of public programs defined in physical terms. It emphasises that the budget is based on functions or programs.

Efficiency Measurement (Productivity)

Most economists in their analysis of an enterprise's efficiency use a variety of partial measures. Productivity is a ratio of some measure of output to some measure of input use. An increase in productivity means obtaining more output from a given input or combination of inputs. Productivity measures are used as an indicator of efficient resource use in a PE, firm, industry or economy. Efficiency accountability, as Cutt (1977:335) defines it, is the ratio of some physical measure of output from the activity or program to the cost of that activity or program, which also indicates productivity.

Typical inputs may be labour, capital, materials and energy. Each of these may be difficult to measure, particularly when any input, such as capital, is subject to changing quality and price. There may be also alternative ways of estimating the capital stock, dealing with price changes over time (EPAC, No.42, May 1990:26). From the many possible measures, economists would choose the most useful indicator to answer a particular requirement for information.

Effective measures for evaluation of efficiency include the capital/output ratio, output per employee (labour productivity), cost per unit of output and a range of financial indicators (such as profit to equity, and equity to debt ratio). For example, labour productivity, with labour input measured either by numbers employed or total hours worked, is an accurate estimate of labour input per unit of product. However, Johnson and Rix (1991:129f.) argue that none of these measures, of themselves, provide a single accurate measure of efficiency of an enterprise, although they can provide a rough guide. The reason is the different domestic and external factors with which each enterprise is involved. For example, there exists variation in the age structure of fixed plant, type of fuels, and technologies used, in the impact of geography and in the regulatory environments. Two implications are drawn from the above argument as follows:

> Aggregative enterprise measures are suspect and tell little about a diverse individual enterprise's efficiency. It also suggests that there [is] a range of causes quite separate from ownership, which contribute to inefficiencies (Johnson, and Rix, 1991:131).

The solution to this problem is the construction of a measure of output per unit of total input as a ratio, instead of partial factor productivity measures. A meaningful analysis of productivity should consider information on total factor productivity (TFP). TFP is a measure of total output produced per unit of input. It is obtained by dividing the total output index by the total input index (Hensher, 1992:434f.). Total factor input is an index of fixed proportions of capital and labour determined by their contribution to final output (TFP) (Johnson and Rix, 1991:130; EPAC, No.42, May 1990:26).[34] Therefore, increasing the level of efficiency (TFP) is accomplished through improvements in the quality of capital and labour, and better organisation (improvements in technology or use of resources). Multi-factor productivity (MFP) which takes all factors of production into account has also been introduced as a more accurate measure (EPAC, No.42, May 1990).

Economy, efficiency and effectiveness are components of value for money. Where they can be measured directly, they are called performance "measures" but where they cannot be, it is possible to construct performance "indicators". The types of indicators that are used in PEs are categorised as volume of activity, operational performance, financial performance, and quality of services[35] (Jackson and Palmer, 1988:206f.).

Efficiency and Competition in Public Enterprises

PEs must be able to respond appropriately if they are to become more efficient through exposure to competitive pressures. Nonetheless, the condition of PEs will

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[34]- Productivity measures have also been suggested for managerial restructuring of PEs as non-divestiture modalities of privatisation. See Section 5.

[35]- Volume of activity indicators include such items as mileage; number of customers or clients; number of buses, trains, aircraft etc.; passenger journeys; passenger miles; production tonnages.

Operational performance indicators include number of staff per customer or client; and cost per unit of output.

Financial performance indicators include operating margins; sales per employee; sales related to costs; revenue per bus.

Quality of service indicators include waiting time for services; percentage of late trains; and first class postal delivery success rates.

deteriorate under competition if:

(i) the enterprise managers are bureaucrats rather than businessmen and have never developed marketing or financial management skills;

(ii) the enterprises are not allowed to cut costs through layoff and closure; and

(iii) the capital base of their firm has deteriorated as a result of government pricing policies and the firm cannot collect on its accounts (Shirley and Nellis, 1991:7).

In these circumstances losses will worsen, increasing budget bleeding and potentially creating a backlash against further reforms. This is the circumstance most developing countries face. Enhancement of a PE's ability to respond to competition depends on improving its institutional environment and its management.

There is no reason to believe that the product mix produced by a private monopoly is valued more highly by consumers than that produced by a public monopoly. In such cases no improvement in allocative efficiency is likely to emerge from privatisation. The scope for improvements in efficiency relates primarily to what can be done to enhance productive efficiency (Hemming and Mansoor, 1988:12).

One way to improve efficiency, in monopolies and large industries that include natural monopolies, is through administrative improvement and employee participation. Johnson and Rix (1991:148) argue that privatisation proposals are based on economic theories of the benefits of competition that show little appreciation of the dynamics of the real world, where large organisations operate in industries that are characterised by a high level of natural monopoly. The urge of competition should provide incentive for enterprises to seek out opportunities to increase both productive and allocative efficiency.

Competition and Contestability

Contestability is a process of comparing the competitiveness of a service or project with others on criteria of quality and cost. Baumol et al. (1982) maintain that the threat of competition or contestability is sufficient for a monopolist to operate in that situation. The theory of "contestable markets" identifies the conditions required to ensure that firms operate efficiently both in terms of managerial or cost-reducing efficiency, and welfare-improving pricing and investment.

> A contestable market is one in which any firm is continuously exposed to actual or threatened competition from efficient producers who can enter the market at low cost, undercut the incumbent's price and acquire market share. The threat of this profit-reducing competition is thus the spur to efficient operations by all firms in the market (Baumol, 1982 cited in Adam et al., 1992:17).

It is the fear of entry that forces the monopolist to keep prices close to costs (Hemming and Mansoor, 1988:14). Some PEs will be able to meet competition objectives only with budgetary support (soft-budget). There may be obligatory reasons why this support should continue where an enterprise has social obligations or where it serves strategic interests. Otherwise, it seems appropriate that commercial considerations should determine the viability of such enterprises (Hemming and Mansoor, 1988:12; Prager, 1992:309).

The World Bank has supported a range of measures designed to expose PEs to greater competition. These include the reduction of barriers, price liberalisation, and the end of monopoly rights (World Bank, 1991:25). One reason for exposing enterprises to market forces is to permit them to raise their prices and tariffs to levels that allow cost recovery (World Bank, 1991:26). However, in monopoly PEs raising the prices does not necessarily result in efficiency gains; indeed it is quite possible to improve financial performance yet decrease efficiency. This idea of raising prices is contradictory to the usual reason for exposing PEs to competition as it is supposed to prevent them from raising prices, as they can easily do when in a monopoly situation.

7.2.3 Effectiveness Accountability

The third type of accountability is termed "effectiveness accountability" and is determined through effectiveness or program monitoring. Effectiveness may be broadly defined as the degree of success in achieving objectives. Program effectiveness ensures that employed resources better meet program objectives (EPAC, No.44, October 1990).

The two concepts of efficiency and effectiveness are clearly related. However, as Cutt (1977:337) believes, they need not always agree. For example the objective of production of excellent graduates may be different from the objective of enrolling a large number of students. The reason is that effectiveness means considering both increase in quantity and cost minimisation while maintaining the quality of the output. This means that if PEs are to be held accountable, measures of accountability must shift from an input-oriented base to an outcome-oriented one (Bellone et al., 1991:131).

Program budgeting is an example of output-orientation. It is based on effectiveness accountability and is distinct from line item or input budgeting. Program budgeting may involve defining objectives, designing alternative systems to achieve these objectives, and evaluating these alternatives in terms of their effectiveness and cost. Evaluation results have an important role to play through improving the management and performance of programs, the quality of decision making and the public accountability of program managers (EPAC, No.44, October 1990). The objectives of government programs need to be reviewed regularly to ensure that they remain consistent with the priorities of the community. It is important to ensure that programs are well targeted and implemented with the least cost once objectives are agreed.

7.3 Measurement for Monitoring Performance

7.3.1 Spreading Responsibility

In some developing countries excessive autonomy has become more important than control of management misconduct. It is apparent that accountability is meaningless without autonomy. The owners of an enterprise cannot hold managers responsible for performance unless the managers have the freedom to decide. But autonomy without accountability is license[36] (Shirley and Nellis, 1991:26). The challenge here is to establish a delicate balance between autonomy and accountability.

Accountability is linked to performance assessment. According to Stewart and Kieron (1992:505), if managers are to be in greater control over the resources required to achieve targets, then they will be held accountable for their performance. There is a specific emphasis on performance assessment and performance indicators which can serve as the basis for a correlation table of performance. A proven way to hold public enterprise managers accountable is to

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[36]- This is later discussed in the case of Iran.

separate the factors that are within their control and then let them know they will be judged according to changes in these variables (World Bank, 1991:30).

Monitoring of management performance is likely to be difficult because of the uniqueness of most PEs in respect to their management functions. Managers are facing administered prices, social welfare obligations, and political interventions. Nonetheless, the difficulty of monitoring should not prevent them from providing an estimate of distinct efficiency ratios or criteria. To neglect management efficiency and set criteria for financial performance, as Officer (1983:23) believes, will encourage the enterprise not to meet financial standards. Without a good monitoring and evaluation system, government is in the dark about the effects of its enterprises (Shirley and Nellis, 1991:45).

7.3.2 Conditions for Successful Performance

What determines successful performance and what difficulty is there in achieving performance improvement? The need for setting clear objectives is one of the factors determining successful performance. Nonetheless, setting objectives is not a sufficient condition. The difficulty lies in achieving objectives especially in PEs which are involved in attaining a variety of goals. It is argued that governments always pursue non-commercial objectives through PEs for political ends. The existence of many examples of PEs which are required to pursue commercial goals is evidence of a contradiction. The presence of non-commercial objectives may be indicative of poor management at the political level, rather than a natural feature of all public ownership. The removal of non-commercial objectives may be a necessary, but not sufficient, condition for altering the objective function of governments (Adam et al., 1992:14).

For the purpose of clarification of objectives, Wettenhall (1987:45) proposes the separation of commercial and social elements of an industry's operation and to deal with them accordingly. His propositions are:

(i) that clear lines should be drawn between the commercial and social elements of an industry's operation;
(ii) that social obligations should be restricted to matters covered by specific political directives; and
(iii) that the managing corporations should recoup the losses in revenue or extra costs resulting from the central treasury.

Those PEs which have social obligation can reasonably be expected to cover costs and this should not be to such an extent as to prevent the balancing of revenues and expenses over a period of a year. They can use a *break-even principle* (Wettenhall, 1987:45; see also Hemming and Mansoor, 1988:12; Prager, 1992:309).

Social welfare measures that many PEs may provide as part of their trading activities should not be seen as a negative while appraising their performance. They should be estimated and included as part of the return on capital provided by the enterprise. They should also be highlighted in the enterprise's statement of account. In this way the extent of subsidies, as Officer (1983:24) suggests, will be identified separately and will come under regular review to ensure that they are in the public interest.

Performance improvement requires certain pre conditions. Habir (1991:65) refers to Jones' prescription (1983:8) that the superior unit should:

(i) set objectives;
(ii) evaluate performance according to those objectives;
(iii) reward and penalise the chief executive officer according to that evaluation;
(iv) appoint the chief executive officers;
(v) provide resources (finances);

(vi) conduct long-range planning and co-ordination among units; and
(vii) do (almost) nothing else.

Enterprise management will perform better if there exists a clear idea of what is expected to be achieved, and if it is then given sufficient autonomy to perform, yet held accountable for results. This implies, at the beginning, clarification of goals and objectives, agreement on the means and level of autonomy, and a process of monitoring and performance evaluation to assess whether objectives are met. This would then be followed up by appropriate rewards and sanctions to managers and staff (Alexander, 1990:201).

For PEs involved in commercial activities, the rate of return on capital is a useful performance measure. However, it is not a sufficient measure when PEs are not operating in a competitive environment. Therefore, this measure must be used with other types of performance measurements used in financial audits, which assesses the internal management without resting its case simply on financial performance. What can serve as a standard is the opportunity cost of a project, i.e. the consumption forgone as a result of the capital being used in this project rather than being put to an alternative use.

Yardstick competition is also a useful measurement to evaluate the performance of public utilities. It proposes that the economic performance of each utility be compared either to best practice, or to some weighted average of the performance of all utilities (Veljanovski, 1992:50). This information can in turn be used to guide regulatory intervention or assist in setting price controls on monopoly utilities. According to Yarrow (1992:63), yardstick competition is not a genuine form of competition, but an approach to regulation. It requires that allowable prices for a given distribution company be set with reference to performance data from other distribution companies.

7.3.3 Performance Contracts

Performance contracts are the main tools to improve autonomy and accountability. Performance contracts have been applied in France, Pakistan and South Korea, as a system of performance evaluation. Through contracts, the process of mutual specification of obligations and responsibilities is being applied in selected enterprises between the government (as the owner) and the enterprise. The World Bank has also advocated performance agreements or *contract plans* as a mechanism aimed at establishing an appropriate balance between autonomy and accountability. They seek to clarify PEs' responsibilities and obligations, specify enterprise objectives and performance criteria, and provide a sound basis for planning investments (World Bank, 1991:27). The early experience with performance evaluation in Pakistan and South Korea shows that even technically flawed indicators seem to improve efficiency, and clearly raise the attention paid to performance by both management and government (Shirley, 1991:45f.; Alexander, 1990:201).

Competitive tendering in contracting-out is one of the mechanisms sometimes used to decide on the agency to be used for service delivery (EPAC, No.44, October 1990:33). A lack of competition in tendering and the costs and problems associated with specifying contracts and in supervising private contractors are problems of contracting-out. The benefits of contracting-out are the effects of competitive pressures on cost control, specialisation, economies of scale, and increased flexibility to meet demand peaks (EPAC, No.44, 1990:33).

7.4 Measurement of Managerial Performance and Accountability

PEs do have special problems of accountability deriving from their positions between the true ministerial department and the private sector, and generally it has been easier to ignore these problems. For example, ministers may become involved when there is the prospect of political gain, rather than to ensure proper accountability. McCarthy and Spall (1992:9) indicate that "politicians are the ultimate controller of administrative systems, and one of their chief problems is to maintain and show the reality of their control."

A variety of revisions are required to ensure proper accountability and thus ministerial and executive control. These include:

(i) standard legislative control;
(ii) the use of policy as a mechanism for control and direction;
(iii) legislative provisions for accounting, auditing and reporting standards;
(iv) maintaining parliamentary scrutiny by committees and other bodies;
(v) improved co-ordination and decision making where it relates to other government activities; and
(vi) defining the relationship between ministers, executive and parliament (McCarthy and Spall, 1992:9).

The focus on the reform of public bodies has shifted to the three types of accountability. However, financial accountability has dominated the other two measurements of efficiency and effectiveness. To implement managerial reform in PEs, all these three measures should be judged significant. To improve efficiency and effectiveness accountability of PEs, *new managerialism* discussion suggests the techniques to be implemented.

7.4.1 New Managerialism - Corporate Management Techniques

A new set of concepts, already prevalent in the private sector, are being applied in the public sector and PEs. They include: objectives/strategies; corporate plans;

strategic management; adaptive decision making; flat organisational structure; financial management systems; program budgeting; corporate identity marketing; performance evaluation and monitoring; management incentives; competition; world best practice;[37] total quality management;[38] networking;[39] management information systems; technology; benchmarking;[40] enterprise bargaining;[41] education; communication; and commercialisation of internal services by contracting-out.

These concepts are constantly being changed and new "innovations" are being developed (McCarthy and Spall, 1992:8). These techniques are most

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[37]- Best Practice is a way of reaching industry specific targets for performance improvement. The value of this approach in focusing discussion and action on key problem areas, seems immense (Russell, 1992:6).

[38]- Total Quality Management is a technique by which a quality culture for international competitiveness is created (Russell, 1992:6). It seeks continuous improvement in the quality of performance of all processes, products and services of an organisation. TQM encompasses principles as follows:
* everyone in the organisation serves a customer
* process and product improvement should be continuous
* systematic measurement techniques should be used
* all employees are involved in product and process improvements
* if you improve the process then product improvement follows
* whenever there is a problem in an organisation, 85 per cent of the time it will be the system (general cause) and only 15 per cent of the time will it be the worker (special cause) (Brown, 1992:60f.).

TQM has been introduced in Malaysia as a device for efficiency improvement in PEs (See Chapter Three, Section 7).

[39]- Networking involves identifying areas where organisations in related fields can find new ways of co-operating and working together, instead of struggling on in isolation (Russell, 1992:6).

[40]- Benchmarking is the process of comparing one's own works, services, and practices against those of other organisations recognised as being the best at a particular function. It is not simply an exercise in measurement, but a continuous learning process that allows the organisation to improve its performance to meet and exceed the standards of the best (Municipal Association of Victoria, 1994:2).

[41]- Enterprise bargaining is an opportunity for negotiation between employees and employers on how to retain and improve the quality of services. It is an opportunity to involve the workforce in understanding the need for productivity, to guarantee the future of the enterprise and a quality customer service (Municipal Association of Victoria, 1994:43).

promising, with clear public business applications (Russell, 1992:6).

The other area of reform embraces the concept of equity in the performance of PEs as a goal for management. Efficiency may be sacrificed for welfare or political stability motives. Economists realise that masking the costs of PEs may be politically beneficial, but it leads to poor economic decisions.

Nonetheless, the introduction of corporate reforms needs to be balanced with fairness and equity to staff and customers. Failure to address these issues will lead to industrial unrest and electoral effects. According to McCarthy and Spall (1992:10), the types of reform that should be examined cover the following areas: (i) protection of individual staff rights such as merit principle/security of tenure;[42] and equal employment opportunities; (ii) protection of consumer rights; consumer service obligations; (iii) responsibility to staff; and (iv) responsibility to the clients.

7.5 The Constraints of Ministerial Accountability

There is a concern that the cost of improving accountability could be greater than the claimed benefit (Forrest, 1982:83). Criticism is often expressed by advocates of competitive neutrality who claim that burdensome reporting regimes put PEs at a competitive disadvantage compared to private industry. This is a matter of confusing the separation of objectives with accountability (Scambler, 1992:2-10). Given a set of corporate objectives, any organisation should attempt to achieve those objectives. In doing so, management practice requires that relevant

[42]- Security of tenure means secure tenure of a job. Academics for example, may have tenure when they are granted secure employment till the end of their career.

performance information be generated and employed. The reviewing and publication of this information should not add significant costs to the organisation. Reporting on workforce issues, for example, may be an additional requirement over the private sector, but merely reflects the additional objectives assigned to PEs. As long as an objective remains, the accountability for achieving it must be maintained.

Some requirements are necessary to the function of accountability. It is obvious that, if parliaments are to carry out their responsibility of scrutiny on behalf of the public, they must be made aware of what they are to scrutinise. Without an immediately accessible and reliable register, the accountability of these government companies is flawed.

The other consideration is that the incentive to eliminate waste in PEs is less intense than in private ones. Soft-budgeting may assure a guarantee for unstable financial situations to cover losses (Prager, 1992:309). An audit is not a service to management, it is an audit of management. It is the sole privilege of the shareholders to choose the auditors. If current practice makes this impractical in the private sector, so be it. But Parliament represents shareholders of government companies and already has its own auditor (Coates, 1990:11). An audit is not an instrument of control, it is an instrument of accountability. The greater the degree of management freedom, the greater is the requirement for accountability. There is no point in being told that information is already available (Coates, 1990:9).

There is a concern about the requirement for human resources and their training. It is said that "to make public enterprise accountable, a minister requires staff and other resources to monitor the public bodies' activities and provide independent advice" (Russell, 1982:43). This indicates the significance of the objectives which may justify the cost of human resources and their training, otherwise as Russell (1982:40) comments, extensive privatisation would reduce the scope of public body accountability.

The alternatives to direct control include combinations of general directions; an exclusive list of organisation functions; and regulatory control (Scambler, 1992:3). The obvious method for improving accountability is to establish mechanisms to ensure that each major component of an enterprise reports in a meaningful manner to the next highest level until finally government reports to Parliament.

In summary, PEs need powerful administrative and managerial discipline to resist the pressure of privatisation. Accountability and managerial reform of PEs are advanced as alternative reform initiatives to privatisation. These are necessary in order to prevent dysfunction of PEs. Even those PEs which are to be privatised need to be corporatised and marketised before privatisation can take place. Hence they have to endure managerial discipline. The establishment of an effective system of accountability is essential as it clarifies the responsible persons, the extent of their responsibility and the deserved reward or penalty that the policy-makers and decision-makers may receive. Administrative and managerial reform demands that an accountability system be established to ensure sound finances, efficiency and effectiveness of PEs. Competition is a prerequisite for the profitability to be of significance as an indicator of efficiency improvement. Yardstick competition and international measurements such as world best practice, benchmarking and networking are some techniques that have been advanced for efficiency improvement in PEs. Performance contracts have been advanced as a mechanism aiming at establishing an appropriate balance between autonomy and accountability. There are also indicators for productivity such as capital/output ratio, cost per unit of output and total factor productivity (TFP) for PEs. Accountability and monitoring management actions are criticised as being too expensive. However, when establishing equity objectives, a cost benefit analysis can be useful to evaluate the projects in terms of maximising the national income.

On the other hand, privatisation has produced wide ranging effects which are not sufficiently appreciated. This is due, partly, to the origins of privatisation in Western capitalist economies where the emphasis lies within the narrow confines of ownership transfer. As far as the objectives of efficiency, effectiveness and equity are concerned, some managerial alternatives have been introduced as privatisation modalities without transferring ownership. Thus, a specific boundary cannot be drawn between accountability and managerial reform initiatives on the one hand and privatisation alternatives without ownership transferring on the other. These could be complementary alternatives in a broad range of reform of PEs.

CHAPTER 3

MALAYSIAN PUBLIC ENTERPRISE REFORM

Malaysia is considered to be a pioneer and model of public enterprise reform amongst developing countries and is one of the first countries in the developing world to adopt a national privatisation policy. Bruton et al. (1992:3) point out that Malaysia has been the subject of several book length studies of economic development and income distribution during the past decade. The privatisation program and the sale of substantial public assets have been among the most extensive undertaken by any country in the world. Therefore, its experience provides useful lessons for privatisation programs elsewhere.

This chapter examines Malaysian public enterprise reform. In order to examine this topic, the first section analyses the socio-economic and political environment in which PEs operate. To provide a wider perspective, the economic structure and the nature of the public sector are analysed in Section Two. This section also considers the structure and role of PEs in the Malaysian economy.

Motives for reform in PEs in general and privatisation in particular are examined in Section Three. This section includes an examination of internal, external, and ideological factors. Policy-making for privatisation follows in Section Four, which examines the process and the provisions which have been considered for implementing the privatisation program. Section Five examines privatisation implementation. In this section the application of policies and theories in the practice of privatisation are analysed. Evaluation of privatisation comes in Section Six, where the performance of privatisation and results and problems are examined. Section Seven examines the feasibility of the alternatives to privatisation. It also examines the rationale and procedures for managerial and administrative initiatives needed to make PEs accountable in order to direct them towards the government's social and economic objectives.

1 Socio-Political and Economic Environment

Socio-political and economic factors have influenced the performance of PEs in Malaysia in significant ways. In order to have a better understanding of the nature and the extent of their impact on public enterprise reform, this section analyses firstly, the impact of the ideology and culture of the country on the role of government and individuals, their effect on conceptions of law and public authority, legal and political traditions, and the measures used by governments in attempting to manage the economy; secondly, the political environment in which PEs operate; and finally, the historical process of the economic reform environment.

1.1 Social Environment

Malaysia covers an area of about 336,700 square kilometres[1] occupying the Malay Peninsula (West Malaysia) and the states of Sabah and Sarawak in the north-west

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[1]- I have relied on Dixon (1991) here; Ariff (1991:195) however, says that Malaysia covers a land area of 329,293 sq. km.

of Kalimantan (Borneo Island). The pre-colonial linkages have had a considerable influence in the islands of South East Asia and the Malaysian Peninsula. The Arab Muslim merchants visited South East Asian ports from, at least, the seventh century AD. The Chinese and the Indians arrived later. However, the spread of Islam into Java and the Malaysian Peninsula occurred mostly during the fourteenth and fifteenth centuries (Dixon, 1991:45). These three groups had the most significant influence on Malaysian social structure after independence in 1957.

Similar to other developing countries, the pattern of income distribution in Malaysia is differentiated. There are rural-urban differences, educated and non-educated differences, and the relative importance of one language compared with another. For example, members of the Malay community are more represented in those categories that are judged to be disadvantaged (Bruton et al., 1992:196).

1.1.1 Ethnic Groups

Since the eighteenth century and until independence in 1957, Malaysia was a British colony. The British introduced rubber planting and large-scale tin mining into the country and then encouraged large-scale immigration of Chinese and Indians to meet the labour needs of these industries. This has created a multi-racial society where the Chinese settled down mainly in the urban areas engaging in tin mining and service activities; the Malays (Bumiputras)[2] in the rural areas engaging in their traditional farming activities, while the Indians were employed mainly in the rubber plantations (Onn, 1986:1).

2- Bumis, or Bumiputras, literally the sons of the soil, include the Malays and the tribes of Sarawak and Sabah.

The population of Malaysia is estimated to be 18.6 million of which about 60 per cent is Malays and other indigenous groups, 31 per cent Chinese, and the remainder largely Indians (World Bank, 1991a:331, World Bank, 1993:64; Cooper and Lybrand, 1994:34).[3] The population is divided into Bumiputras and non-Bumiputras (non-indigenous people).[4] Bumiputras are economically more backward, while the non-Bumiputra, particularly the Chinese, are mostly engaged in the modern sectors including manufacturing, commerce, and finance and are more affluent. According to Ariff (1991:195) economic imbalance had affected the racial harmony and political stability of the nation and resulted in the formulation of the New Economic Policy (NEP) in 1971, to redress the problem of ethnic inequities.

1.1.2 Culture and Tradition

The majority of the members of the Malay community follow a morality-based way of life. They wish to retain their life style and their culture rather than give them up for the income that could be obtained in an unpleasant environment (Bruton et al., 1992:227). Bruton et al. (1992:304) assert that this could be the reason why members of Islamic movements have put pressure on the government to change the Constitution to make it more compatible with Islamic law, particularly after the 1979 elections. The Malaysian government recognised these demands and responded to these pressures by incorporating the material as well as spiritual aspects of development in the Fifth Malaysia Plan. Bruton et al.

3- According to Ariff (1991:195) Malays and other indigenous groups constitute about 54 per cent, Chinese about 35 per cent, and Indians roughly 10 per cent.

4- The Chinese and Indians are regarded as immigrants and non-indigenous.

(1992:308) maintain: "Values such as trustworthiness, responsibility, diligence, discipline, and cooperation are used in the plan in a way that clearly indicates that they are not simply political rhetoric." The establishment of an Islamic Development Bank and an Islamic Insurance Scheme, and giving considerable attention to the distribution and absorption of Islamic values, were also responses to the demands of the predominantly Malay community. To justify this, the Fifth Malaysia Plan strongly stated the principle that "material development alone at the expense of spiritual needs of man will be detrimental to the well being of the Malaysian society" (Bruton et al., 1992:317). Nonetheless, numerous Islamic groups were raising important questions about the development process and its consequences (Bruton et al., 1992:223).

There is one feature in Malaysia's multicultural community, namely commitment to the family system, which is a common characteristic of the three principal ethnic groups despite their differences in culture. Strong family links are observed, and the extended family is extremely important to each group (Bruton et al., 1992:184). Malay society is a cooperative society, based on mutual help, or "gotong royang".[5] This cooperation exits in both social and economic areas. The offer of help or service is mutual and is expected be reciprocated later. The concept of "ummah" is related to an Islamic community whereby fellow members are expected to help each other any time, anywhere. Various social customs also help bind the Malay community together and feelings of unity arise among the Malays as a result of observing these social customs. Another important value of the Malay community is self-respect, and every Malay is required to maintain it at

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[5]- Gotang royang refers to the community self help and inter-group cooperation.

all times (Bruton et al., 1992:185). This has helped Malaysian society to pursue a single direction while accommodating cultural and ethnic diversities.

1.2 Political Structure

Malaysia is a federation of thirteen states, comprising eleven from the Malay Peninsula and two from the Island of Borneo (Sabah and Sarawak). Nine of the eleven peninsular states are ruled by Sultans, while the others are headed by governors appointed by the King. The King is elected by the Sultans from amongst the Sultans of the various states to serve for a period of five years. The King is a constitutional monarch and head of the state. The system of government is based on parliamentary democracy. It has two Houses, viz. the House of Representatives (*Dewan Rakyat*) and the Senate (*Dewan Negara*) (Ariff, 1991:195; Onn, 1986:7).

Since independence in 1957, politics in Malaysia has been dominated by the UMNO,[6] a Malay ethnic party which has been victorious in all eight general elections.[7] It has been preserved by an informal intercommunal pact, or settlement of the ethnic question, by which the ethnic elites have agreed that the largest group, the Malays, should dominate government (Bowie, 1994:169). Opposition parties include a new Malay party - Semangat'46 (Spirit of '46, referring to the date of UMNO's formulation) - two small Malay parties, the main Islamic opposition party PAS (Partai Islam Se Malaysia: Malaysian Islamic Party), and Chinese opposition party (Bowie, 1994:184). Parliament is an important vehicle

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[6]- United Malay National Organisation, UMNO, is Malaysia's first postwar political party.

[7]- Malaysia achieved independence in February 1957. Tunku Abdulrahman became the first Prime Minister. He has been the head of the UMNO, and Chief Minister after elections held in July 1955 (Malaysia 1990-91:17).

for the expression of opposition views, and its composition is viewed as an important measure of Barisan [8] support, because constitutional changes require a two thirds majority.

Malaysia has been a parliamentary democracy since 1957. The Cabinet, headed by the Prime Minister, is the supreme policy-making body. It is made up of ministers, who must be members of either the Dewan Rakyat (Lower House) or the Dewan Negara (Upper House of Parliament) and they are appointed by the King, on the advice of the Prime Minister (Onn, 1986:7). The Prime Minister is appointed by the King, acting at his discretion, but the person chosen must have the confidence of Parliament.

1.3 Economic Environment

Malaysia is a resource rich economy, with oil, natural gas, and non-mineral resources. Total oil reserves are estimated to be 2.3 trillion barrels of oil, 39 billion cubic feet of non-associated gas and ten trillion cubic feet of associated gas (Onn; 1986:133; see also Jomo, 1993a:175-6).

Malaysia became a lower middle-income economy in 1980s (Adam et al., 1992:211). However, based on information from the World Bank (1991a:331), Malaysia is on the edge of becoming an upper middle-income country with per capita income of US $2320 in 1990.[9] It was $888 in 1960 (Bruton et al.,

[8]- This refers to Barisan Nasional (National Front), a multi-party, multi-ethnic coalition of the United Malays National Organisation (UMNO), the Malaysian Chinese Association (MCA), and the Malaysian Indian Congress (MIC) (Malaysia 1990-1991:16).

[9]- GDP per capita in 1991 was US $2500 (World Bank, 1993:63). Per capita income reached $3405 in 1994 (Mohamed Jawhar bin Hassan, 1995:186).

1992:186). According to the World Bank (1993), by 1990 less than 5 per cent of the population were in poverty.[10] The economic performance of the country suggests that it will become a newly industrialising economy (NIE) joining the ranks of Korea, Taiwan, Hong Kong, and Singapore before the end of the 1990s (Ariff, 1991:4).

The economy has undergone fundamental changes since independence. At independence, the economy was dominated by the agricultural sector, which accounted for over 40 per cent of GDP, 60 per cent of formal employment and 70 per cent of export earnings. It was the world's largest producer of natural rubber and tin and wholly dependent on export earnings from these commodities. Over time, however, while remaining a world leader in these two commodities, the country has diversified activity across its broad resource base, and has developed a downstream hydrocarbon industry and manufacturing activity. The latter two sectors came to dominate the economy in the 1980s (Onn; 1986:12).

From 1957 until the late 1960s, the emphasis was on import substitution. The World Bank recommendation then was "import substitution under mild protection backed by investment incentives" (Ariff, 1991:10). During the 1970s there was a shift towards labour intensive and high technology export-oriented production. As a result, manufactured exports increased to over 50 per cent of all exports (Adam et al., 1992:213).

Since 1970, the economy has experienced significant growth in line with other newly industrialised countries (NICs). However, between 1981 and 1982, the economy faced a severe recession because of a deterioration in the terms of trade.

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[10]- It was estimated to be 50 per cent in 1970 (Brown, 1993:37).

The current account deficit grew dramatically and the public sector deficit, which had averaged 10 per cent of GDP during the first NEP decade, increased to 21.7 per cent of GDP in 1982. The severity of the recession of the mid-1980s added extra stimulus to the need for even greater diversity in the economy. This period was followed by a policy of greater liberalisation, which encouraged foreign participation in the domestic economy.

External demand for Malaysian products is a significant economic factor in the nation's economic welfare. However, the high degree of concentration in the commodity mix has exacerbated the problem of external influences on the economy (Ariff, 1991:12). To remedy this, exports have been diversified and non-traditional exports such as electronics and textiles established. According to Jomo (1989e:139), the main sources of recovery and growth of the economy were firstly, improvements for most Malaysian primary commodity prices from late 1986; secondly, a significant increase in volume of outputs of major exports, especially non-renewable natural resources; and finally, progress in manufacturing export activity.

As a result, Malaysia's production base broadened with manufacturing accounting for growing shares of national output and employment (Ariff, 1991:7). The 1985-7 recovery program saw the economy return to pre-recession levels of activity with real GDP growth rates of 5.3 per cent, 8.7 per cent and 7.6 per cent for the years 1987, 1988, and 1989 respectively.

After the adoption of the new economic policy (NEP) in 1971, the public sector's share of investment increased to 50 per cent of total investment. However, since 1986, with the economic restructuring program and development of a more private sector oriented strategy, public sector investment has been dropping back (Adam et al., 1992:213).

1.3.1 The New Economic Policy (NEP) - Objectives

In 1971, the government launched the NEP with the goals of national unity and social integration. It was adopted to promote growth with equity (World Bank, 1993a:134). The NEP was an attempt to bring economic equality to the Malays whose rural village life was disintegrating (Hill et al., 1989:129). This policy envisaged the development of a system of positive social and economic actions to abolish poverty and to restructure society (Schollosstein, 1991:229).

The NEP had two parts. The first involved the reduction, and later eradication, of poverty as well as the restructuring of society to correct economic imbalance, thereby reducing and eventually eliminating "identification of race with economic function". The second part envisaged the modernisation of rural life and the creation of a Malay commercial and industrial community at all levels (Milne and Mauzy, 1986:133).[11]

The main concern of the NEP was to address the debate on growth-equity trade-off issues (Bruton et al., 1992:270). The reality was that "Malaysia had become the world's leading exporter of rubber, tin, and palm oil, but the sons of the soil (Bumiputra) were not sharing in the spoils" (Schollosstein, 1991:228). Objectives of the economic policy were intended to change this situation. These objectives were aimed at: strengthening national integration by emphasising growth, attempting to reduce and eventually abolish poverty, and reducing ethnic

[11]– See also Bruton et al., 1992:270; Jomo, 1990:4.

and regional disparities (Somogyi, 1991:25; Onn, 1986:8).

In order to introduce equity objectives, the government participated more directly in the establishment and operation of a wide range of productive enterprises. This was done through wholly owned enterprises and joint ventures with the private sector. The idea was to achieve economic balance, which referred to the shares of different ethnic groups in management and ownership. It also included income equality between rural and urban areas and among the various regions (Bruton et al., 1992:271f.). The idea of the government as a *trustee* for Malay interests emerged early in the NEP period. The government remained the trustee until individual Malays could take over.

The objectives of the NEP as asserted by Adam et al. (1992:214), were:

(i) the promotion of national unity and integration;
(ii) the creation of employment opportunities; and
(iii) the promotion of overall economic growth.

The main economic objective was improvement in the economic balance between the races or the reduction of racial economic disparities, and thus the promotion of national unity.

Further aspects of economic life in Malaysia, other than the crucial element of distribution of corporate assets, were also considered in the NEP. Much of the regulation and intervention by the government through the NEP was aimed at abolishing poverty and restructuring society so that the pattern of employment, ownership, and control in the economy would reflect the racial structure of the country (Ariff, 1991:20). Milne and Mauzy (1986:134) assert that there were gains in the spread of services and improvements in the quality of life. For example, the social security system was successful in making medical care available for almost all Malaysians.

Between 1970 and 1984, the incidence of poverty declined sharply because of state intervention. The reduction in the incidence of poverty among fishermen and farmers was especially remarkable. Poverty among fishermen reduced from 64.7 per cent in 1976 to 27.7 per cent in 1984, and among farmers from 89 per cent in 1970 to 34.2 per cent in 1984. Such large reductions in poverty could not have taken place without considerable help from government policies and programs (Bruton et al., 1992:220f.).

The NEP expired in 1990, and in July 1991 it was replaced by the national development policy (NDP). Implementation of the NEP resulted in impressive real GDP growth and improvement in the standard of living of the Bumiputra. Both economic performance and welfare of Bumiputras have been greatly enhanced. The ownership structure in the country has improved in favour of Bumiputras, but it has fallen far short of the 30 per cent target set up by the NEP. At the end, the Bumiputra's share in the corporate sector stood at 20.3 per cent compared with 2 per cent in 1970 (Salleh and Meyanathan, 1993:39; Ariff, 1991:25).[12] However, the overall performance of the economy has been moderate by regional standards.

The radical change in standards of living and economic performance of the Bumiputra, however, was accompanied by some problems. Public enterprise performance was lower than expected. The explanations were ambiguous

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[12]– At the time the NDP was announced, the share of the Bumiputra accounted for 20.3 per cent of the total paid-up equity capital in the corporate sector in 1990. The non-Bumiputra held a total of 46.2 per cent, with the Chinese and the Indians having 44.9 per cent and 1 per cent, respectively, while the foreigners had 25.1 per cent and nominee interests, 8.4 per cent (Malaysia Towards 2020, 1992:40).

objectives, political interests affecting the choice of managers, and considerable monopolistic power (Bruton et al., 1992:298). Moreover, it has been argued that the NEP contributed to a serious degree of cronyism, especially with regard to government contracting and licensing procedures (Adam et al., 1992). Access to public funded business is said to have reduced public sector efficiency and raised concerns about government intervention in the economy. This, in turn, shaped the privatisation program (Adam et al., 1992). However, the difficulties of the 1980s are said to have stemmed from the lack of policies to relieve dependency on rubber, oil, palm oil, and timber. According to Ariff (1991:22), policy-makers are agreed that the NEP was not a negative factor. Due to the NEP, the Malaysian economy continued to grow at creditable rates during the 1970s and 1980s.

1.3.2 Trends-imply change

The early 1980s was a time for a fundamental review of development. There was also a change in emphasis from equity to growth. Finally, there was a relaxation of the NEP restrictions, especially those that applied to foreign investment. The reduced role given to the NEP did not mean, however, that its objectives were completely neglected. Growth was necessary before its objectives could be achieved. According to Bruton et al. (1992:309-317), the main conclusion is that the various measures and criteria of equity show the same pattern over the 1980s as in the 1970s. Government intervention, through the formation of the NEP and its consequences, shaped the conduct of economic policy towards the identified objectives. Through the NEP, public enterprise development was achieved and privatisation policies were initiated.

Government policy towards the development of the PE sector in the 1970s, and the push for privatisation in the 1980s, was driven by the needs of the NEP. Following the formulation of the NEP in 1970, PEs became one of the devices for assisting the Bumiputra population to participate more fully in the nation's commercial and industrial activities (Salleh, 1991:598). For example, Pernas (Perbadanan Nasional: National Corporation), with over 95 enterprises, was set up to increase the participation of the Bumiputra community in the industrial and commercial sectors.

An explicit connection between the privatisation program and the objectives of the NEP, was a minimum 30 per cent Bumiputra participation requirement in each privatisation transaction. An instrument designed to achieve this objective is the National Unit Trust which invests as an agent of Bumiputra, on their behalf (Salleh, 1991:612). In other words, the privatisation program was linked closely with economic and social objectives.

2 The Role and Structure of Malaysian PEs

2.1 Rationale for Development of PEs

By the 1980s, Malaysia's public enterprise sector was amongst the largest in the world outside the centrally planned economies. It accounted for almost one-third of the country's gross domestic product (GDP), estimated at between 29 and 31 per cent, with 659 active PEs in 1987 (Sheikh; 1992).[13] Why did Malaysian PEs

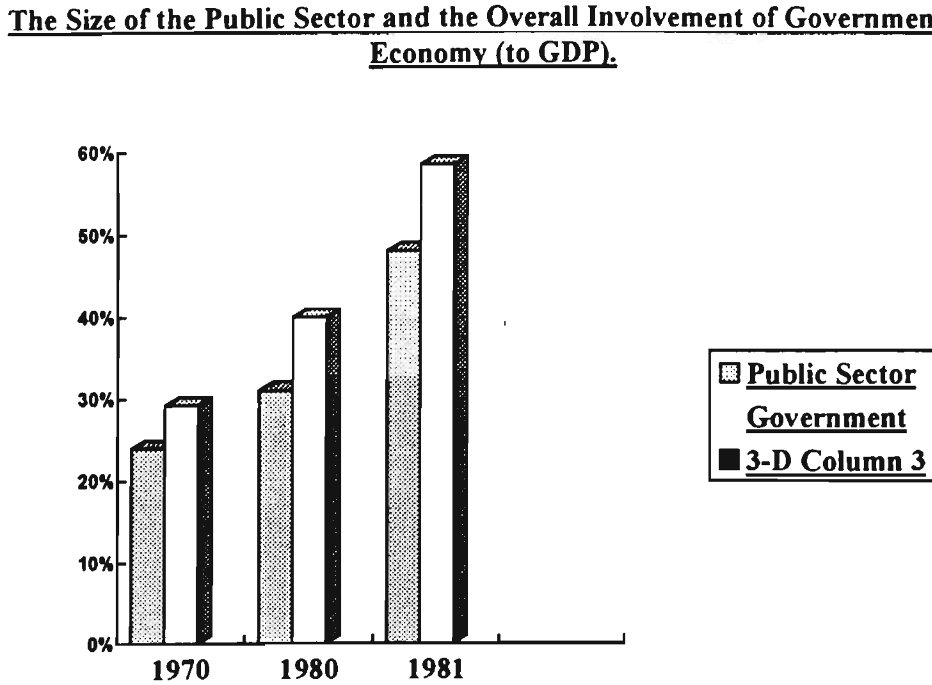
[13]– It had fallen to about 25.6 per cent in 1988 (Ariff, 1991:21).

grow so large? An appreciation of the origins and development of the PEs sector is an important prerequisite to understanding the program of reform in Malaysian PEs.

The factors influencing the emergence of PEs in Malaysia included those common to other countries, but there are some factors unique to Malaysia. During the period up to 1970, government intervention in commerce and industry was almost non-existent and Malaysia maintained minimal PEs (Adam et al., 1992:16). The first factors that resulted in the growth of the public enterprise sector in Malaysia were market failure and natural monopolies (Shaikh, 1992). Two of the reasons were that the private sector was insufficiently developed to undertake large and risky enterprises and that natural monopolies were considered best undertaken by the public sector (Mohd Sheriff, 1992). Examples of these natural monopolies are *Tenaga Nasional Berhad* (National Electricity) and the *Postal Department.*

The traditional role of PEs has been the provision of *public goods* and services which cannot be satisfactorily supplied by the private sector (Mohd Noor, 1991:18). This role of the state as provider increased substantially, so that the government's contribution to GDP increased from 24 per cent in the 1960-70 period, to 29 per cent in 1971-75, 31 per cent in 1976-80, and peaked in 1981 at 48 per cent mostly by the creation and expansion of PEs (Hensley and White, 1993:72). Figure 3.1 shows the public sector growth during 1970-81.

Figure 3.1: Overall Contribution of Government to the Economy During 1970-81 (i.e. to the GDP).



The factors unique to Malaysia include socio-political factors which resulted in government intervention and an increase in the role of PEs.

2.1.1 Socio-Political Factors

The expansion of PEs followed the establishment of the NEP which was also a response to two important historical and political events in 1969. First, was the national election held in May 1969, which resulted in a win by the Alliance Party, but with a substantially reduced majority.[14] The second event was the outbreak of ethnic riots in Kuala Lumpur following the election (Puthucheary, 1990:110; Bruton et al., 1992:268).

Since independence, Bumiputras have tried to shape the country in their own terms. Puthucheary (1990:110) maintains that the Malays claim that they

[14]- The Alliance Party could not get the majority of two thirds of votes required for it to have the right to amend the Constitution in favour of the Bumiputra, as it had done before.

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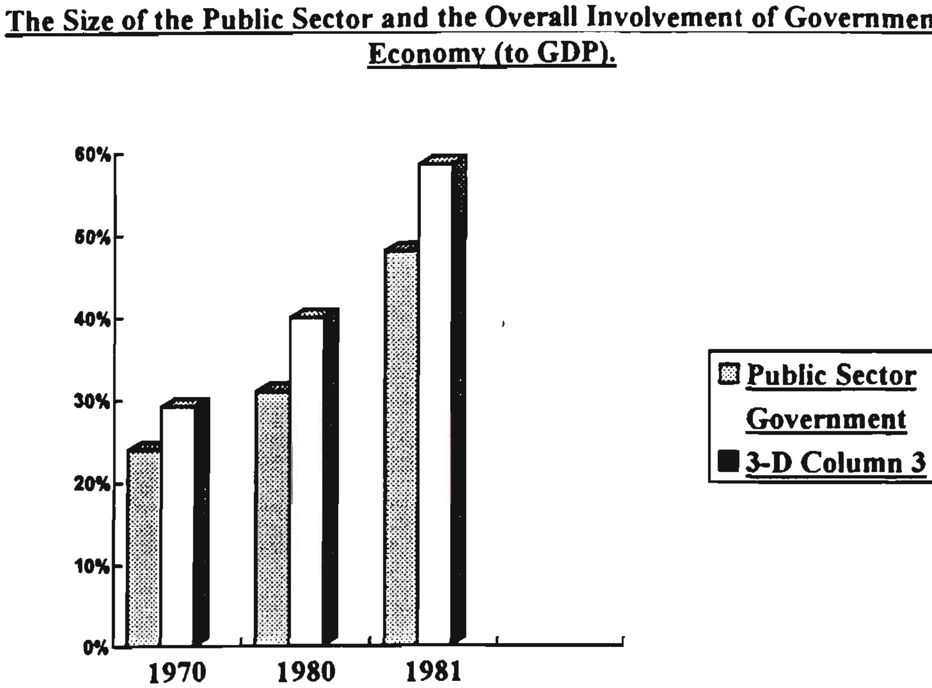

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should have special political rights by virtue of their status, because their ancestors were in the country when the British colonised it. They call themselves Bumiputras or "sons of soil" to distinguish them from the other ethnic groups whose ancestors were immigrants to the country.

However, the result of the 1969 election shocked the Alliance of the UMNO and the two ethnic minority parties, the Malaysian Chinese Association (MCA) and the Malaysian Indian Congress (MIC). A demonstration of victory was held by the mostly Chinese opposition parties in Kuala Lumpur to celebrate their gains. Malays feared losing their position, which led to racial tensions being intensified. Then communal chaos erupted and a state of emergency was declared.

These two events provided the background to the NEP, which envisaged a greater direct role for government and a new role for PEs, as a means of promoting economic growth and social equity. After the riots, the Malays' leaders arrived at two conclusions. First, that the ethnic violence indicated the existence of economic discontent and that this called for basic action to be taken.[15] Brown (1993:37) asserts that the violent racial riot led to the realisation that the benefits of economic growth, after independence, had not been evenly distributed. The riot was, in fact, a response to the failure of the *trickle down* effect of market-led[16] development to achieve a socially acceptable sharing of income, employment and wealth between the economically disadvantaged Bumiputra and the other ethnic

[15]- Behind the "13 May" riots lay very major differences in the degree of poverty and access to financial opportunities. The average per capita income of Malays was only half that of the Chinese community (World Bank, 1991:331).

[16]- During 1957-70, the first decade after independence, the government continued the colonial laissez-faire policies for industries, but intervened to promote rural development and to provide a social and physical infrastructure to reduce the economy's dependence on rubber and tin.

groups (Salleh and Meyanathan, 1993:5). Bumiputras had been engaged in low income and rural activities and there was a need to transfer them to industrial and urban occupations in order to bridge the income gap between them and non-Bumiputras (Adam et al., 1992:216; Hill et al., 1989:129). The second conclusion was that the diagnosis and appropriate remedies needed to be spelled out clearly. The solution to ethnic conflict was to be dealt with realistically and openly (Milne and Mauzy, 1986:132).

As a result, a white paper titled "Towards National Harmony" was published by the Malays' leaders. This paper proposed constitutional changes: "to remove sensitive issues from the realm of public discussion in order to allow the smooth functioning of parliamentary democracy, and to remove the radical imbalance in certain sectors of the nation's life and thereby promote national unity" (Bruton et al., 1992:269). The result was a "New Economic Policy" which was embodied in a series of five-year plans. The objective was to focus on accelerated economic growth and promotion of the interests of the Bumiputra (Dixon, 1991:183). The period of 1971-85 was an era of state-led development of social infrastructures which led the rise of PEs in Malaysia.

Political concern was dominant. By spending heavily on agriculture, UMNO sought to secure the devotion of the mostly rural Malay community (Bowie, 1994:169). The ruling party, UMNO, created its own corporate vehicle and began accumulating stock from Malay share issues and taking advantage of ownership quotas to develop its own stable of companies (Bowie, 1994:174-6). Instruments such as protection, the provision of finance, licensing, quotas and government contracts were used to redress the economic imbalance between

Malays and Chinese. On the other hand, the Chinese held their own by forming strategic political partnership with Bumiputra counterparts (Haggard, 1994:288). In addition, Mahathir and the UMNO leadership used the heavy industries policy as an attractive vehicle to hasten the redistribution of economic power as depicted in the NEP.

2.1.2 State Intervention

Following the race riots in 1969, it was accepted that economic inequality in Malaysia was excessive and that state intervention was required to achieve rapid economic progress amongst the Bumiputra community. Thus the NEP was biased towards the Bumiputra who retained political control. It was also initiated as a mechanism to redistribute wealth more broadly within the domestic economy (Leeds, 1989:742). PEs were engaged in addressing these issues.

PEs initiated radical change to meet the new socio-economic objectives. To achieve these objectives, the government moved from the laissez-faire policy of 1957, to the policy of intervention in the economy in 1970 (Mohd Noor, 1991; Adam et al., 1992:16). Part of the government's solution to the ethnic and social problems was to establish public bodies to purchase or create corporate assets on behalf of the Malays and indigenous groups (Bumiputras), as well as providing discriminatory employment opportunities in favour of these groups (Ng and Toh, 1992:43).

For the development of heavy industries, the government created companies such as the Heavy Industries Corporation of Malaysia which undertook many of the large projects in the automotive, petrochemical, steel and cement industries and expanded capital investment by more than M$2 billion (Salleh, 1991:601). Malaysian PEs, while continuing to consolidate their own policies and operations, are involved in providing an encouraging environment for healthy economic expansion (Somogyi, 1991). Due to the positive role of the PEs, the overall involvement of government in the economy rose from 29.2 per cent GNP in 1970 to 39.9 per cent in 1979 and peaked two years later at 58.4 per cent (Salleh, 1991:596) (see Figure 3.1).

2.2 The Role and Structure of PEs

Following the formulation of the NEP in 1970, the role of PEs began to increase more rapidly as an important instrument for assisting the Bumiputra population to participate more fully in the nation's commercial and industrial activities. By 1991, Pernas (Perbadanan Nasional: National Corporation) had over 95 enterprises, and Majlis Amanah Rakyat (MARA: Council of Trust for the Indigenous Peoples, a Bumiputra Trust) 64 enterprises operating in trade, retail, hotels and plantations. These were providing opportunities for entrepreneurship development and for enhancing commercial skills among the Bumiputra community (Salleh, 1991:596; Craig, 1988:254; Young et al., 1980:70).

PEs were directly involved in the development process, after 1969, with the aim of establishing new industrial activities in selected growth areas and of creating a Bumiputra commercial and industrial community (Salleh, 1991:601). As a result, significant growth occurred in the number of statutory authorities, companies and joint ventures with commercial, industrial and socio-economic objectives (Hill et al., 1989:129).

The expansion was so rapid that the PE sector was growing at a rate of 100 enterprises per year by the mid-1970s. The expansion had taken place mostly in the areas of manufacturing, service, and non-financial PEs (NFPEs). However, the process of creating new PEs was stopped after the election of Mahathir bin Mohammad in 1980.[17] Table 3.1, depicts the extent of the growth of PEs in different areas of economic activity during the period 1960-90.

2.2.1 Types of PEs In Malaysia

There are two broad categories of PEs: financial PEs, and non-financial PEs (NFPEs) in Malaysia.

Financial PEs

Financial PEs are of three types. They comprise first, departmental enterprises that were required under the law to maintain their financial accounts in accordance with commercial standards, e.g. the National Electricity Board, Telecommunications Department, and Waterworks Department.

Secondly, are public corporations and statutory bodies that were 100 per cent government owned, and established by the various state and federal statutes. The Federal Land Development Authority (FELDA) and Malaysian Rubber Development Corporation (MARDEC) are examples of this category. Thirdly, are state-owned companies (SOCs) established under the 1965 Companies Act. These were involved in commercial or industrial activities and competed with domestic or foreign enterprises.

[17]– Mahathir bin Mohammad took office in July 1981.

Table 3.1: Growth of PEs During 1960-90.

Industries	1960	1960-4	1965-9	1970-4	1975-9	1980-4	1985-7	1989-90
Agriculture	2	1	3	18	21	23	12	8
Construction	2	4	0	9	26	25	5	10
Extraction	0	1	0	2	16	6	0	7
Finance	0	6	3	28	22	20	4	12
Manufacture	3	3	18	59	68	62	29	23
Services	2	1	7	43	51	85	19	30
Transport	6	6	6	8	14	14	5	3
NFPE sector	15	16	34	139	196	215	70	87
PE sector	15	22	37	167	218	235	74	99

Source: Salleh, 1991:599.

For example, the Heavy Industry Corporation of Malaysia (HICOM), Petronas (Petroliam Nasional Berhad: National Petroleum Company), Malaysian International Shipping Corporation (MISC), Malaysian Airlines (MAS), and other enterprises created by the Federal Government and the State Economic Development Corporation (SEDC), the investment arm of the government fall under this category (Salleh, 1991: 596; Salleh and Meyanathan, 1993:15).

Non-Financial Public Enterprises (NFPEs)

NFPEs have been established to promote growth in areas where the private sector was not prepared to enter. They were also established to promote regional development, social restructuring, ensure political control, reduce bureaucratic constraint and nationalise foreign-controlled companies through purchases of equity (Salleh and Meyanathan, 1993:16). The important role of these NFPEs has been to improve the welfare of the poor and to raise the relative economic position of the Bumiputra.

For the government, there were several advantages in using the NFPEs as development agents. First, they were free from normal government controls. Secondly, they were not subjected to the same parliamentary scrutiny as a government ministry or department. Thirdly, they were empowered to establish subsidiary companies. Finally, their ownership structure could be easily varied to meet the requirements of the NEP. Thus once a PE was financially viable, some or all of its shares could be transferred to private Bumiputra individuals.

Adam et al. (1992:216) argue that despite restructuring and the fact that privatisation measures have been attempted since 1987, the size of the public sector has not diminished in any significant way. The government continues to hold a majority or significant part of the shares of the privatised enterprises, and effective control is exercised over these enterprises by the government. Thus, many privatised enterprises would still be classified as PEs. By 1991, there were over 1,100 PEs in Malaysia comprising utilities such as transport, communication, water supply, energy, and finance and non-traditional sectors such as services, construction, and manufacturing (Adam et al., 1992:215).

2.3 Performance of Malaysian PEs

The expansion of the size and role of the public sector and related PEs also increased other economic indicators such as public employment, public debt and public expenditure.

2.3.1 Financial Performance

In the late 1970s, Malaysian authorities pursued a cautious fiscal policy, accumulating surpluses in good years and incurring deficits in scarcity years, which helped protect the economy to a considerable extent from external shocks (Ariff, 1991, 30), and during the decade between 1970 and the early 1980s, state-owned enterprises (SOEs) played a relatively modest role.[18] For example, investment in NFPEs was less than 6 per cent of gross investment, much lower than the regional average. But during 1981-85, this ratio shot up to 20 per cent (World Bank, 1993:33). Overall public investment increased at an average annual rate of 1.6 per cent in real terms throughout the 1970s. According to Salleh (1991:604), during the period 1981-85 investment by PEs grew at an annual average rate of 30 per cent compared to the annual average rate of 16 per cent for public investment as a whole.

In order to finance the expansion of the public sector and the trade deficit in 1981 and 1982, internal and external borrowing increased at a rapid rate. By 1982, the amount owed to the federal government by statutory bodies, PEs, and the state governments was approximately M$17 billion or 37 per cent of government total debt (Salleh, 1991:598; Ariff, 1991:16). In terms of share of total operating expenditure, interest payments grew from 11.00 per cent in 1970 to 11.3 per cent in 1980 and 25.1 per cent in 1985. As a result, the total federal government's interest service charges grew from M$0.04 billion in 1979 to M$1.55 billion in 1985. During 1980-82, absolute debt obligations doubled from 45 per cent to 93 per cent of GDP (Hensley and White, 1993:73). Jomo (1989:39) maintains that the fiscal and debt problems of the period of recession were intensified by Malaysia's balance of payments and high interest rate.

18– SOEs, here, refer to both financial and non-financial PEs (NFPEs).

To finance its development projects and industrial ventures, Malaysia borrowed heavily from external sources. External borrowing comprised project loans and market loans. Project loans were obtained from multilateral lending institutions such as the World Bank and the Asian Development Bank (ADB) as well as from government-to-government bilateral sources at concessional rates of interest. Market loans were largely syndicated loans obtained from international markets at commercial rates of return (Ariff, 1991:30). Malaysia is one of those countries that seeks selective lending and advice rather than seeking high level assistance from the World Bank (World Bank, 1993:15).

Nevertheless, an excessive dependence on foreign credit and an inability to correctly forecast trends in exchange rates led to the poor financial performance of some PEs. According to Salleh (1991:505) "The sharp increase in the external debt of the PEs has increased the overall dependence of the economy on external resources." Table 3.2 shows the overall changes clearly.

Table 3.2 Non-Financial Public Enterprises (NFPEs) External Debt (RM million).[19]

Debt/year	1981-2	1982-3	1983-4	1984-5	1985-6	1986-7
Outstanding	15,386	24,283	31,763	37,245	42,249	50,639
Federal government	8,278 (53.9%)	13,158 (54.2%)	17,728 (22.8%)	20848 (56%)	23070 (54.6%)	28,310 (55.9%)
NFPEs	3,071 (20%)	3,715 (15.3%)	7,657 (24.1%)	9,656 (26%)	12,027 (28.5%)	14,862 (29.3%)
Private sector	4,019 (26.2%)	7410 (30.5%)	6378 (20.1%)	6,741 (18%)	7,152 (16.9%)	7,467 (14.7%)

Source: Economic Planning Unit (EPU); Salleh 1991:503.

[19]-Malaysian Ringgit.

By the end of 1986, Malaysia's external debt rose to $22 billion, although the ratio of foreign debt to GNP was reduced to 43 per cent in 1989 due to external reserves (Somogyi,1991:36-8). Schollosstein (1991:234) points out that foreign investment in Malaysia has been a significant drain on the balance of payments (BOP) because of the dividends and interest paid for those investments. This, in turn, caused a mushrooming of Malaysia's foreign debt, from just over $5 billion in 1981 to nearly $20 billion in 1987, and a corresponding deterioration in the debt service ratio from 3.5 to 14.3 during that period.

Malaysia's financial dilemma was also the consequence of monetary policy through the devaluation of the Malaysian currency. Salleh (1991:605) maintains that the strengthening of major currencies led to an increase in the external liabilities of the PEs, especially those involved in heavy industries. The reason was the depreciation of the US dollar since September 1985. This caused an increase in the size of the Malaysian external debt denominated in most other currencies. As a result, the government had to let the Malaysian Ringgit depreciate with the US dollar (Jomo, 1989:79).

Systematic weaknesses in macro-economic management were also exposed during the recession of the mid-1980s. The budget deficit was large by Asian standards, and the increase in the external debt burden exacerbated the situation. The trade deficit worsened the country's balance of payment difficulties because of the sharp decline in commodity prices and the sizeable deficit in the service account (Ariff, 1991:16).

The percentage of profitable PEs varied between about 55 and 62 per cent during 1981-6 (Table 3.3). A large proportion of the profitable companies were in finance, transportation and extraction. Those in services and manufacturing experienced poor results. While those in agriculture were rather unstable due to a combination of international conditions and management problems (Salleh and Meyanathan, 1993:21).

Table 3.3: Percentage of Profitable Companies in the NFPE Sector.

Year	1981	1982	1983	1984	1985	1986
No. of Companies	498	576	631	676	702	574
Percentage	61.6	55.5	56.7	58.0	54.8	55.2

Source: Ministry of Public Enterprises, Salleh and Osman (1991).

From the viewpoint of profitability, the financial performance of NFPEs was not satisfactory. Financial information shows that nearly half the NFPEs incurred losses in 1988. Another study shows that out of 770 companies examined by the government, only 378 recorded profits, while 383 suffered losses. Reported accumulated profit was M$4.6 billion while accumulated losses were M$5.6 billion (Salleh and Meyanathan, 1993:21). The major problems included over-exposure to external liabilities, less than optimal capacity utilisation, weak management, increased input costs and, in some cases, inadequate technology.

However, analysis indicates that performance during an international recession does not reflect performance under normal conditions. More importantly, the NFPEs were established to achieve social objectives and the objectives of the NEP, not the mere objective of profit-making.

For example, Petronas is the single largest and by far the most profitable of the Malaysian PEs with a turnover of M$6.7 billion and profit of M$3.8 billion in 1988. Moreover, Petronas consists of 10 companies (four of which are in the 20 largest PEs) with a combined estimated turnover of M$12.6 billion, about 27 per cent of total PEs sector turnover. Petronas and its affiliated companies are also internally efficient domestic monopolies, which, however, have to operate as price-takers in international markets (Adam et al., 1992:224). Petronas has consequently remained outside public enterprise reform and in view of its strategic nature, it has not been considered in the privatisation debate.

A comparison between small and large PEs in Malaysia shows that small PEs were doing worse than the ones with economies of scale. The lower performance of some PEs is argued to be the consequence of a lack of evaluation and neglect, the pursuit of socio-economic objectives, and flawed investment decisions.

Nevertheless, to analyse the problems associated with the performance of PEs and NFPEs, there is a need to examine the managerial and administrative shortcomings of PEs.

2.3.2 Managerial and Economic Issues

The main reason for poor financial performance of PEs is said to be poor management (Puthucheary; 1990:116). Weaknesses in the management of some PEs was due to the fact that until the late 1980s, the government did not have the most basic knowledge of the activities of enterprises in which it was the major shareholder. Moreover, poorly designed incentive structures created accountability and agency problems (Adam et al., 1992:226).

The sectoral categorisation of PEs is given either by active or inactive status. Two sectors - manufacturing and services - account for more than half (56.2 per cent) of the active PEs (Table 3.4). Of the 1,133 enterprises, 286 (25.2

per cent) have been identified as inactive. These include enterprises whose operations have ceased, are closed down or dormant, under liquidation, in pre-operation stage, under receivership, suspended or are merely "shell" enterprises (Salleh, 1991:603).

One of the management problems of PEs in Malaysia was insufficient evaluation of management performance. However, the task of evaluation was difficult because of the lack of clarity of objectives, which ranged from profitability and income distribution to socio-economic and employment objectives (Salleh, 1991:611). Inability to prioritise the objectives further complicated this.

Other factors responsible for inadequate managerial performance include a scattered control structure, lack of incentives, and easy access to funds. The lack of a mechanism for setting priorities allowed the managers considerable scope for the behaviour which they adopted (Puthucheary, 1990:117).

Table 3.4: PEs and their Status.

Industry	Active	Inactive	Total
Agriculture	108	35	143
Building and construction	89	40	129
Extractive industries	19	16	35
Financial institutions	102	12	114
Manufacturing	250	82	332
Services	226	71	297
Transportation	53	16	69
Others	-	14	14

Source: Salleh 1991: 603.

The lack of an adequate system of accountability and monitoring is also said to be a reason for PE imperfection. PEs have enjoyed a great deal of autonomy, but this autonomy has not been subject to adequate accountability. Shaikh (1992:214) argues that neither of the major controlling agencies - the Implementation Coordination Unit (ICU) or the Ministry of Public Enterprise (MPE) - had a proper system for evaluating management performance or succeeded in holding management accountable for results.

Concerned with the poor performance of some PEs, the government's response to the need to improve their performance was (i) a significant change in development expenditure and to avoid using the PE sector to implement development objectives; (ii) a direct attack on individual PE performance; and (iii) the privatisation program (Adam et al., 1992:226). On the other hand, the government made serious efforts to renew the management of PEs. Improvements have taken the form of rationalisation of public sector industries, cost reduction, and product diversification (Puthucheary, 1990:17)

2.3.3 Domestic Economic Factors

There are some domestic economic factors which are responsible for the weak performance of PEs in Malaysia. These factors are: inaccurate forecast of demand and prices; problems related to technology; and problems pertinent to debt structure (Salleh, 1991:610f.).

First, at the feasibility study stage, forecasts of the price or demand for specific commodities were inaccurate or failed to foresee declines in demand for some commodities. As a result, the income of some PEs declined. For example, the fall in the prices of petroleum and other export commodities caused an abrupt downturn during 1985-6. The fall in prices also caused faltering output growth, reduced investment, and increasing unemployment (Bruton et al., 1992:362). Secondly, the designs of infrastructure projects were often flawed. Therefore, their costs were also borne by PEs. Thirdly, the factors pertinent to pricing policies, absence of incentives, lack of "profit orientation", and dependence on government funds were other factors that caused problems affecting performance of the PEs (Salleh, 1991:610). Despite these difficulties, Malaysia compensated for these weaknesses by exporting significant amounts of oil in the late 1970s, when the price of oil increased (Bruton et al., 1992:362).

The government and the public sector managers learnt from their experiences and took measures to improve performance. Since the second half of the 1980s, the Malaysian economy has improved. This improvement in economic performance had favourable effects on PE performance, especially for those PEs which were primarily concerned with commodities and commercial services (Salleh, 1991:605).

However, efforts to increase the authority and prestige of the public sector did not generate enough dynamism in the management of PEs to make them profit-oriented. There were no effective tools to exert control or to ensure accountability, and pressure to show a profit was also weak. Therefore, the performance of some managers of PEs was below an optimal level. In the absence of effective accountability, some managers took measures for large-scale investment even if it resulted in excess capacity (Salleh, 1991:610).

It is argued that despite the government intervention in the PE sector to maintain the value of assets appropriated for the Bumiputras, these PEs had been successful only in the sectors where natural or other monopoly conditions prevailed. The non-monopoly sectors were, however, in disarray (Adam et al., 1992:226). As a result, restoring the value of these assets (in terms of the income stream they generate) has become a priority.

Fear of takeover sometimes serves as an incentive preventing PEs from showing a profit, as the government has handed over profit-making PEs to private hands. As part of the program to redistribute wealth to the Bumiputra, the PNB (Permodalan Nasional Berhad: National Equity Corporation) has acquired several companies from federal and state agencies at prices that reflect the cost of assets rather than the market value of the company. Since profitable companies tend to be prime candidates for such takeovers, this has created a negative incentive for managers of PEs to show a profit. In such an environment, managers tend to design cross subsidisation schemes or make provision for uneconomic services that serve to minimise the threat of being taken over (Shaikh, 1992:216; Salleh, 1991:610).

2.4 The Impacts of Malaysian PEs

Many PEs were created to meet socio-economic objectives such as improvement of income distribution and the provision of low-cost housing. Since their creation, these PEs have continued to pursue socio-economic objectives, even after meeting their initial goals. While pursuing these benefits for society as a whole, their costs are borne by each enterprise and this undermines their profitability. The consequence is that the managers of loss-making PEs are able to hide inefficiencies under the guise of striving for socio-economic objectives. The controlling agencies, therefore, need to distinguish costs associated with socio-economic objectives from other financial information.

Thus, negative impressions based on the financial burden of PEs have led to a less than objective assessment of their role. Mohd Noor (1991:18) states that this negative feeling is "coupled with the pervading belief that governments have in the first place no business to be in business". Even the successful and high-performance PEs are difficult to defend against these doubts. This negative perception is also a reflection of the prevailing degree of confusion and uncertainty. While a PE may pursue commercial objectives, often, it is also made to shoulder increasing demands for socio-economic programs. It may operate in a free market environment, but at the same time, it is often obliged to transact business on peculiar terms and conditions. Yet, PEs are required to show positive returns in their accounts.

In spite of all the anxieties, Malaysian PEs have generally contributed towards the national development effort, especially in achieving the goals of the NEP. They have contributed towards redistributing wealth and ownership. PEs came into operation to reduce distortions brought about by the open economy. The mandate given to them was clear and precise, "they were expected to contribute towards a more balanced ownership distribution of corporate wealth and fill in the entrepreneurial gap which existed in the Bumiputra community" (Mohd Noor, 1991:19). It is undeniable, however, that based on profitability alone most PEs have become non-performing. The reason is that "most trust enterprises were set

Malaysia have achieved the social and political objectives assigned to them. These establishments created new economic and business groups, added to their experience and, with government support, enabled them to enter business. These new groups were encouraged by the state to become more actively involved in economic and trade activities. PEs also enhanced the equity aspects of the NEP objectives. Internal problems such as financial stringency, as well as external pressures arising from the international economic situation, produced the momentum for the government to initiate reform in PEs. Since then, the government has been trying to reduce the role of PEs by privatisation and reducing the level of investment in those enterprises. Reform motives are analysed in the next section.

3 Privatisation Motives

This section examines motives for the privatisation program in Malaysia. It deals with the following major issues:

(i) internal and external motives for privatisation;

(ii) the objectives of privatisation; and

(iii) the objectives of the NEP and privatisation program.

3.1 Internal Factors

Malaysia initiated privatisation based on specific and intrinsic reasons. The rationale for privatisation included some features that were unique to Malaysia, while other principal motives were similar to those driving other developing nations (Salleh, 1991:611). Malaysia, like many other countries, was dependent on export-led growth, which fell victim to problems such as the deep recession in industrialised countries.[20] Privatisation was mostly aimed at improving the structure of the economy which was dependent on the export of few commodities. Financial as well as managerial factors were the two main internal factors influencing the reform initiatives in Malaysia.

3.1.1 Financial Issues

The economic recession and the government's increasing financial burden provided a rationale for the privatisation policy. The world recession which began in 1980 was an immediate consequence of the 1979 increase in oil prices. The economic recession experienced by industrialised countries led to problems for commodity export-oriented economies throughout the world. The slack world markets had an immediate impact on Malaysia's exports. In 1981, export earnings fell by almost 4 per cent and had hardly regained the 1980 level by 1982 (Bruton et al., 1992:305). This resulted in a steep deterioration of prices for Malaysia's primary sources of income, while imports continued strongly, especially of capital goods. Therefore, with a sharp fall in the foreign exchange reserve, the Malaysian balance of payments went into an alarming deficit of 93 per cent of GDP in 1982 compared with 45 per cent of GDP in 1980. The fiscal crunch was a pressing reason for privatisation and other public sector reforms in Malaysia (Ng and Toh, 1992:44; Bruton et al., 1992:305).

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[20]– In these cases internal factors are influenced by the external factors, and the distinction of category is complicated.

According to Salleh (1991:611):

> As domestic and external deficits widened and financing became more burdensome, an obvious item for adjustment was public spending. This resulted in privatisation, which in one form or another emerged as an option for many governments. Malaysia [was] no exception.

Leeds (1989) points out that the emergence of the privatisation policy reflected two concerns. The first was the performance of the PE sector. However, this was less pressing during the public sector boom of 1981 and 1982. It became particularly important, however, after the recession of 1985-7. Leeds refers to Mahathir's scepticism about the efficiency of public enterprises:

> Public enterprises never seem to be profitable or efficient. Even when they are monopolies they cannot seem to earn their way, much less [pay] tax or dividends to the owner, the Government. More often than not, a privately owned enterprise which has been making profits and paying taxes, not only ceases to do both on nationalisation, but requires subsidies and copious injections of capital every now and then by the Government (Mahathir, 1984:7 cited in Leeds, 1989:744).

This analysis about PEs is more consistent with that of the international institutions in the privatisation debate, rather than being related to the performance of PEs. This encouraged the government to move towards PE reforms.

The growing instability in 1985-7 was likely due to the depreciation of the Ringgit from September 1985, against the Yen, some major European currencies, and the US dollar. Jomo (1989c:85f.) rightly suggests that the depreciation of the Ringgit in late 1985 and during 1986 significantly increased the size of Malaysian's external debt denominated in the Ringgit. The external debt of the NFPEs was also greatly affected by the depreciation of the Ringgit.

3.1.2 Managerial Factors

The privatisation policy was also a reflection of the government's growing disappointment with the performance of the government bureaucracy in running enterprises (Mahmood and Mat, 1992:433). Weak administrative performance of PEs was said to be the result of a lack of competition and protection from market forces. This also led to inefficiency and low productivity (Salleh, 1991:611). As a result, PEs came under increased scrutiny as most of them continued to register worsening results. The poor performance of PEs demanded basic reforms to enable them to confront global competition (Hensley and White, 1993:73). Concern on this aspect of performance was expressed in 1988 by the Prime Minister in the following terms:

> Management is not one of Malaysia's strong points. In the first instance, we do not have enough managers. Of the ones we have, a good number are unfortunately mediocre. Some we have seen are downright dishonest. If privatisation is going to remedy the ills of nationalisation, then we must have good managers (Ng and Toh, 1992:60).

Privatisation was assumed to be a remedy for managerial weaknesses and shortages of managers.

3.1.3 Political Factors

Political factors include those benefits the ruling party may gain to strengthen its future political stability by privatisation. Since 1986, the Malaysian government has tended to privatise large infrastructure projects and to divide them between well connected individuals or Bumiputra companies with UMNO links (see Jomo, 1993a:180). According to Bowie (1994:191), it was usually accompanied by a foreign partner with technical expertise - rather than undertaking the projects itself. This eases the financial burden on the government and strengthens private sector construction while, in the case of politically connected companies, ensuring a steady flow of public money into UMNO's corporate treasury.

While UMNO has employed redistributive goals as a blanket rationale for the awarding of government contracts to UMNO linked enterprises, the attempts to exclude dissenting groups and factions have been justified in terms of the need for a strong executive state unfettered by the nitpicking of an independent judiciary or a hostile opposition (Bowie, 1994:184). This trend of political rigidity is related to a political split which emerged in UMNO in 1987 (see Scholosstein, 1991:252-5). Mahathir's leadership style and the alleged use of government development policies to benefit leading politicians and their "cronies" were the stated reasons for the political split.

An example of cronyism was the M$2.3 billion contract in 1987 for the project of the 960 kilometre North-South highway from Singapore to Thailand to United Engineering Malaysia Berhad (UEM) - an UMNO controlled company (Bowie, 1994:182; Tsuruoka, 1990:44). UEM also serves as the main contractor for the M$1 billion project to build a second transport link between Johor and Singapore. It has also received the privatisation contract for the lucrative chain of public pharmaceutical outlets operated by Malaysia's Heath Ministry. UMNO's Fleet Group also received a 49 per cent interest in the joint venture company, Celecom, while Telekom Malaysia controlled the remainder (Tsuruoka, 1990:44).

The government justification was that UEM was controlled by a private company. Furthermore, in August 1987, the Prime Minister defended the award of the privatisation of the North-South Highway to UEM Berhad, on the grounds that UMNO had to make money to cover the costs of its extravagant building, the Putra World Trade Centre (Jomo, 1989:6; Jayasankaran, 1995:43). The political connection element is so established in the Malaysian mind that almost everyone given a contract is assumed to be connected with the political camps (Jayasankaran, 1995:44).

On the other hand, liberalisation has been feasible politically because the principal beneficiaries are foreigners and members of an expanding, mostly Malay, business elite with ties to the governing Malay Party. Bowie (1994:188) asserts that this strengthens the party's financial security and secures its political future while advancing the permanent NEP goal of sustaining a Malay commercial and managerial class.

It appears that the privatisation program in Malaysia is mainly a tactical approach rather than a systemic or pragmatic one as it pursues specific political and economic goals (see Chapter 2, Section 3.1.3). Pleasing the party faithful and raising quick funds to reduce the budget deficit include these goals. They are seen as means towards attaining specific objectives.

3.2 External Factors

3.2.1 Role of the World Bank and IMF

In Malaysia, pressure from the IMF has been less intense than it has been on other countries. Gouri et al. (1991: 44, 52) state that "IMF pressures are subdued in Malaysia." Nonetheless, it is the combination of fiscal pressures which leads to an adverse balance of payments deficit and which in turn attracts the World Bank and IMF's involvement through loans and aid programs.

Bruton et al. (1992:311) maintain:

> Although the World Bank and IMF pushed their conventional restructuring package, Malaysia did not formally accept that package and the conditions that its acceptance would impose. It did, however, proceed with its own version of adjustment.

Due to the implementation of an economic structural adjustment program, public sector development expenditure increased slightly in 1983, remained constant in 1984, and fell 15 per cent in 1985. Commodity imports declined by almost 7 per cent and the inflow of foreign capital continued. Therefore, the overall deficit of the government was less than 10 per cent of GDP in 1985 compared with 20 per cent three years before (Bruton et al., 307-311). According to Nellis and Kikeri (1989:667), in Malaysia, as a non Bank supported operation, privatisation has resulted in an improvement in the financial performance of the privatised firms.

However, project loans from the World Bank grew significantly during 1975-86. These grew from $1.1 billion in 1975 to $2.7 billion in 1980, to $5.1 billion in 1985, and $6.2 billion in 1986 (Jomo, 1989:80). Nonetheless, market loans, from private sources, grew faster (Table 3.5).

Table 3.5: Project Loans and Market Loans During 1975-86 ($billion).

Type of loan/ Year	1975	1980	1985	1986	1991	1992	1993	1994	1995
Project Loan	1.1	2.7	5.1	6.2					
Market Loan	1.3	2.2	15.5	17.8					
Total Loans	2.4	4.9	20.6	24	17.8	19.8	25.2	17.6	16.7

Source: Jomo, 1989c:78-86; and *Asian Development Outlook* 1994:104. Loans during 1991-5 include direct foreign loans.

Market loans generally involve higher interest rates and virtually no supervision of how the borrowed funds are used. However, project loans which usually come from multilateral and aid agencies may involve other hard terms, especially once the country's credit rating drops due to excessive borrowing, declining balance of payments, etc. The debt outstanding including IMF credit and net short-term capital during 1987-90 was $22,758, $20,400, $18,576 and $20,381 respectively (World Bank, 1991a:337). This large level of external debt accumulated in the 1980s, according to Brown (1993:43), established the need to attract more direct foreign investment.

According to Jomo (1989:78) many of the loans were directed to "non-performing projects" which were not expected to yield sufficient returns to service the loans. Such projects included poorly planned projects, such as Kuantan Port, East-West Highway and the $1.2 billion Komatar Complex in Penang, and heavy industrial projects, such as the Proton (Perusuhan Otomobil Nasional) car project, and the new Cement plants in Langkawi and Perak.

External pressures dominate where economies are dependent on trade which makes them vulnerable to these pressures (Gouri et al., 1991:45; Gouri, 1991b:117). On the basis of these facts and a selective economic restructuring policy, Malaysia initiated an adjustment liberalisation during 1986-90. According to Salleh and Meyanathan (1993:7), the 1985-6 recession triggered an adjustment and liberalisation program which included market liberalisation and promotion of private sector growth. This shift was given a new impetus by the Promotion of Investment Act 1986, which provided incentives for manufacturing, agriculture and tourism. The government also kept public spending under control, focusing on the provision of infrastructure to create the favourable environment needed for private enterprise to grow.

3.2.2 Ideological Pressures

Privatisation policy is assumed to be accompanied by ideological pressure while it is directed by external pressures. IMF loan facilities come with the conditionalities of market ideology. This market oriented ideology gets stronger due to pressure from foreign investors and their association with sympathetic indigenous industrialists who are interested in collaborative ventures with foreign investors (Jomo, 1989:80). Malaysia opted for market ideology to expand private sector activities with a view to achieving growth and development.

Furthermore, Malaysia opted for a strategy of reliance on market forces, due to changes in the regional and international economy. This option made Malaysia dependent on external factors, and has been criticised due to the adverse consequences for Malaysia's development. Chandra Muzaffar (1989b:23) maintains that the type of development which is pursued is the reason for the intense impacts of the international economic crisis on Malaysia. He explained that this type of development has made Malaysia:

(i) dependent upon international market prices for raw materials;
(ii) dependent upon the export of manufactured products owned, controlled and distributed by multi-national corporations;
(iii) dependent upon imports in almost every sphere of economic activity; and
(iv) prevented the building up of an autonomous base in food production and manufacturing.

Chandra Muzaffar (1989a:16-17) also argues that the market economy ideology seeks to integrate the Malaysian society into an international system that dominates it and denies its independence. He explains that even Malaysia's present drive into heavy industries has given the industrialised countries an opportunity to locate their heavy industries in Malaysia. It is a response to a new stage in the international division of labour, where the industries will also be controlled through the technological and market dominance of the industrialised countries. Industries, from this point of view, are more important when they grow out of an autonomous industrialisation program.

Resistance against this ideological pressure has been evident, however, for a long time. In Malaysia, there is an idea that colonialism forced un-Islamic practices on Muslim peoples and *brainwashed* some Muslims with secularistic visions (Mauzy and Milne, 1984:633). Therefore, there is also criticism by the Council of Ulama (Islamic scholars) of the government regarding its non-submission to the Islamic Law in the country: "The authorities say they uphold Islam, but their Islam was learned from colonial masters. We have no Islamic constitution, no Islamic Law" (*New Strait Times*, 22 November 1982, cited in Mauzy and Milne, 1984:643). However, Mahathir's justification in response to these criticisms was that the government also considers non-Muslims' concern for "fairness and justice" (Mauzy and Milne 1984:643). Mahathir's justification was not acceptable from the Islamic scholars' point of view. Chandra Muzaffar, founder of a non-partisan, multi-ethnic reform movement, described this justification as "provoking fears among the non-Malay community that Islamic law and an Islamic lifestyle will be imposed on non-Muslims as well as Muslims". Chandra Muzaffar's comment implied the point that Islamic law, in essence, let other religions be free in their belief and their practice.

The government has tried to respond to ideological pressures in a practical, pragmatic way. One of the Mahathir administration's policies was the *Look East Policy* which calls for discipline and hard work. The other policy was support for the teachings of Islam in administrative reform. In Mahathir's view, the first may be a means to material improvement, and the second a path to spiritual development. The two are meant to be integrated: each is concerned with moral values and both prongs point in the direction of "discipline through Islam" (Mauzy and Milne, 1984:648). The *Look East Policy* rests on the perception that new models of economic progress and industrialisation are needed, and that Japan and South Korea are good examples to follow. According to Mahathir, Western countries are no longer seen as setting the appropriate standards, either materially or morally. They are no longer making headway technically, and they are marked by a materialistic attitude, self-interest, atheism, lack of honour, and exploitation of fellow humans (Mauzy and Milne, 1984:627). This position of the government helped it in promoting its own reform program.

Nonetheless, dissatisfaction with the West did not lead to any dramatic shift in foreign policy, although it was reflected in a statement defining Malaysia's foreign policy priorities. In that statement, ASEAN countries came first, then Islamic countries followed by non-aligned nations and, fourth, Commonwealth countries. Given that Western influences were rejected, Japan and South Korea were to be emulated. Japan, because of its amazing economic success, and South Korea, whose level of economic development is closer to Malaysia's and thus more relevant as an example (Mauzy and Milne, 1984:627).

In summary, a key internal pressure for privatisation was the lower than expected performance of some PEs. This situation arose because of the ambiguous objectives of PEs, and the government's financial support to compensate for their weak performance. The financial crunch to the economy after the 1979 oil shock was another internal pressure. These internal factors and pressures from the World Bank and IMF to meet conditions to obtain loans produced an appropriate situation for PE reform initiation. Although reform has created ideological conflicts, these tensions have somehow eased as reform initiation was coordinated with the objectives of the NEP. The next section addresses the types and the features of various policies associated with the objectives assigned to and motives for privatisation.

4 Privatisation Policies in Malaysia

The policy of privatisation was a device to achieve economic, managerial, and social objectives of governments. Malaysia was no exception.

From the point of view of policy in Malaysia, the racial conflict of 1969 was the precipitant for significant changes to be made to the predominant economic strategy of the time. However, further policy changes also appeared necessary as the NEP approach ran into problems in the early 1980s (Bruton et al., 1992:348).

The Malaysian government shifted from a protectionist policy to a policy of significant privatisation in 1983. This was considered a critical change from the past objectives of the NEP. However, the government argued that this policy was based on the objectives of the NEP, while taking into consideration specific conditions of the economy at that period.

The national policy for economic management suggested a gradual reduction in the role of government in economic management but the policy-makers still needed to have concern for ethnic equity by protecting the special interests of the Bumiputra. The measures for privatisation developed in Malaysia include a very strong element of involving the indigenous population in the privatised industries (Sankar, 1991:206). While examining the above factors, this section addresses privatisation policy-making in Malaysia. It deals with the features of policy-making, policies for foreign participation, private sector capability, the capital market and privatisation safeguards.

4.1 Privatisation Policy of Government

4.1.1 The "Look East" Policy

Policy-making for reform in PEs was initiated by the *Look East* policy. The *Look East* policy adopted in 1981 was an explicit attempt, in addition to its socio-cultural aspects, to emulate the heavy industrialisation efforts of Japan and Korea (World Bank, 1993:310). Look East implies *Stop Looking West*, a point which was emphasised by the Prime Minister himself who criticised Western domination of the East and imitation of various aspects of Western culture by Malaysians. Instead, he proposed that Malaysians Look East, where values, work ethics, and management practices stress hard work, loyalty to the enterprise, commitment, determination and initiative (Mahathir, 1984:41 cited in Bruton, 1992:316; Milne and Mauzy, 1986:146).

The belief was that the impressive development in the countries of the East, notably Japan and Korea could provide alternative models closer to Malaysia. The purpose of following these examples was to achieve high productivity, through following a strong work ethic and management philosophy and practices (Mahmood and Mat, 1992:432). Japan and South Korea were appropriate countries to refer to in the new policy. Spreading such ideas through "leadership by example", organisation and discipline were emphasised frequently.

The *Look East* policy had a high moral content while intending to produce material pay-offs. It aimed for the establishment of a clean, efficient and trustworthy administration and a moral and efficient civil service. The Prime Minister saw these values as compatible with Islam - a relationship summed up in the government slogan, "Discipline through Islam" (Milne and Mauzy, 1986:147). Enthusiastic acceptance of a value such as hard work was presented as an Islamic virtue. There is support for hard work and discipline in the Qur'an, the Hadiths (sayings of the holy prophet Muhammad) and numerous famous studies. Therefore, from a cultural point of view, the policy has been criticised because it hardly makes sense to advise Malay Muslims with their own work ethics to emulate Japanese or South Korean work ethics (Jomo, 1989:19). However, application of these measures, which may bring economic and social benefits to the people, is not contradictory to Islam. The policy aimed to enhance good work ethics and dedication to the service of the state and the people among civil servants.

Much of this policy thrust focused on increasing economic co-operation with Japan in the areas of trade, investment, and technology transfer (Hensley and White, 1993:73). The establishment of the Heavy Industries Corporation of Malaysia (HICOM), which was an example of active government participation and intervention in the country's industrial development, symbolised an ambitious industrialisation program (Ariff, 1991:10). The Malaysian Business Council, which was formed in 1991, also resembles Korea's highly successful Export Promotion Council (World Bank, 1993a:187).

Malaysia has taken measures to implement the *Look East* policy through education and training schemes, the use of trading companies on the Japanese pattern, and through the concept of *Malaysia Incorporated* (Milne and Mauzy, 1986:148). Malaysia's *Look East* policy was the extension of the idea of "Malaysia Inc". It was an effort aimed at modelling certain aspects of Malaysian industrialisation and practices on the Japanese experience.

The term *Malaysia Incorporated* was the focal point of privatisation and reform in PEs. In October 1983, privatisation discussions began under the banner of *Malaysia Inc.*, the Prime Minister's concept of the country as a corporate entity and of a new policy of co-operation between government and the private sector. Initiatives were led by Prime Minister Mahathir Mohammad who proclaimed the policy of creating *Malaysia Incorporated.* The World Bank (1993a:186) maintains that in Malaysia, officials have applied this concept in their effort for growth with equity, a particularly important goal in a multi-ethnic society.

4.2 Privatisation Objectives and Framework

Malaysia's record in privatisation is likely to be the most significant in Southeast Asia, both qualitatively and quantitatively. It was rated as among the world leaders in the area of privatisation (Ng and Toh, 1992:49). The policy framework for the reform was also clear and precise. "Malaysia is the possible exception in the Asia-

Pacific region that outlined and openly spelled out the policy of public enterprise reform" (Sankar, 1992:201).

The privatisation program was based on the assumption that the transfer to the private sector of activities and functions which have traditionally been carried out in the public sector will create positive changes in organisation, management and performance of PEs (EPU, 1993a:2).

The centrepiece of the program, issued in 1985, specified a number of objectives to be pursued through privatisation:

(i) reduction of the financial and administrative burden of government;
(ii) promotion of competition and increased productivity of PEs;
(iii) stimulation of private entrepreneurship, investment and growth; and
(iv) promotion of the objectives of the NEP through increasing the supply of private equity (Adam et al., 1992:227, see also Bruton et al., 1992:315).

The first objective of privatisation is associated with relieving the government of undertaking and maintaining a vast network of services and investments in infrastructure. The second objective is intended to improve the efficiency and effectiveness of PEs by the introduction of employee incentives. Economic growth will be obtained by the commercial and profit orientation of private enterprise. Fulfilment of the National Development Policy (NDP) objectives was to be achieved through restructuring the ownership pattern in the economy (EPU, 1993a).

As has been pointed out above, a unique feature of the reform in Malaysian PEs is the linkage between privatisation and the NEP targets. One of the main stated objectives of privatisation was to promote the attainment of the NEP income distribution targets (Adam et al., 1992:24).

In this respect Salleh (1991:612) states that:

> The challenge to the policy maker was to link the traditional objectives associated with privatisation and the overriding national goal of redistributing wealth to the Bumiputra community.

Bumiputra participation appears as a central element of the privatisation process. Although there is a clear preference for private Bumiputras participation, the government would consider allowing *trust agencies* or other government companies to participate initially in the ownership of the privatised enterprises. Foreign and non-Bumiputra participation is allowed, but subject to strict ownership conditions in accordance with the NEP. Malaysian ownership must be 70 per cent of which 30 per cent must be Bumiputra ownership (Adam et al., 1992:228).

Any privatisation transaction would have to include a minimum 30 per cent Bumiputra participation. In order to satisfy this condition, if individual Bumiputra investors are not able to participate in the transaction, the National Unit Trust, as an agent of the Bumiputra community, has to be prepared to temporarily invest on their behalf. According to Salleh (1991:612), individual Bumiputra investors are expected to have the financial capability to purchase their shares from the trust in future.

4.2.1 Privatisation Policy and the NEP

Privatisation in Malaysia has been driven almost entirely by the NEP to achieve economic and social objectives. As has been pointed out above, the asset sales have created conditions for the Bumiputra and their institutional representatives to enhance their economic base and acquire the entrepreneurial ability needed for economic growth and competitiveness. Privatisation is thus the second phase in the NEP, when asset accumulation by government is redistributed to individual

Bumiputras and Bumiputra institutions (Adam et al., 1992:255). The asset distribution mechanism has created a new economic structure in Malaysia where Bumiputras now play a significant role in trade and business.

The growth mechanisms in Malaysia suggest that PE reform does not explicitly contradict the underlying post-1969 socio-economic policies, but the reforms have entailed a shift in the respective roles of the public and private sectors as devices for the attainment of the NEP goals. Leeds (1989:745), points out that the government could not ignore efforts to fulfil its promise to the Bumiputra community in relation to the redistribution of wealth and to getting their shares both in terms of equity and employment.

This growth has strengthened the process of transformation in the economy. The method of asset sales is considered as an appropriate measure linking the objectives of the NEP with the privatisation policy. The objective of equity, in particular social equity, was clearly spelled out as a policy objective. Social equity has taken the form of redistribution of wealth and income through the allocation of a certain proportion of the shares to the Bumiputra (Ng and Toh, 1992:44).

However, there are signs that the government now wants to be pragmatic about the NEP. It has relaxed some of the rigid NEP rules, especially those governing foreign equity. The introduction of the new development plan (NDP) in 1991, was the beginning of a new era in which specific emphasis is placed on the goal of economic growth.

4.3 The Features of Policy in the Privatisation Program

The privatisation initiative was a selective program which was strongly implemented in Malaysia, despite the pressures of a constrained trade and financing environment (Commander and Killick, 1988:94). It provided an opportunity for the government to formulate and to implement policies to counter internal and external pressures.

The peculiar feature of the privatisation policy in Malaysia is its specific restriction as to the social distribution of equity investments and the process of investment proposals and reviews. In accordance with the objectives of the NEP, special consideration was given to the ownership structure of all the enterprises divested, so that by 1990 there would be at least 30 per cent Bumiputra ownership, 40 per cent for other Malaysians, and 30 per cent for foreign interests. This was one of the controlling means for the redistribution of wealth and economic restructuring of Malaysia. However, this has been reviewed and altered in the most recent Privatisation Master Plan (Hensley and White, 1993:74; PMP, 1991:27).

Privatisation is viewed by governments as a means of raising short-term finance. Therefore, the sale of PEs rather than restructuring was encouraged in order to relieve financial problems (Gouri, 1991:31). As there was concern about the limits to domestic debt financing and sizeable fiscal deficits at the time of privatisation, asset sales were to be used to support short-term revenue raising efforts. However, the percentage of equity sold in each public issue has been low - the only exception being Malaysian Airline System (MAS), where 30 per cent was sold - and the tendency of the government to discount new shares indicates that short-term revenue considerations have not been the main feature of the Malaysian privatisation program. The following paragraphs examine the various aspects of privatisation policy regarding foreign participation, the capital market and the structure of the private sector.

4.3.1 Foreign Participation and Investment Policies

In Malaysia, foreign investment is welcomed subject to the constraint of the NEP. Before the establishment of the NEP, over 61 per cent of share capital was owned by foreigners (Table 3.6). Therefore, a great deal of income generated in Malaysia was being paid to foreigners (Bruton et al., 1992:225). In the second plan, no ownership targets were set for the non-Malays and foreign interests.

Table 3.6: Ownership of Share Capital by Sector, 1970.

Type of owner	Rubber	Tin	Manufacturing	Financial institution	Trade	All
Malay	10	4	2	3	1	2
Total residents	22	33	40	48	36	39
Foreign	78	67	60	52	64	61

Source: Bruton et al., (1992:224).

The growth of Malay ownership was expected to take place at the expense of foreign interests. Under the NEP, as noted above, foreign participation was limited to 30 per cent. It was not until 1984, however, that the rigid rules regarding foreign participation were relaxed (Bruton et al., 1992:273).

The rules limiting foreign equity participation were relaxed under certain conditions in order to encourage more foreign investment in "high technology" industries (Milne and Mauzy, 1986:144). By 1985, estimates showed that foreign interests controlled only about one quarter of share capital, below the 1990 target of 30 per cent (Bruton et al., 1992:311). The government apparently was convinced that foreign investment was necessary if growth was to be maintained without large-scale government help.

Foreign investment in Malaysia is coordinated by the Malaysian Industrial Authority (MIDA), a mostly Bumiputra staffed, quasi-governmental body that creates the incentives necessary to attract new capital into the country and is used by foreign investors for their one-stop shopping (a term Malays detest) (Schollosstein, 1991:236). Applications are considered by the Foreign Investment Committee (FIC) and are granted if:

(i) the investment does not adversely affect control or ownership structure in the economy;
(ii) it leads to benefits in terms of Bumiputra participation and employment;
(iii) it has a positive effect on export earnings, diversification and local resource use; and
(iv) it does not have [adverse] environmental or other strategic implications (Adam et al., 1992:260).

In principle, 100 per cent foreign ownership is prohibited, but exceptions can be made in some cases. Any company which was set up with foreign capital between October 1989 and December 1990 is exempted from the NEP equity restructuring requirement, provided that:

(a) it exports at least 50 per cent of its output, and
(b) it employs at least 350 full-time Malaysian workers in proportions corresponding to the racial composition of the country (Schollosstein, 1991:236; Ariff, 1991:21).

Foreign participation in Malaysia may take the form of equity financing, debt financing and/or management expertise (EPU, 1993:24). In equity financing of the privatised entities, investors are allowed to invest a maximum of 25 per cent of the market share capital. Caution has been exercised with regard to foreign participation in strategic projects. "For projects of strategic and national importance, foreign ownership will have to be widespread in nature so as to ensure that no one foreign party will have undue influence on the company" (Malaysia Towards 2020, 1992:82; PMP, 1991:28). Debt financing could be in the form of the provision of loans to successful companies for the financing of their privatised projects. Management expertise could be provided by foreign companies in order to meet the need for effective and efficient management for privatised projects.

According to Mahathir (1992:206), the foreign participation scheme is to be based on the objective of enhancing the absorptive capacity of the capital market and accelerating the industrialisation drive. Mahathir Mohammad points out the rationale behind this policy as follows:

> This is essential for the Malaysia Industrialisation Drive. Again, we will not abandon a winning strategy. But we will fine-tune it to ensure that measures are in place to ensure that Malaysia maximises the net benefit from the inflow of foreign investment.

The Fifth Malaysian Plan, published in early 1986, states that "the emphasis of development for the second half of the 1980s will be based on growth with stability. At the same time in view of resource constraints, increased efforts will be made to mobilise resources and improve efficiency" (Bruton et al., 1992:309). It was further emphasised that the government would not borrow as it had in the early 1980s. Financial stability includes balance of payments strength as well as the government budget position and price levels.

Although local investors are expected to take advantage of the investment opportunities made available by the privatisation policy, foreign participation was considered appropriate under the following conditions:

(i) where the expertise is needed to upgrade efficiency, and such expertise is not available locally;
(ii) where foreign participation is required to promote the export market;
(iii) where the supply of local capital is insufficient to absorb the shares offered; and
(iv) Where the nature of business requires global linkages and international exposures (EPU, 1993a:23; PMP, 1991:27).

In practice, foreign investors can only purchase the privatised company shares after the initial issue, when the level of demand is affected by the rate at which the price trades up (EPU, 1993a:22). Finally, the choice of foreign partners in the areas of privatisation where Malaysia is judged to be already an expert (as in telecommunications), is very selective. For example, foreign partners are brought in only when there are gaps in the projects it is undertaking (Malaysia Towards 2020, 1992:82).

Foreign investment in Malaysia consists of both direct and portfolio components. Joint ventures form the bulk of direct foreign investments, although new forms of foreign investment - such as licensing and franchising arrangements - are also growing in importance (Ariff, 1991:15). These foreign borrowings have been applied to finance expensive investments in heavy industrialisation. As a result, there was less capital for other uses (Jomo, 1989:38).

There is an argument that heavy industry has become very dependent on foreign partners, consultants and contractors who are paid lucratively to speed up the construction and completion of projects. According to Jomo (1989b:39) quite a number of contractors have taken control out of the hands of government, especially foreign operators who were awarded lucrative turn-key contracts with total control over design, material and construction, and often using over-priced imported technology and supplies.

Malaysia's way of transferring technology and creating employment is expensive. According to Jomo (1989:39), instead of seeking the cheapest and most appropriate technology, the government often gave contracts to big Japanese and South Korean firms without any open competitive tendering process. The attraction for foreign investors was cheap and educated labour, abundant land for development, superior infrastructure, political stability and favourable foreign investment laws which were enacted in 1987 (Tsuruoka, 1992a:45-7).

4.3.2 Structure of Private Sector

New policies about private sector activities were advanced in the *Malaysia Incorporated* policy of the government. It was an attempt to emulate the "*Japan Inc.*" approach, particularly the close relationship between Japanese ministries (especially MITI) and big business. This Malaysian initiative was intended to promote a new macro-level partnership or compact between the public and private sectors. This was a concept which viewed the country as a corporate entity, with the government providing the policy parameters and support, and the private sector providing commercial expertise and shrewdness in solving problems.

To achieve the goals of this policy, efforts were undertaken by ministries and Federal departments to promote co-operation between the private and public sectors (Government Report, 1991:54). In fact, there has been considerable co-operation and collaboration between the government and the private sector, as proposed in the concept of *Malaysia Inc.* which gained endorsement in the mid-1980s (Ariff, 1991:22; Bruton et al., 1992:315). The government provided the environment in terms of infrastructure, deregulation and liberalisation, and macro-economic management. The private sector was assumed to have the main role in growth, while the privatisation program was seen as the centre core of *Malaysia Inc.* (Adam et al., 1992:216).

Directions on privatisation were first drawn up in 1985 (Malaysia 1985). Subsequently, the Fifth Malaysia Plan (1986-90) gave an even greater role to the private sector to provide dynamism in the economy. This was followed in February 1991 by the release of the country's Privatisation Master Plan (PMP), in which the techniques of privatisation were specified and the services and the entities to be privatised and restructured were identified (Ng and Toh, 1992:42).

However, there were questions as to the private sector's ability and enthusiasm to provide an environment for movement towards the national objectives of the government. The provision of competition, realisation of efficiency gains, the financial sector capacity to mobilise savings for private sector investment and the government's capacity to regulate private sector monopolies effectively were other issues concerning the initiation of the privatisation program.

On the other hand, domestic private investors felt that the government had not committed itself enough to the promotion of domestic investment as opposed to investment from overseas. The Prime Minister's response was that "this is not completely true but we will redress the situation as we get better feedback" (Mahathir, 1992:206). In the past, the domestic private sector had mostly failed to meet the targets set in successive Malaysia Plans.

It was argued that domestic investors - predominantly Chinese - did not have the interest or technology to invest in projects offering uncertain returns (Jomo 1989b:39). In addition, the Malaysian domestic private sector is a mutual system in which business grants a piece of the action in return for state support and protection from unexpected regulatory outcomes (Haggard, 1994:289). Therefore, Malaysian authorities claimed that foreign investors would be more easily persuaded to get into joint ventures, with the government providing capital subsidies and protection in the domestic market (Jomo, 1989b:39).

With regard to competition, the licensing system was seen as a barrier to competition for export enhancing (or labour/saving) equipment, which had been approved subject to the maintenance of the NEP equity and employment criteria such as Bumiputra participation (Adam et al., 1992:260). The argument is that the licensing scheme acts as an additional barrier to entry for incumbent firms, denying contestability to markets, and permitting the continuation of monopolistic operations. Although the private sector was strong enough to provide a degree of competition, the relative balance was still in favour of PEs. (Adam et al., 1992:73). Structural rigidity in the economy such as segmented labour markets, industrial licensing and foreign participation policy were seen as barriers to the private sector (Adam et al., 1992:261).

4.3.3 Capital Market and Privatisation

In Malaysia, financial institutions and commercial banks - including government-owned commercial banks - are largely autonomous with freedom of entry for new banks and branch expansion. There is also a relatively large securities market (World Bank, 1993:37). Malaysia is said to have one of the more dynamic emerging stock markets in the world. The equity market is a large and developed one. It consists of two trading exchanges, the Kuala Lumpur Stock Exchange (KLSE) and the Bumiputra Stock Exchange. There are also 49 country funds investing in Malaysian stocks, including the IFC's Malaysia Fund Inc., which is listed on the New York Stock Exchange (Adam et al., 1992:262). Nonetheless, there seem to be some weaknesses in the Malaysian capital market. EPU (1993a:20) maintains that "The Malaysian equity market is relatively well developed by regional standards, nevertheless, it suffers from inadequate liquidity, limited sectoral coverage and limited participation by institutions".

Privatisation issues may crowd out[21] other private sector issues, unless foreign capital and portfolio inflows are high. Indeed, many large PEs planned for privatisation are monopolistic, and dividends can be kept high by maintaining monopoly pricing. The evidence from the first phase of the privatisation program shows that the continuation of the transfer of wealth through the capital market dominated the efficiency gains from greater competition (Adam et al., 1992:267). According to Hensley and White (1993:77), the capital market still lacks depth and has limited liquidity in spite of being developed by market standards. Large scale privatisation is, therefore, constrained by the extent of the absorptive capacity of the domestic capital market.

In order to avoid the crowding out of capital demand by the private sector, consideration needed to be given to the promotion of investment demand, particularly from new equity investors, from employees of privatised entities, and from the Bumiputra community. This would not only provide the needs of the privatisation program, but also simultaneously promote development of the local capital market. The Government is reviewing policies and measures to increase

[21]– Crowding out occurs when deficit spending by the government forces the reduction of private investment spending on exports (Baumol et al., 1989:749).

and enhance the absorptive capacity of the capital market because billions of Ringgit worth of Government agencies and projects are to be listed on the exchange. (Malaysia Towards 2020, 1992:70).

Enhancing the absorptive capacity of the capital market can be encouraged through co-operation between institutional investors as well as individual entrepreneurs and companies. Lembaga Urusan Tabung Haji and Lembaga Tabung Angkatan Tentra are examples of the institutional investors. Active Bumiputra participation is also encouraged through procedures for share ownership by employees, such as management buy-outs and employee share ownership plans (ESOP) (Malaysia Towards 2020, 1992).

Privatisation which involves public issues of shares has the effect of deepening and broadening the Malaysian stock market. It serves to increase the number of stocks as well as introduce new sectors and thus increase market capitalisation. The experience of privatisation in Malaysia shows that privatisation issues have not only increased the number of stocks traded on the Kuala Lumpur Stock Exchange (KLSE), but also has introduced five new sectors, viz. airlines, shipping, broadcasting, telecommunications and the electricity supply industry (EPU, 1993a:21).

4.4 Privatisation Safeguards

4.4.1 Privatisation Policy and the Public Interest

There is concern about the public interest in Malaysia in connection with the privatisation program. Privatisation is based on assumptions about the government's inability to perform efficiently and the point that privatisation reduces its need for external borrowing. The prime motivating factor for privatisation is profit-oriented. On the other hand, privatisation often leads to job reductions for optimum profit gains to be met and is likely to give rise to unemployment and under-employment. Besides, privatisation tends to increase the burdens on consumers.

Raguanthan (1990:210) argues that in spite of the growth of per capita income during 1970-80, it is still very low - about US$4,000.[22] Therefore, the government has to provide services through revenue allocations because the community is too poor to pay for them. Here, of course, it is agreed that the burden placed on revenue by inefficient and poorly organised PEs is great.

An equitable mechanism is needed to provide services in a subsidised form through national revenue, since in Malaysian society there continue to exist wide economic imbalances between the majority in the rural sector, and those in the suburban and urban sectors. It is only by this means that the level of income of the poor can be improved. In such an economic environment a large-scale privatisation exercise, as practiced in largely capitalist states, is not feasible. Any such policy in a situation of economic imbalance will result in the exploitation of the poor. Raguanathan (1990:211) maintains that the state has the responsibility not only to provide services, but also to protect the poor in so far as costs are concerned.

The Prime Minister, Mahathir Mohammad, points out that one obligation of the private sector is to consider measures of social responsibility and social justice. He maintains that Malaysia cannot deregulate if the freedom provided to

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[22]– As has been mentioned earlier in Section One, the Malaysian per capita income is less than this figure, i.e. about $3,406. See Section One Economic Environment.

enterprise becomes merely licence to exploit without any sense of social responsibility. He states:

> Our companies must have a high sense of corporate duty. Our struggle to ensure social justice to uplift the position and competitiveness of the Bumiputras and to achieve the other social objectives - must be your struggle too (Mohd Sheriff Kassim, 1992:211).

Furthermore, he warns that privatisation cannot continue if its objectives are defeated by those who think only of personal profit without social responsibility. He underlined the public interest in implementing privatisation and claimed that:

> The Government is fully aware of the need to protect the public interest, to ensure that the poor are provided access to essential services, to guarantee that quality services are provided at minimum cost, to avoid unproductive monopolistic practices and to ensure the welfare of workers (Malaysia Toward 2020, 1992:204).

On the basis of these acknowledgments, the establishment of safety clauses became a part of government policy in order to address some of the negative consequences of privatisation.

4.4.2 Built-in Safety Clauses

It seems that effective privatisation policy requires effective regulatory bodies or built-in safety clauses as a guarantee against unfavourable consequences for the public interest. Built-in safety clauses have become an essential component of successful PE reform. The establishment of regulatory bodies and the retention of golden shares by the government are two elements of these safety clauses in Malaysia.

Regulatory Framework and Competition Policies

In order to ensure that the public interest is fulfilled, the Government has instituted regulatory bodies to watch over the privatised entities. The role of regulator is to enforce rules and regulations; being concerned with promoting industry in a systematic manner; and to aid the growth and development of industry in line with national and social objectives. Ensuring efficiency, productivity and competitiveness is another task of the regulatory body. Efficiency is viewed from the interests of shareholders. Therefore, government continues to have an influence and effect on the PEs even after they have been privatised (Malaysia Towards 2020, 1992:75).

The approach to regulation in Malaysia is clarified in its Rules and Regulations Regarding Acquisitions, Mergers and Take-overs. These are considered as the means of reconstructing the pattern of ownership and control of the corporate sector consistent with the objectives of the NEP. According to Somogyi (1991:37), effective regulatory safeguards are in place to protect competition where monopolies arise in the privatisation process. To create a competitive environment, an appropriate regulatory framework has been prescribed, either to be newly established or to be strengthened to regulate natural monopolies (PMP, 1991:26). The task of the regulatory bodies is to ensure that consumers' interests are protected, especially in terms of price, quality, and availability of services. These regulatory bodies have been established to monitor privatised enterprises such as the Klang Container Terminal. The staff of the regulatory bodies often includes people who were employed in the enterprises before privatisation.[23] In addition, employment in privatised companies is protected for a transitional period and pension rights of staff are guaranteed.

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[23]- Interview with Dr Zeinuldin Abdulrahman in Economic Planning Unit (EPU), 16 September 1993, Kuala Lumpur.

Proposals for unifying the regulatory structure for all privatised enterprises are in the Privatisation Master Plan (PMP). However, there is a separate regulatory structure in the Telecommunications Act of 1989, which follows a number of similar regulatory and competitive structures employed in the United Kingdom such as Oftel and Ofgas.[24] However, there is an argument by Adam (1992:269), that the structure of these regulators is not clear. These are independent regulatory bodies, while the PMP proposes a uniform regulatory framework covering the regulation of all utilities.

A lack of clarity concerning the ability of these agencies to deal with private sector monopolies, and an underestimation of the resource costs required to manage price regulation are other criticisms of regulatory bodies. Nonetheless, the significant role of regulatory bodies and regulations as safeguards for privatisation cannot be ignored.

Golden Shares and Partial Privatisation

A unique feature of privatisation in Malaysia is the use of *special rights* or *golden shares* when PEs are sold.[25] Many public flotations of Malaysia's large PEs have represented only partial privatisation, with the state retaining majority control. Three of the assets sales have used Golden Shares - 48.6 per cent of Malaysian

[24]- Much of the detailed conduct of regulatory policy in the second phase of the privatisation program in the UK has been delegated to Oftel, Ofgas (office of gas supply), Ofwat (water), Offer (electricity), and Monopolies and Merger Commission (MMC) (Stelzer, 1992:62, 70; Hensher and Beesely,1992:7; Yarrow, 1986:199). These offices are responsible for two essential regulatory tasks - price control for (natural) monopoly and promotion of competition in situations where there is a typically high starting market share. They also provide a sharp focus for the first time for consumer complaints. There was hope that the initial deficiencies in the regulatory frameworks could be corrected.

[25]- The *golden share* concept is a protection provision allowing the holder powers of veto over fundamental decisions of the company.

International Shipping (MISC), 42 per cent of the Malaysian Airline System (MAS), and Sport Toto. The government still holds 70 per cent of the national car maker Proton, 75 per cent of Telekom Malaysia, and 76.9 per cent of the national electric utility Tenega Nasional (TEN) (Hensley and White, 1993:75; Adam et al., 1992:254). The other reason for partial privatisation is the government's intention to dilute further shareholding.

The *golden share* is an instrument of the safety clauses, which the government can use to veto decisions it judges are against the public interest. As the guardian of the public interest the government must ensure that:

> the poor have access to essential services; that the quality of the output of privatised entities is up to pre-specified levels; that services are provided at minimum cost and at affordable prices. It will also ensure that unproductive monopolistic services are avoided and welfare of the workers protected (Malaysia Toward 2020, 1992:76).

In the case of the privatisation of telecommunications, the government exercised extreme caution through the continued existence of the old Telecommunication Department, which now licenses and regulates the privatised agency (Salim, 1991:394). This arrangement was used to prevent the transfer of a public monopoly to a private one.

The Workers and Employees' Rights

The underlying principle behind the policy was one which strongly supported employees and stated that employees will not lose the benefits they enjoyed previously (Adam et al., 1991:250; Gouri, 1991a:95). In negotiations over the Klang Container Terminal (KCT) sale, for example, three options were available.

They were:

(i) Depending on their employment status, workers could opt to retire with generous lump-sum severance pay and entitlement to early pension benefits.

(ii) Employees could opt not to join KCT, regardless of their function. KPA (Klang Port Authority) would be obliged to retain these people without loss of pay, conditions, grade, etc.

(iii) Workers could choose to terminate their contract with KPA and join KCT, the new company, on terms no less favourable than before. KCT employees could not be fired for a period of 5 years, except in disciplinary cases (Adam et al., 1992:250).

In general, two alternatives were offered for those who wished to join the privatised entity. One was a government scheme of service, and the other was more commercially oriented. The latter gives the employee the right to purchase shares in the privatised entity and to enjoy bonuses that are declared as and when warranted based on the performance of the entity. These *employee share ownership plans* (ESOPs) and *employee loyalty share scheme* (ELSS), have been introduced to enhance the employees' sense of faithfulness and obligation towards the company (EPU, 1993a; PMP, 1991:28). The attractive packages promoted co-operation among employees and reduced resistance to privatisation efforts.

It is claimed that an inherent contradiction affects implementation of the new policy. Salleh (1991) argues that there is tension between the government's desire to dispose of specific PEs' assets and the equally important concern of protecting the rights and privileges of public sector employees. He states that:

> On the one hand, privatisation should promote competition, improve efficiency, and increase productivity. On the other hand, all schemes for privatisation must include provisions whereby the employees will not lose in any way the benefits that they enjoy while employed by the government (p.613).

However, it should be taken into consideration that apart from the benefit to a group within society, these provisions are used to guarantee the consolidation of privatisation.

Limitation of Shareholding

The final issue regarding government policy is the restriction on all public share sales so that no one shareholder (other than the government) can hold more than 10 per cent of the stock. This was echoed in the "1985 Guidelines" on privatisation that specified:

> as far as possible the ownership of share capital of companies involved in privatisation should be equitably distributed so that no one interest will hold an absolute majority (Adam et al., 1992:254).

While this constraint was supposed to be driven by a need to prevent concentration in the hands of non-Bumiputras, it raised the problem of shareholder free-riding[26] and the failure of shareholders adequately to monitor and control the management of the enterprise. This is said to sustain the situation of sub-optimal shareholder monitoring, particularly as control is re-concentrated in the hands of PEs.

In Malaysia, assets are systematically underpriced and risks are massively underwritten by public sector institutions, thereby compromising the underlying fiscal/efficiency, private sector and capital market objectives of the program. However, as Adam et al., (1992:57) state these cautions may be relaxed somewhat in the future. The responsibility of government, in this regard, increases when divesting its share and decreasing its proportion of ownership of companies to the public (Helmi Mohd Noor, 1992:11). Regulations can be helpful at this stage.

[26]- The free-riding problem arises when provision of a service to one individual or group automatically benefits others (the free riders) whether or not the others contribute to the costs (Baumol et al., 1988:752, 356).

In summary, the policy for privatisation in Malaysia was associated with the objectives of the NEP. It was also part of the "Malaysia Incorporated" policy in which the government attempted to close the relationship between business and the government. Privatisation was first a response to short-term financial problems but was also a long-term plan for economic growth and social equity. A variety of devices were applied to the privatisation program, and policies were made to protect consumers, workers, and employees. These were efforts to prevent deregulation being a licence to exploit without a sense of social responsibility. Foreign participation was allowed only under specific conditions and regulations, and shares to foreign parties in strategic projects were distributed so that no party had an undue influence on the company. However, the domestic private sector was wary of entering projects with uncertain revenue. Malaysia's capital market was large and developed in spite of lack of liquidity and other weaknesses. Nonetheless, some measures have been taken to attract the employees and Bumiputra community into investing in the market place.

5 Privatisation Implementation in Malaysia

5.1 Institutional Arrangements

An adequate supply of competent managers is needed for privatisation to be successful. This refers not only to those who have the expertise and experience to be chief executive officers, but also to production, marketing, personnel and financial managers of large-scale privatised enterprises. In Malaysia, steps have been taken place to manage the privatisation program under an appropriate process. The following paragraphs examine these provisions.

The administration of the privatisation program is based on the principle of centralised planning and decentralised implementation. Planning the program for implementation is centralised at the Economic Planning Unit (EPU, 1993a:25). The institutional arrangements established to manage the privatisation program consist of (in ascending order) four Technical Committees (Sectoral), the Privatisation Secretariat (Functional), and the Privatisation Committee (Main), all eventually answering to the Cabinet (Hensley and White, 1993:74). The main advisory body, reporting to the Cabinet, is the privatisation committee whose chairman is the Director-General of EPU.[27] The committee comprises members from the main ministries (Finance, Energy, Communication and the Implementation Coordination Unit). The executive body, below the main committee, is the Privatisation Secretariat established under the EPU and it consists of 10 to 15 staff.

There are two types of initiation of privatisation projects; government initiated projects and private sector initiation. The Secretariat initiates plans and manages the large-scale privatisation projects which have emerged directly from government policy initiatives such as the proposed telecommunications, railways and electricity sales. The government is undertaking a continuous review of entities to encompass those that were not covered by the Privatisation Master Plan Study. The entities that are identified in these review exercises are then selected to form the rolling Action Plan, after detailed privatisation studies have been

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27- Ali Abul Hassan bin Sulaiman is the Director-General of the EPU.

undertaken on each of them.

The private sector is also encouraged to initiate projects. Private sector organisations can apply for those enterprises which are not yet identified by the Government and also those identified by the Government and for which the private sector proposal contains certain unique features (EPU, 1993a:11).

Submissions received by the EPU are sent initially to the relevant technical committees, after which successful applications are reviewed by the main committee and sponsors give evidence prior to the applications being sent to Cabinet. Successful privatisation proposals are then coordinated by the EPU, generally with support from institutions in the Kuala Lumpur financial sector. These processes of identification and selection, as Adam et al. (1992:228) argue, rely more on personal initiations and the earlier decisions of other countries than on individually structured proposals.

Proceeds from the sale of government shares in privatised entities could be channelled into a special fund, as proposed in the PMP, to finance the expenditures incurred in the implementation of the privatisation programs. After all, these expenditures are related to conducting feasibility studies, the restructuring of potential candidates for privatisation and for compensation that may arise as a result of privatisation. The proposal to set up the Fund is still being evaluated by the government (Mohd Sheriff Kassim, 1992:18; PMP, 1991:28).

5.1.1 Privatisation Action Plan

The Privatisation Action Plan (PAP) was designed in order to arrange efforts in priority order. The Action Plan enables implementation of privatisation in a more systematic and organised manner in coordination with the national macro-economic policies and development strategy. Formulation of the PAP was based on an analysis of a large sample of PEs. Out of 424 government entities studied, 246 entities were considered to be candidates for privatisation during the 1990s (EPU, 1993a:7; Malaysia Toward 2020, 1992:77). However, it must be noted that not all these entities are to be finally privatised. In total, of the 246 potential privatisation candidates considered, 147 existing enterprises have been selected for privatisation during the period 1991-5, and some of them are to be restructured prior to privatisation (Hensley and White, 1993:78) (See Table 3.7).

Table 3.7: The Privatisation Action Plan.

No. of PEs studied	424
No. of privatisable entities	246
No. of the selected PEs for privatisation during 1991-95	147
No. of the retained PEs	178

Source: EPU, 1993a; Malaysia Towards 2020, 1992:77; Hensley and White, 1993:78.

Careful consideration is to be given before a decision is made whether or not to privatise an entity. Therefore, the pace of privatisation is slow. The other reasons for this slow rate could be accounted for as follows (EPU, 1993a:8):

i) lengthened negotiations between government and private sector, particularly on projects initiated by the private sector;

ii) need for new laws in such cases as government's abattoirs; and

iii) assessments of assets and shares of some projects have not been agreed upon.

In the preparation of the PAP several factors are taken into account, including the feasibility and desirability of privatising the PEs under review. The feasibility criterion is determined by two factors, firstly, the ease of privatisation and secondly, the attractiveness to the private sector. The ease of privatisation is judged in terms of the extent of restructuring required to prepare for privatisation and the need for legal and regulatory changes. The attractiveness of the candidate to the private sector is determined primarily by its competitive market position, growth potential and financial profile (PAP, 1991:36).

The desirability is based on a sector analysis and is made in terms of the priority which the government attaches to economic development and changes in that sector. Desirability is also related to the relative advantage which the private sector could be expected to enjoy over government in that sector in terms of the efficient provision of goods and services to meet national objectives. The combination of feasibility and desirability criteria can be explained using a privatisation grid shown in Table 3.8.

The grid divides privatisation candidates into four categories. First, the *immediate privatisation* category consists of candidates which rank high in ease of privatisation and attractiveness to the private sector (feasibility) and in terms of the government's objective priority (desirability) (PMP, 1991:38).

Table 3.8: Privatisation Grid.

*Desirability** *Feasibility***	High	Low
High	Immediate Privatisation	Priority Restructuring
Low	Back-burner	Consider Future

Source: Adapted from PMP, 1991:37-39.
*Desirability (Economic policy),
**Feasibility (Ease, Attractiveness).

Second, the *priority restructuring* category consists of candidates which rank high in terms of the government objective, but are either difficult to privatise or unattractive to the private sector in their present form. Some forms of restructuring, therefore, need to be undertaken in respect of these candidates before they are privatised.

Third, the *back-burner* category consists of candidates whose privatisation is perfectly feasible, but where the benefits of privatisation are likely to be less evident than in the case of other candidates. They are, therefore, less deserving of privatisation.

Fourth, the *consider future* category consists of enterprises which rank poorly both in terms of feasibility and desirability for privatisation. These should remain in the public sector until more attractive and important candidates have been privatised.

The PAP is a systematic and organised approach to policy implementation which seeks to ensure that it is in accordance with macro-economic policies and development strategy. The PAP consists of a two-year rolling plan which is reviewed at the end of each year, detailing the entities to be privatised and those to be prepared for privatisation (PAP, 1991:33). The yearly review takes stock of progress made and determines the entities to be privatised during the next two years (Table 3.9).

Table 3.9: Privatisation Action Plan in Malaysia for 1990-6.

End 1990	End 1991	End 1992	End 1993	End 1994
Prepare Action Plan for 1991-2	Review Implementation in 1991 and prepare Plan for 1992-3	Review Implementation in 1992 and prepare Plan for 1993-4	Review Implementation in 1993 and prepare Plan for 1994-5	Review Implementation in 1994 and prepare Plan for 1995-6

Source: Adapted from EPU, 1993a: 7-9; PMP, 1991:34.

The privatisation projects involve a selection by government of enterprises for privatisation. Sequencing is determined by the government and each project is managed on a tender or public sale basis. The Malaysian government initially adopted an "invitation" approach, with an enticement that consideration would be given on a "first-come first-served" basis. Approval of submissions was based on the following factors:

(i) that privatisation proposals were profitable;
(ii) that employees were "not disadvantaged" by privatisation; and
(iii) that the cost benefit analysis directly addressed the needs of the NEP (Adam et al., 1992).

Another guideline used to determine eligibility is the capability of the private sector proposer to implement the proposal and the possession of certain permission rights or technical knowledge. The procedure for evaluating the proposals is as follows:

> If the proposal meets the prescribed guidelines of privatisability and uniqueness, a letter of exclusivity will be given to the private sector party concerned to conduct a feasibility study and submit a complete proposal to the Economic Planning Unit, Prime Minister's Department. Upon evaluation of the complete proposal, should the Government find it acceptable, negotiation will be carried out with the private sector party concerned and an award will be made when an agreement is reached. Should the negotiation fail, the project will be privatised through competitive bidding as if it was a Government initiated project (EPU, 1993a:13).

According to Adam et al., (1992:229) this approach to privatisation planning has met severe criticism from inside the country. The first-come first-served approach, which was promoted initially as an accelerating policy and an incentive to submit projects, lacks transparency and lacks equity in terms of access to information and raises concerns about cronyism. The second concern is the significant bureaucracy and increased centralisation of economic power in the hands of the Kuala Lumpur elite. The third concern relates to the conception that privatisation is only the personal commitment of Dr Mahathir who has taken personal charge of the "Malaysia Inc." program. There is a strong belief that without Dr Mahathir, privatisation in Malaysia would fade out (Adam et al., 1992). These criticisms have prompted the development of the PMP in an attempt to re-establish the momentum of privatisation and to address the criticisms of cronyism and lack of transparency by strengthening the government initiative aspects of the policy as against the invitation element.

5.1.2 Privatisation Stages

Some of the candidates for privatisation require restructuring either prior to or after privatisation. Candidates for restructuring fall into two categories (EPU, 1993a:10). The first category represents PEs which are already operating in the free market environment, but are not showing good performance. These companies were established under the Companies Act to achieve objectives such as: promoting Bumiputras participation in the corporate sector, establishing industries which provide the basis for further industrial growth such as heavy industries, and other objectives. There are other categories of PEs which are not exposed to the discipline of market forces, but are undertaking economic activities. These are government departments or statutory bodies set up by way of Acts of Parliament.

A government department or a statutory body has to pass through a few stages before it can be privatised. This is depicted in Table 3.10.

Table 3.10: Stages of Privatisation.

COMMERCIALISATION:	CORPORATISATION:	DIVESTITURE:
Government Department; Self-accounting Entity	State-owned Corporatisation	Private-sector Company

Source: adapted from EPU, 1993a:10; PMP, 1991:43.

The first stage that the entity has to pass through is the commercialisation stage. At this stage, user charges are introduced, followed by commercial accounting and commercial performance objectives.

The second stage is the corporatisation stage and the creation of a state-owned corporation. This stage involves the transfer of government assets and liabilities, usually from a government department or a statutory body to a company still owned by the government but operating on commercial lines. Several changes will be made with a view to enhancing productivity and efficiency. Some of these changes are as follows:

(i) Replacing bureaucratic administration with commercial management;
(ii) Introducing clear financial and operational performance targets and commercial accounting; and
(iii) Replacing centralised production-oriented decisions with consumer and market driven decisions (PMP,1991:44).

The last stage that a government department/ statutory body has to go through in the privatisation process is the divestiture stage. This involves the transfer of ownership of the corporation from the public to the private sector through public flotation, private sale or management buy-out (MBO) (EPU, 1993a:11; PMP, 1991:44-45).

5.2 Privatisation Modalities

In the reduction of the boundaries of the government's role, a range of techniques have been employed that encompasses both divestiture and non-divestiture options.[28] Techniques commonly used on the privatisation program have included: private sale, public offering, private placement (through the capital market), joint venture, market contract or lease, employee stock ownership plan, liquidation, concession or Build Operate-Transfer (BOT) and MBO.

The objectives of privatisation have been matched, by Salleh (1991:618), with modalities utilised in privatisation implementation. However, only three types of modalities have been considered in this respect (Table 3.11). Sale of assets has also been regarded as a cure for all objectives of privatisation.

The private sale of equity and assets results in the transfer of management responsibility, assets and personnel. The entities privatised under this method include Sport Toto Malaysia, Malaysia Airlines, Malaysia International Shipping Corp (MISC), Edaran Otomobil Nasional (EON), Cement Industries of Malaysia (CIMA), Pernas International Hotel and Properties (PIHP), Klang Container Terminal, and Syarikat Gula Padang Terap. Under a partial divestiture program,

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28- Divestiture is one version of the strategy for privatisation. It comprises public offering of shares, private sale of shares, sales of government or enterprise assets, the reorganisation of an enterprise into separate entities, and management or employee buy-outs (purchases). The non-divestiture options are contracting-out, leasing and deregulation as well as an early retirement scheme for civil servants and the New Remuneration System for the civil service, with rewards based on performance. The latter two are attempts at debureaucratisation and the introduction of a corporate culture into what remains of the public sector (Ng and Toh, 1992:49).

the government has already floated the equity of a few major PEs on the Kuala Lumpur Stock Exchange (Ng and Toh, 1992:49).

Table 3.11: Objectives of Privatisation and Modalities Assigned.

Objectives	Management Contract	Leasing	Sale
Efficiency	+	+	+
Growth	+	+	+
NEP	x	x	+
Financial burden	-	x	+
Admin. burden	x	x	+

Source: adapted from Salleh, 1991:618. Note: + : objectives can be achieved; - : objectives cannot be achieved; and x: objectives can be partly achieved.

Market contracts or the lease of assets involves the transfer of rights to use assets for a special period, for example 21 to 30 years, in return for specified payments.[29] This modality is applicable to fixed assets of the project to be privatised, particularly if the assets are large and its nature is strategic such as seaports and airports (EPU, 1993a:4). Leases of assets have been used in such cases as the RMAF Aircraft Maintenance Depot and Shah Alam Abbatoir (Mohd Sheriff Kassim, 1992:11). Estimates of lease rentals payable are based on future business prospects of the privatised project and not on the current value of the assets.

Finally, management contracts involve the contracting of private sector management expertise to manage a government entity for a fee. This requires the transfer of management responsibility and does not result in the transfer of assets. Examples of this type of management transfer were the privatisation of Marketing

29- An example of a case of Build Operate-Transfer (BOT) project is the construction of the North-South Highway (Malaysia Toward 2020, 1992:238).

Activities associated with the Marketing of Advertisement Time for Radio Malaysia, Rubber Industry Smallholder Development Authority (RISDA), and Symenyieh Dam (EPU, 1993a:5; Mohd Sheriff Kassim, 1992:11). A MBO means allowing managers and employees of existing government facilities or companies to buy these entities. The entities privatised under management buy-out methods include tourist facilities at the National Park, Kumpulan Fima, Premba and the marketing arm of Radio Malaysia (Malaysia Towards 2020, 1992:64).

In general, a variety of methods have been employed in Malaysia. Of the 37 projects privatised by 1991, at least nine were privatised through divestiture of ownership via public or private replacement, two through leasing, four through management contract, and three entities - Pos Malaysia, Keretapi Tanah Melayu Berhad and Institute Jantung Negara - corporatised. Interestingly, privatisation of Klang Container Terminal (KTC) at Port Klang was an example of a combination of methods including an outright sale, a lease arrangement, and a management contract (Hensley and White; 1993:76; EPU, 1993a:8).

5.3 Privatisation Alternatives

Corporatisation and other non-divestiture modalities were utilised as alternatives for the divestiture of PEs. For example, corporatisation was implemented in the Telecommunication Services Act 1985, which established the legal framework for the creation of the new telecommunications enterprise established in 1987, which became known as Syrikat Telecom Malaysia (STM). STM attempted significant reforms of its operations in the areas of billing, bad debt recovery and marketing. Repair and service overload have been reduced and cash flow improved, while expenditure is expected to be reduced to 75 per cent of pre-corporatisation levels and competition has also been introduced with private enterprise in the supply of corporate value-added networks such as computer lines and systems (Adam et al., 1992:256). In electricity, the transition from corporatisation to privatisation of Syarikat Lektrik Malaysia (SLM) was carried out in one year from 1990 to 1991.

The corporatisation option was also employed in Malaysian telecommunications to be followed by the flotation of shares (Salim, 1991:383). Corporatisation, as Mohd Sheriff Kassim (1992:221) states, has been used by the government as one of the initial steps towards privatisation and has assisted in increasing efficiency and extending market discipline.

However, corporatisation as a step to privatisation has faced specific problems in Malaysia. The problems have varied from purely administrative to legal; from the unions to society; and from the task environment to wider national needs (Salim, 1991:404). These are present in any program of privatisation.

In some cases, management contracting-out was applied by contracting private sector management - both local and foreign - into an organisation. For example, a Chinese entrepreneur was appointed as the executive chairman of a steel production company (Perwaja Trenganu Berhad) which had been losing millions of dollars. In the case of the National Automobile Company (Perusahan Otomobil Nasional: PROTON), a management team from Japan has been appointed to enhance the local management (Puthucheary, 1990:118). PROTON was finally privatised in 1992.

However, public share issues were used as the main instrument of asset sales in the privatisation program. Proceeds from public sales totalled RM216.4

million (Malaysian Ringgit) out of RM437.6 million total proceeds to mid 1990. However, when the role of the *golden share* is taken into account, it seems that public share issues have not entirely transferred control to the private sector (Adam et al., 1992:263). Furthermore, evidence points to a decrease in the number of individual shareholders through the realisation of capital gains and therefore concentration of equity in the hands of large institutions. For example, the number of shareholders in MISC contracted from 60,000 to 5,000 following the first three months of secondary trading. This phenomenon is not unusual in share markets when systematic under-pricing is prevalent. The same share behaviour is still occurring in the United Kingdom share sales through the stock exchange. It raises the issue of the extent to which the privatisation program is opening the economy to greater private sector control in Malaysia (Adam et al., 1992:265).

Since the announcement of the privatisation policy in 1983, 57 projects have been privatised.[30] Of the total, 40 represent the taking over of existing PEs by the private sector, while the rest represent the construction of new infrastructure projects (EPU, 1993a:13) (See Appendix F).

In summary, attempts have been made to establish an appropriate system to implement the privatisation program in Malaysia. For this purpose, first, privatisation functional and technical committees were established. Secondly, the privatisation action plan and measures were established in order to prioritise the privatisable projects. Thirdly, proceeds from the sales of privatised companies

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30- According to EPU (1993b:40), the number increased to 73 projects up to May 1993. The number of privatised projects as at 31 December 1990 was 37 projects (PAP, 1991:57).

were channelled to a special fund to finance expenditures incurred in the implementation of the privatisation program. Fourthly, stages of commercialisation, corporatisation, and divestiture have been considered in order to restructure those candidates from statutory bodies. Finally, a variety of modalities and different alternatives to divesture of assets have been applied.

6 Privatisation Evaluation

Malaysia has implemented an advanced and widely applied privatisation program compared with most developing countries. Praising the twelve year old program of privatisation, Jayasankaran (1995:42)states that "Malaysia has proved that privatisation works."

However, during 1984-9, the total proceeds from the sales of assets was small. According to Adam et al. (1992:242), they amounted to 0.2 per cent of GDP in 1985 and 1989 and the cumulative proceeds from all asset sales during 1984-9 totalled RM437.6 million, equivalent to less than 0.1 per cent of GDP. While the size of the PE sector was estimated to be approximately 25 per cent of GDP, the scale of privatisation program has been small.

After 1991, however, the privatisation program shifted to a higher gear. This occurred when the makers of Proton (national car) made their first offering of shares. In addition, 250 PEs valued at more than RM16 billion ($5.9 billion) were offered for privatisation during 1991-5 (Tsuruoka, 1990:44). Proceeds from the sale of shares of PEs has been increasing and generated $6.7 billion by 1993. The figure is higher as these entities had investment plans of $24 billion for the period 1991-95 in their development plans (EPU, 1993a:16; Adam et al., 1992:255).

Government managed sales have involved the sale of only a minority equity holding, the creation of Special Right Shares for the government and also emphasised the pursuit of NEP objectives. Privatisation was also used as a management and employee incentive scheme. However, the role of employee share participation was limited except in the case of the Malaysian Airline System (MAS) in which 28 per cent of the shares were allocated to directors, employees and agents (Adam et al., 1992:248-250).

Privatisation was more compatible with the objectives of the NEP rather than any other goal. The social goal of Bumiputra ownership, which was intended to reach 30 per cent, actually increased from 2 per cent in 1970 to 20.3 per cent by the early 1990s. This allowed the government to compromise, using Pernas and PNB[31] gradually to buy more wealth for the Bumiputra through the rest of the century (Salleh and Meyanathan, 1993:39). The World Bank (1992:9) asserts that in Malaysia, the proper execution of privatisation improved Malaysian domestic welfare. In the following paragraphs the results and problems of privatisation in Malaysia are examined.

6.1 Privatisation Results

In order to evaluate the results of privatisation, the performance of privatised enterprises is examined, followed by an analysis of the financial and administrative effects of privatisation, and its consequences concerning the public interest.

31- Permodalan Nasional Berhad (PNB) and Pernas are two trust holding companies for Bumiputras.

6.1.1 Privatisation and Enterprise Performance

Identifying causal effects in efficiency gained from privatisation is difficult. The available evidence points to improved performance following privatisation, although frequently the improvement preceded the actual sale. Such improvements can be seen in a variety of financial, operating, and productivity indicators. Identifying the causes of these improvements is difficult as most sales occurred during a period of rapid economic recovery following the 1985-7 recession and a number of the enterprises sold were in sectors with high pro-cyclic elements. According to Adam et al. (1992:251), in only four cases - Sports Toto, Port Klang, and the two 100 per cent sales (Gula Padong and Cawangan Percetakan) - was the privatisation more than partial, involving a change in ownership and control.

Some signs of success have emerged in the enhancement of the performance of some privatised enterprises. According to EPU (1993b), Malaysian Airline System, MAS, Klang Container Terminal, KCT, Malaysian International Shipping Corporation, MISC, and PROTON have been identified as successful cases.

MAS has outperformed the market index by 100 per cent over the first five years since its listing, although its privatisation did not involve a change in management. Its operating revenue has grown from RM1.578 billion in 1988 to RM1.897 billion in 1989. Then, it rose to RM2.306 billion in 1990, to RM2.908 in 1991 and RM3.507 billion in 1992. Pre-tax profit during the period 1988-92 was RM157.42 million, 204.53 million, 200.62 million, 205.54 million, and 119.55 million respectively (Table 3.12).

Table 3.12: Proceeds and Pre-tax Profit of MAS During 1988-92.

Year	Proceeds	Pre-tax Profit
1988	RM1.578 billion	157.42 million
1989	RM1.897 billion	204.53 million
1990	RM2.306 billion	200.62 million
1991	RM2.908 billion	205.54 million
1992	RM3.507 billion	119.55 million

Source: EPU, 1993b:20-23.

The privatisation of Klang Container Terminal (KCT) was another case of efficiency improvement. A major improvement was also achieved through changes in management attitude and structures following the replacement of a public sector management structure with a commercial-form management system (Adam et al., 1991:253; EPU, 1993b:27). In this case, EPU (1993a:13) reports that in the first 18 months of privatisation, the average length of time that each container remained on the dock declined steadily from eight days to 2.8 days. It has also been stated that KCT, which used to handle 17 to 18 boxes an hour before privatisation, is now handling 28 boxes an hour. Container throughput at the terminal doubled to more than 500,000 twenty-foot equivalent units (TEUs) in 1992 compared with about 200,000 annually before privatisation (EPU, 1993b:24-27). In another report on KCT, Hensley and White (1993:76) point out that two years after the divestiture of the handling functions and associated loading and unloading of ships, the turnaround time per vessel was reduced to 8.9 hours and there was an increase in throughput from 1113 ships in 1985, to 1257 ships in 1987. This performance improvement is shown in Table 3.13.

Table 3.13: The Performance Improvement of KTC After Privatisation.

Function	Before Privatisation	After Privatisation (% of growth)
No. of boxes handled in an hour	17-18	28 (25-30%)
Throughput in a year	200,000	500,000 (60%)
No. of ships loaded and unloaded in a year	1113	1257 (11%)

Source: EPU, 1993; Hensley and White, 1993:79; EPU, 1993b:24-27.

The MISC (Malaysian International Shipping Corporation) also improved performance, as indicated by its transformation from a loss-making to a profit-making company. It is said that the company, which suffered losses in 1982 and 1983, is not only back on the profit track, but is well poised to take advantage of any recovery in the shipping industry (EPU, 1993b:28). Since its listing in February 1987, MISC recorded a 14.4 per cent improvement in turnover for the financial year ended 31 December 1992 to RM1.98 billion from RM1.73 billion in 1991. The predicted pre-tax profit for 1993 was RM560 million (EPU, 1993b:29).

Proton, which commenced production in 1985, was listed in March 1992. Its share issues were oversubscribed 6.44 times and attracted a record RM2.06 billion. This was after the swap of shareholding with shares of Hicom (Heavy Industries Corporation of Malaysia), Minister of Finance Inc., Mitsubishi Corp., Mitsubishi Motors Corp., Kualapura Sdn Bhd., and PNB, in November 1992. Proton, which had incurred losses in the early years of operation, turned around in 1989 with a profit of RM32 million.[32] Profits in the years 1991 and 1990 wiped out its accumulated losses of RM165 million registered since operations began in 1985 (EPU, 1993b:32-35). The point is that the indicated profit was being made

32- PROTON registered a pre-tax profit of RM$159 million in its fiscal year ended in March 1990 (Tsuruoka, 1990:45).

before Proton was listed on the stock exchange in March 1992. Furthermore, Proton is protected by steep tariffs which created an environment in which car prices tripled in ten years (Jayasankaran, 1994:64).[33]

Somogyi (1991:25) asserts that Malaysia succeeded and overcame the problems of economic imbalances, structural weaknesses, and poor prospects for growth. Therefore, its experience over 1986-90 offers a model for countries embarking on the implementation of reforms. In Malaysia's case, a far reaching program of liberalisation and structural reform, backed by cautious macro-economic policies to ensure strict observance of resource constraints, controlled the economic slide and revived growth.

Judged by the aims set by the government, the privatisation program is a success. The state's role in micro-management of the economy has improved and healthy growth has been seen in profitability. However, opponents of privatisation point out that the privatisation program and the change of ownership are not the only factors leading to performance enhancement and profit-making by those enterprises. Tsuruoka (1990:42-3) argues that concentration on profits is somewhat misleading. Much of the rise in profits is due to the rapid expansion of the Malaysian economy since 1986.

Furthermore, most key transport and heavy industrial operations that have been corporatised have also improved under the program despite government ownership. In January 1987, the Telecommunications Department was formally corporatised and its operational function taken over by STM. After corporatisation, it recorded a large revenue, from which its profit in 1987 was

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33- See also Malaysia Towards 2020, 1992:111

RM5 million. The organisation expected to make a RM6 billion profit by 1995, due to its fast expansion (EPU, 1993b:14; EPU, 1993a:12-14).

According to Tsuruoka (1990:43), mismanagement still exists in the privatised companies. Finally, most of the former enterprises such as Malaysian Airline System (MAS) still operate as monopolies, but now in the private sector. It seems that factors other than the mere change of ownership have been effective in those privatised enterprises with performance improvement.

6.1.2 Reducing the Administrative Burden of Government

Privatisation has made visible progress in reducing the administrative burden of the government in terms of obligations to personnel and improvement in efficiency. In terms of personnel it is estimated that privatisation so far has reduced the public sector workforce by some 40,000 employees (Hensley and White, 1993:76). Meanwhile, EPU (1993a:16) reports that privatisation has managed to reduce the public sector workforce by 73,300. Finally, it is stated by the director-general of the EPU that 92,700 employees had been taken off the state payroll by 1995 (Jayasankaran, 1995:43). Privatisation of big projects and entities like the Telecommunication Department, National Electricity Board and Postal Services Department, which together had 61,708 employees and annual operating expenditures of $3.2 billion, has brought about a remarkable relief from the administrative burden of government.

Privatisation also has enabled the government to rechannel its funds from the privatised projects towards areas where public relief measures are needed more urgently. It has contributed to attaining the objectives of the NEP.

Furthermore, in relation to development plans, the reduction of burden is more considerable:

> In terms of development expenditure the figure is even higher as these entities had investment plans of $24 billion for the period 1991 to 1995 to expand capacities, upgrade existing networks, improve and modernise services (EPU, 1993a:16).

As a result, there is considerable opportunity-cost savings. The director-general of EPU in this regard points out that "if we had done all infrastructure projects ourselves, it would have cost us at least RM$41 billion" (Jayasankaran, 1995:43). This has created a surplus budget and decreased the external debt ratio service to below 2 per cent of gross exports from a figure of 20 per cent in the mid 1980s.

6.1.3 Financial and Economic Growth

Reduction in the administrative burden of the government has resulted in positive effects on financial and economic enhancement. First, the one-off proceeds from the sale of government interests in companies have helped somewhat to reduce government borrowing to finance government expenditure. For example, the sale of shares of PEs has generated $6.7 billion. Apart from one-off proceeds, recurrent income from privatisation comes in the form of lease payments, and more generally, as corporate tax. In addition, the government's financial burden in privatised projects has also declined with loan repayments undertaken by some of these entities.

The case of construction of the North-South Highway in a more direct manner through Build-Operate Transfer has also been advanced as one of the factors generating growth in the economy.

EPU (1993a:15) mentioned that:

> This has encouraged private entrepreneurship in sectors previously within the domain of the government and permitted an enhanced rate of infrastructural project implementation at a time when the public sector cannot afford to increase its development expenditure substantially.

These types of projects have contributed to savings in government capital expenditure of more than $8 billion which can be rechannelled to other development projects (EPU, 1993a:15). Competition has also been introduced into industries such as STMB (Syrakat Telekom Malaysia Bhd) through licensing of competitors.

Malaysia's GDP has grown continuously from 1965 to 1990. However, from 1980 to 1990, when the privatisation program got under way, the growth of GDP was diminishing, although it again rose sharply to 8.8 per cent at the end of the 1980s (Table 3.14). This could have been the result of total economic activity and the industrialisation policy rather than merely the privatisation policy. The reason, as Adam et al. (1992:98, 269) state, is that the total privatisation program has affected only a small proportion of the GDP because during the 1980s the scale of privatisation was small.

The important point is that during the implementation of privatisation, the rate of inflation was kept low at an average rate of 2.7 per cent, which is mainly indicative of the ability of the economic managemers of the country. Thus, not only has privatisation not led to an increase in the rate of inflation, but during its implementation, the rate of inflation has decreased from 5.4 in the 1970s to 2.7 in 1980s (Table: 3.14).

Table 3.14 GDP Growth Based upon Constant 1987 Prices
and the Rate of Inflation.

Year	GDP Growth	Rate of Inflation
1965-1973	6.7	2.1
1973-1980	7.5	5.4
1980-1990	5.2	2.7
1989	8.8	2.8
1990	9.4	-

Source: World Bank, 1991a:335.

6.1.4 Privatisation and the Public Interest

It is understood that while privatisation is a useful means to an end, it is not a panacea. Therefore, it must be considered in conjunction with a wide range of economic and social changes. Mohd Sheriff Kassim (1992:220) Secretary-General of Ministry of Finance, points out that privatisation is part of a process of wider change which the government can promote within the Malaysian economy and society.

Ragunathan (1990:211) maintains that the poor, who make up the majority of the population, have the right to be provided with basic services such as hospitals, transport, social and communication services. The national revenue belongs to the people and they have the right to benefit from this revenue through the provision of services. This is the most effective way for revenue to be passed on to the people.

According to EPU (1993), the national policy of the distribution of wealth through the restructuring of society is to be pursued in the implementation of privatisation in Malaysia. However, steps have been taken to guarantee the public interest and to demonstrate concern about consumers' and workers' affairs through regulatory bodies.

Regulatory Bodies

Regulatory bodies have been established to watch over the privatised entities. As Helmi Mohd Noor (1992:5) states:

> Malaysia is perhaps one of the few countries where consumers have been enjoying the same rate of tariff after privatisation. In countries such as the United States of America and the United Kingdom, consumers had to pay more for their basic services after privatisation although there were reductions for long distance and overseas call charges.

The regulatory bodies were established as safeguards against the problems of a monopoly situation in privatised enterprises. For example, in the privatisation of telecommunications as a monopoly, caution was exercised through the continued existence of the old Telecommunication Department, which licenses and regulates the privatised agency (Salim, 1991:394). A regulatory body was established in the case of Port Klang, with the task of controlling and monitoring operations, prices and the needs of the consumers in Klong Container Terminal Bhd (KTC).[34]

Furthermore, the design and implementation of the regulations were subject to the distributional objectives of the NEP. These aims were realised in the sales of MAS and MISC, through the design of preferential permission to purchase equity, and through the design of a government *golden share* that maintains a substantial degree of control over the companies after privatisation (Adam et al., 1992:53). After all, the promotion and protection of the Bumiputras' relative asset holdings were significant distributional objectives of the NEP.

34- Interview with Dr Zeinuldin Abdulrahman in Economic Planning Unit (EPU), 9 September 1993, Kuala Lumpur.

Bumiputra Participation and the Objectives of the NEP

With respect to the restructuring target of the NEP, the privatisation program has impacted positively on Bumiputra participation in the corporate sector. The program has helped to increase Bumiputra participation with projects achieving at least 30 per cent Bumiputra participation. Moreover, in some cases Bumiputra participation has exceeded 51 per cent and in a few cases - such as Premba Bhd and North Klang Strait Bypass - Bumiputra participation is 100 per cent. Bumiputra promoters have also played an important role in the development of a number of new projects (EPU, 1993a:16-17). The Bumiputra community has effectively taken advantage of opportunities provided by the policy in terms of wealth, ownership and the development of entrepreneurial competence.

The Poor and Hardcore Poor in Malaysia

In the march towards full industrialisation and implementation of privatisation, Malaysia has not forgotten the dilemma of the poor. Since March 1992, the Finance Ministry has approved an amount of RM700 million for disbursement to hardcore poor families. The amount was allocated for Amanah Saham Bumiputra's Development Program for the Hardcore Poor. Under the scheme, each hardcore poor family obtained an interest free loan of RM5,000 for investing in Amanah Saham Bumiputra (ASB: Bumiputra's Trust Fund) by the end of 1993. Families earning less than RM175 a month in the Peninsula, RM225 in Sarawak and RM260 in Sabah are considered to be in the hardcore poor category. Other criteria include the level of housing, health and education. The RM700 million allocated for the hardcore poor is in addition to the RM600 million allocated by the Government under the Sixth Malaysian Plan (1991-1996) for projects that emphasise food and nutritional requirements for under-nourished children and provision of decent shelter (*Business Times*, 15 September 1993:1).

It is part of the government's objective to raise the standard of living of the hardcore poor and make them free from poverty. Through the scheme, hardcore poor families obtain returns in the form of dividends and bonuses every year, which enable them to increase their income.

The World Bank recently commented that "Malaysia together with South Korea has come close to eliminating poverty" (*Business Times*, 19 September 1993). Hardcore poverty among Bumiputra had fallen to 3.8 per cent in 1989 from 25.3 per cent in 1973. According to the Second Outline Perspective Plan (OPP), in 1990 the incidence of poverty in Malaysia had been reduced to 17.1 per cent and the incidence of hardcore poverty was only 4 per cent. By the year 2000, the government plans to have reduced the incidence of poverty to 7.2 per cent and the hardcore poverty to less than 1 per cent. A survey conducted by Mohamed Jawhar bin Hassan (1994:186-194) indicates that the poverty rate declined to 8.8 per cent in 1994 (Table: 3.15).

Table 3.15: The Extent of Poverty in Malaysia.

Year	Rural	Hardcore Poverty
1973	50	25.3%
1987	24.7	3.8%
1990	17.1	Not identified
1994	8.8	-
2000	7.2	less than 1%

Source: The World Bank statistic in Business Times 15 September 1993; Mohammad Jawhar bin Hassan, 1994: 186.

The World Bank attributed Malaysia's success in poverty eradication to a development strategy that sees growth and equity as complementary and not a trade-off. "This strategy led to policies that strengthened both aggregate demand and supply" (*Business Times*, 19 September 1993). Demand was increased by pursuing macro-economic stability and by strengthening domestic and foreign investment, while supply was strengthened by investing in education for both males and females.

The final judgement is a compromise. In equity, success was achieved. More importantly, the government created the perception that this issue was of prime importance, thereby enabling the policies of the past six years to be implemented without undue social distress. According to Salleh and Meyanathan (1993:39), Malaysia chose to focus on equality of outcome in the 1970s and 1980s, and it now seems that the government is ready to focus on equality of opportunity, while building up human skills so that all Malaysians will be able to take advantage of opportunity when it comes.

6.2 Privatisation Problems

6.2.1 Structural Problems

Structural problems are obstacles to the implementation of privatisation. These obstacles could be categorised as resistance, legal constraint and absorptive capacity of the financial system.

Fear on the part of the staff and workers and consumers created resistance against privatisation. Most government departments and PEs were overstaffed and when they were separated for privatisation, the threat of retrenchment had a significant impact on employees (Salleh, 1991:620). Fears of workers in the public sector delayed several planned privatisation moves. According to the government's Plan, nearly 100,000 more employees (13 per cent of national workforce) were expected to be transferred to the private sector (Tsuruoka, 1990:42). Shouts of opposition followed the new owners getting control of the enterprise. There was concern about dismissal because of the necessity to reduce expenses and to make economies.

According to Chandra Muzaffar (1989:23), industrial relations in privatised industries also presented problems. The government argument was that in-house unions protect the interests of labour and thus it tried to control unions by introducing in-house unions. The aim was to develop more harmonious employer-employee relationships similar to those obtaining in Japan. This created concerns about unions. For example, Chandra Muzaffar contends that a weak labour movement is not in the interests of the country because it leads to greater social inequalities and encourages an aggressive sort of capitalism which results in consolidation of monopolies and the pushing up of prices of goods and services beyond the means of the poor.

Another source of resistance came from consumers of goods and services who have relied on subsidised supplies for decades.[35] The anxiety of these consumers is founded on the anticipated increases in prices as the government allows the private owners to set and determine their own prices in order to optimise profits.

35- Interview with Dr Zeinuldin Abdulrrahman, in Economic Planning Unit (EPU), 16 September 1993, Kuala Lumpur.

As in many other countries, in Malaysia resistance was strongest in the initial stages of divestiture. However, after confidence grew in the possible benefits of privatisation and after action by the government regarding regulation in favour of the employees and establishing a competitive environment, the resistance decreased.

One of the problems of privatisation implementation is reconciliation of privatisation efforts with existing legislation. Most of the legal constraints involve laws to protect personnel in PEs within social and national security policies. According to EPU (1993a:18), the government has amended a number of laws in the Constitution and laws relating to specific government functions. The relevant laws are being reviewed and the necessary amendments will be made when needed.

The financial system of Malaysia still lacks depth and has limited liquidity, in spite of being well-developed by regional standards. The government's strategy has led to all share issues being oversubscribed due to the quality of the assets, pricing of the issues and the expectation that the entities concerned could perform even better in private hands. The latest Malaysia Plan calls for $32 billion in new investment in Malaysia, of which $13 billion is expected to come from foreign sources (Hensley and White, 1993:77).

There is an argument that the multi-layered process of privatisation planning and organisation in Malaysia lacks effective integration. It also suffers from a lack of authority at top technical and functional levels. According to Hensley and White (1993:78) complex privatisation that involves large-scale international projects requires continuity. This argument fails to take into account the national objectives and the associated government policies.

6.2.2 The Adverse Consequences of Privatisation

Consequent problems include factors which also relate to the implementation process. These are factors such as cronyism, valuation of the PEs and mismanagement of privatisation.

Political cronyism and the granting of contracts or allocation of shares for political reasons are matters of controversy in Malaysia. An example is:

> ... the siphoning of nine out of 10 million shares of the privatised national telecommunications company to three private companies allegedly linked to a top leader from one of the component parties of the ruling coalition, rather than to the holding company that will hold these shares in trust for the community the party claims to represent (Ng and Toh, 1992:64).

In this respect, Tsuruoka (1990:42) argues that in Malaysia, much of the effort for privatisation have been concentrated on transferring economic patronage to the ruling UMNO party and taking it away from the hands of the government. This has been done under the guise of promoting the objectives of the NEP.

In addition, the influence of the private sector is increasing. In many cases, it is popularly believed that there are strong influences from private interests who try to determine what is to be privatised, in what manner and to whom. Privatisation does not often involve even the formalities of an open tender system. Instead, many beneficiaries are believed to have been chosen on the basis of political and personal connections. An example of this was the awarding of a $1.4 billion water supply project to Antah Biwater (A joint venture) without open tender (Jomo, 1989:127). On the other hand, a notable factor in the Third World countries is that competitive bidding is difficult because of the small number of bidders, and selling without the bidding process exposes the government to charges of favouritism and corruption. Malaysia is no exception.

The valuation of assets to be privatised and the way that they are being prepared for privatisation is controversial. The problem of asset appraisal may be because the PEs are not operating on a commercial accounting basis, and having an asset appraisal undertaken by a professional accountant can be prohibitively expensive for small investors (Salleh, 1991:621). There is also ridicule from the sceptics who claim that privatisation will only result in the transfer of assets from one wealthy elite (the government) to another (big business) (Salleh, 1991:613).

Some issues which have not been adequately dealt with have caused concerns about privatisation. These issues, as Jomo (1989d:128) maintains, are:

(i) the existence of formal and informal collusion, e.g. cartel-like agreements;

(ii) the existence of special influence and privileged information which some companies enjoy and enables them to consistently bid successfully for profitable opportunities from privatisation;

(iii) the implication of two sets of services, i.e. one for those who can afford privatised services and the other for those who cannot, and hence have to rely on public services, e.g. medical services and education;

(iv) the effects of minimal investment by private contractors concerned with short-term profit;

(v) increased cost of living - especially in remote and rural areas - due to the economic costing of services, e.g. telephones, water supply and electricity; and

(vi) the deflationary consequences of fewer jobs or lower wages, or both.

Summary

Malaysian style privatisation was a drive towards a smaller government role in the economy as part of a worldwide movement in the 1980s to give the private sector more room to grow. Nonetheless, it was, at first, part of the NEP which was started in 1970 to relieve poverty and to help the indigenous groups of Bumiputras become involved in entrepreneurship. The government role in directing the economy was significant during the privatisation program. Policy-making for privatisation was relatively comprehensive because it could prevent potential problems for consumers, workers and domestic industries. The establishment of regulatory bodies and safety clauses for the public interest were appropriate actions in this area.

There are some cases of profitability in the privatised entities, expansion of their activities and improvement in efficiency. Nevertheless, several other factors, contributing to this success, should not be ignored. The expansion of the economy after 1986, utilisation of spare capacity of industries, and changes in the managerial structures of enterprises were effective factors in the successful performance of privatisation. The application of a variety of appropriate modalities of privatisation such as leasing, contracting, corporatisation, and so on, were also factors contributing good performances from those privatised enterprises. Some enterprises had achieved considerable improvement in efficiency and profitability even before offering their shares to the private sector.

Structural problems as well as adverse consequences of privatisation were observed, including legal problems, cronyism, dependence of the economy on foreigners and the removal of subsidies. Nonetheless, the constant growth rate of the GDP, the low rate of inflation and the reduction of the rate of hardcore poverty are the results of the active involvement of the government in economic policy-making. Malaysia's policy for privatisation has been a mostly internal initiative which has taken into account social and public interest considerations. In brief, it can be said that privatisation in Malaysia has been a moderately successful initiative and its benefits have outweighed its problems. The next section examines effective alternative reforms other than privatisation applied in Malaysia.

7 Reform Other Than Privatisation:
Managerial Reform in Malaysian PEs

7.1 Rationale for Administrative and Managerial Reform

Three reasons can be advanced for the establishment of administrative reform measures and for the enhancement of accountability in Malaysia. First, the concern for a greater accountability of the civil service. This concern emanated from the findings of the auditor-general, which were based on cases of waste and inefficiency in government departments during the 1970s. Secondly, the effect of the world recession and the downturn in business, which generated criticism against waste and inefficiency. The global economic downturn and consequent financial constraints forced the government to reduce the burden of public expenditure. Thirdly, the "Look East" Policy that had significant influences on administrative reform and helped the establishment of a clean, efficient and trustworthy administration and the reduction of public expenditure.

Mahmood and Mat asserted that the most important aspect of efficiency and effectiveness of the public sector is the attitude or the character of the officers towards their office and duties (1992:434). They continued that this includes their attitude towards clients, responsibilities, equipment, expenditure and costs, and their dedication and sincerity in pursuing organisational and national goals. To accomplish this level of efficiency, a number of tactics were applied. Leadership by example, the inculcation of friendly and respectful service and total training programs [36] have been among the tactics initiated since the early 1980s.

The Audit Act of 1978 enabled the auditor-general to carry out extensive management audits. These involved the assessment and evaluation of the performance of departments in terms of efficiency, economy and effectiveness in the pursuit of their objectives (Mahmood and Mat, 1991:431). This signifies financial accountability as well as efficiency and the effectiveness accountability of departments in achieving their goals.

7.2 Reorganisation of Management of PEs

Administrative improvement undertaken by the public sector has been pursued since independence. With independence the government received the administrative machinery left by the British which was primarily oriented towards the maintenance of law and order and the collection of revenue. The reason for administrative reform was the need for modernisation and economic improvement (Mahmood and Mat, 1992:423). The task of modernising was undertaken by the government due to the change in the role of the government from regulatory and

36- Total training places emphasis on attitude as well as skill and knowledge.

system maintenance to a role of national planning and development administration. The emergent trend in public sector reform in Malaysia indicates an intensified search for greater efficiency, effectiveness and productivity of the public service as well as the related accountability.

The aim of these efforts was to increase output as well as to provide more efficient, speedy and effective delivery of services. A significant change in the system of public administration was the introduction of various policies, programs, and activities during the 1980s. According to the Government report (1991:1), amongst these were: *the civil service code of ethics*; *the clean, efficient and trustworthy concept*; inculcation of *Islamic values in administration*; *leadership by example*; and introduction of *tags and the punch clock system*.

7.2.1 Mechanisms for Administration Improvement

A working group and a think-tank were established in March 1986 and used as mechanisms for administrative improvement. The working group, which is called PANEL[37], aims to identify, implement and monitor administrative improvements in a systematic and coordinated manner. The Panel was established at the highest level to coordinate efforts toward managerial improvement in the public sector.

37- Members of PANEL are officials at the highest level including:

(1) Chief Secretary to Government - Chairman
(2) Secretary General, Ministry of Finance
(3) Director-General of Public Services
(4) Director-General, Implementation Co-ordination Unit (ICU), Prime Minister's Department
(5) Director-General, Malaysian Administrative Modernisation and Management Planning Unit (MAMPU), Prime Minister's Department (Government Report, 1991:2).

Other members by invitation are from deputy ministers and other departments such as Director of National Institute of Public Administration (INTAN).

The objectives of PANEL, therefore, are to:

(a) consider programs to improve the public administration system; and

(b) identify measures to improve the public administration system.

7.3 Progress for the Improvement of Public Administration

Through discussion in PANEL meetings and other meetings, several programs for administrative improvement have been identified and strategies for implementation of these programs have been introduced. In 1990, for example, thirteen programs were identified and emphasised, as follows:

(i) quality and productivity management and improvement;
(ii) administrative improvements at ministerial and federal department levels;
(iii) implementation of Malaysia Incorporated concept;
(iv) efforts towards streamlining regulation and procedures: a study on the system of licensing and permits pertaining to business and investment;
(v) leadership, decision-making and organisational management;
(vi) inculcation of positive values and attitudes in the public service;
(vii) improvement of counter services in government departments;
(viii) improvement of systems and work procedures and the use of modern office equipment;
(ix) extension of computer usage and information technology;
(x) an effective project planning and implementation system;
(xi) personnel management in the public sector;
(xii) accountability and financial management improvement; and
(xiii) management consultancy (Government Report, 1991:4).[38]

38- There was an emphasis on the importance of these programs and the program of TQM in administrative reform of Malaysia's public sector and PEs. Interview with Mrs Sundari, director of administration reform in Malaysian Administrative Modernisation and Management Planning Unit (MAMPU), 17 September 1993, Kuala Lumpur.

In 1992, Total Quality Management (TQM) was introduced to improve quality and productivity management. TQM is a process that involves the whole organisation and has a customer orientation. This process is aimed at creating a culture of excellence in any organisation by modifying, replacing or strengthening the existing culture. The ultimate aim of TQM is to enable an organisation to achieve total quality in all its operation. According to Ahmad Sarji (1993:24-28), all the individuals in the organisation are collectively responsible for ensuring the success of the quality improvement efforts, while top management is responsible for providing effective leadership. The role of government, in this respect, is to establish a favourable work environment. TQM worked in with the private sector to increase the quality and productivity of products.[39]

The implementation of the New Remuneration System (NRS) was also a notable change which was introduced in January 1992. This was established by a system of personnel administration and management based on performance as well as on structural changes in public service organisations. Three other initiatives were taken in 1992, focusing on new and improved approaches to management and administration in the public service. They were the *micro accounting system*, the *guidelines for development project planning and preparation*, and an improved *system for management of public complaints*. Guidance for the implementation of these programs was issued in the form of *development administration circulars* (Ahmad Sarji, 1993:1-5).

39- Interview with Mrs Sundari, director of Administration Reform in Malaysian Administrative Modernisation and Management Planning Unit (MAMPU): 17 September 1993, Kuala Lumpur.

The PANEL took some steps to improve the quality of services. This was based on acknowledgment of the fact that the objectives of government can be further enhanced if administrative improvement is planned and implemented by ministries and departments and are carried out on their own initiative and creativity. The PANEL, accordingly, suggested that each ministry and department submit a list of successful administrative improvement programs implemented in their respective agencies and put forward five new suggestions to improve their administrative system in the near future. Five major areas of the administrative improvement program are outlined as: *system and procedures*, *manpower development*, *organisational structure*, *productivity programs* and *technology* (Government Report, 1991:51-56).

According to the Government Report (1991:57-59), the program has increased customer satisfaction as well as improving the image of the public service. Examples of these successful efforts are procedures by which potential investors are encouraged to invest in Malaysia with convenience in terms of time and money. Another case was the Ministry of Works which undertook various efforts to highlight concepts of *values and ethics* in the public service.

Technology is another example of the area of administrative improvement. It includes the introduction of computers and other office equipment to improve the quality of goods and services provided to the customer (Government Report, 1991:54). The Ministry of PEs, for example, acquired a mainframe computer in 1987 to computerise the processing of applications for commercial vehicle licences and to store information pertaining to these licences. This assisted the process of decision-making and the initiation of legal action against owners of licences who did not comply with prescribed regulations (p.61).

Effort was made to consolidate good values and positive work ethics in the public service in a continuous program emphasised by the national leaders. The aim of applying these cultural motives is "to enhance the quality of service and create a competitive edge at the international level" (Ahmad Sarji, 1993:415). A book entitled *Values and Ethics in the Public Service* has documented all matters concerning values and ethics in the public service. It embraces such issues as:

(i) assimilation of Islamic values;
(ii) concept of values and ethics in the public service;
(iii) culture, values, and ethics in management of organisations in the public service;
(iv) value systems incorporated in the public service regulations;
(v) work ethics in the context of organisational management; and
(iv) internalising good values in the public service (Ahmad Sarji, 1993:416).

There are also "The Twelve Pillars" introduced by Ahmad Sarji at the seminar on Values and Ethics on March 1992. The essence of these is:

(a) the value of time;
(b) the success of perseverance;
(c) the pleasure of working;
(d) the dignity of simplicity;
(e) the worth of character;
(f) the power of kindness;
(g) the influence of examples;
(h) the obligation of duty;
(i) the wisdom of economy;
(j) the virtue of patience;
(k) the improvement of talents; and
(l) the joy of originating.

In order to emphasise and implant discipline and a positive work ethic among public servants, a number of simple devices and new management practices were established in all government departments. Some of the widely followed practices are: *name tags* (for personal identification); *punch clock* (for punctuality); *desk file manual of office procedures*; *open office system*; *public information* (service centres); *office automation*; and *quality control circle/total quality management* (Mahmood and Mat, 1992:435).

7.3.1 Strategies for Implementation of Programs

In acknowledgment of the fact that successful implementation of programs depends on the use of effective implementation strategies, in 1992 the PANEL gave emphasis to seven implementation strategies as follows:

(i) *development administration circular*;
(ii) *idea sharing and consensus building*;
(iii) *documentation and information distribution*;
(iv) *training and examination*;
(v) *follow-up and follow-through*;
(vi) *inspection visits*; and
(vii) *recognition and awards* (Ahmad Sarji, 1993:9).

The *development administration circulars* were utilised in order to convey government directives and guidelines on new administrative improvement programs to all public sector agencies. These circulars were accompanied by directions which gave clear and comprehensive explanations of the concept, objective as well as examples of processes or activities which could be used for guidance by the public sector agencies.

Through *idea sharing and consensus building*, all new ideas on administrative improvements are identified, tabled and discussed at PANEL meetings and other meetings. In this way, all heads of government agencies are able to contribute directly to the ideas discussed. This helps to remove the impediment to administrative improvement which is to be followed and expanded throughout the entire public sector. The adoption of ideas is by consensus (Government Report, 1991:5).

Documentation and information dissemination is aimed at increasing the knowledge, know-how and understanding of public servants concerning these programs. Various publications such as information booklets, guidebooks, magazines, bulletins and pamphlets are used by ministries and departments to better inform their clients of the various services provided by them, the ways and means of obtaining such services and the progress made in improving or revolutionising these services (Ahmad Sarji, 1993:10).

Training and examination are aimed at ensuring capable and skilled workers who can effectively manage and administer the improvement programs within their departments. It is based on an acknowledgment that the performance of public service depends very much on the quality of the human resources recruited, trained and maintained in the public service. In Malaysia, a number of measures have been introduced to achieve a meritocracy and facilitate quality performance by the public sector. Some of these personnel management strategies are:

(i) competitive examination, testing and interviews for executive recruitment;
(ii) pre-service professional training;
(iii) advanced technical and management training at masters and doctoral levels;
(iv) specialised advanced management training for senior executives; and
(v) training prior to promotion (Mahmood and Mat, 1992:435f.).

Follow-up and follow through are strategies involving constant monitoring of improvement programs by the heads of ministries, departments and statutory bodies. The heads of agencies are personally responsible for program completion because they are required to report on progress in implementing improvement programs. The report of the PANEL on the progress and achievements of the administrative improvement program is used as one of the key measures for the selection of departments to receive the various Public Service Awards (Ahmad Sarji, 1993:14-15; Government Report, 1991:5).

An inspectorate unit was established in MAMPU and *inspectorate visits* undertaken in order to monitor and assist government departments in the implementation of administrative improvement programs. Inspectorate visits are carried out in order to monitor, evaluate and obtain feedback on the level of implementation of programs and projects. The secretaries-general of ministries, state secretaries and heads of departments are to carry out these inspectorate visits. These visits are a form of follow-up action and are surprise checks on the performance of departments at all levels, to observe progress in the implementation of administrative improvements at both state and area levels. At the end of each visit, a detailed report is prepared for the consideration of the Chief Secretary and the report is also sent to the head of the department, for his information and action (Government Report, 1991:6; Ahmad Sarji, 1993:15).

Recognition and awards for those who show excellence in performance are considered an integral part of administrative performance. Such rewards act as motivation to the recipients as well as others who desire to be rewarded. In 1992, the government introduced two new awards programs. One was the *Public Sector Innovation Award*, and the other was the special awards supplementary to the existing *Public Service Quality Awards* (Ahmad Sarji, 1993:17).

7.4 Types of Control and Accountability Measures

Three types of control mechanism and accountability system have been realised in Malaysia. These are: departmental control; organisational control; and legislative control. The government has continued its efforts to instil values concerning *discipline*, *integrity* and *accountability* amongst public officials. *Discipline* is secured by following or complying with the set of work ethics and value systems. Integrity is related to values such as honesty, sincerity, trustworthiness, and unremitting concern for the public interest (Ahmad Sarji, 1993:427). The Government Report (1991:249) puts emphasis on accountability in public sector management so that public servants are made responsible for the proper management and utilisation of government assets and resources. Accordingly, several institutions have been established to control discipline, accountability and integrity among public officials.

The *Anti - Corruption Agency* (ACA) is a government institution directly responsible for enforcing the laws against corruption. Corruption encompasses three types of corrupt practices: (i) accepting or giving any excess as an incentive or reward to any person for taking certain action; (ii) giving knowingly any receipt, account or other document, which contains any false, inaccurate or imperfect statement with the intention to mislead its principal; and (iii) using public position or office for personal financial advantage (Ahmad Sarji, 1993:429). Cases of criminal acts not involving corruption received by the ACA are redirected to other government agencies for action (Malaysia 1990/1991:56). Once convicted of criminal acts, the employee cannot continue to work in PEs. It is also said that no one is immune to the law, even the King.[40] In the case of an allegation of corruption, ACA requires disclosure of personal assets as well as those of wife, sons, daughters, and agents and trustees to ACA.[41]

Measures undertaken by ACA have been attempts to diminish and prevent corrupt practices from spreading amongst the civil servants and members of the public. Ahmad Sarji (1993:428), points out that organising seminars for heads of departments; effective follow-through of disciplinary reports prepared by ACA; strengthening the internal control system; positive inspection to ensure honest officials of their promotion; law enforcement and disciplinary proceedings; prevention through information and education; and prevention through administrative record are some of the safeguard measures undertaken by the government.

The *Central Information Collection Unit* (CICU) is another government institution. In 1985, the government set up the CICU to monitor the performance and financial position of 841 PEs in which the government has a stake (Jomo, 1989:79). The *Public Complaints Bureau* is another government institution which is responsible for dealing with public complaints. These are complaints related to actions undertaken by the government which are unfair, connected with abuse of power, mismanagement and so forth (Ahmad Sarji, 1993:427). Public complaints cover all aspects of government administration except matters relating to "government policies, and those matters under jurisdiction of the ACA, Legal Aid

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40- Interview with Mrs Sundari, 17 september 1993, Kuala Lumpur.
41- For example, in one case, ACA ordered Energy, Telecommunications and Posts Minister, Samy Velu to disclose his assets over an alleged misappropriation of 9 million shares in TeleKom Malaysia. Samy Velu, who is president of the Malaysian Indian Congress (MIC), is alleged to have traded these shares to three companies owned by ethnic Indians. See Doug Tsuruoka, 1992b:56.

Bureau, Special Cabinet Committee on Government Management and Public Accounts Committee" (Ahmad Sarji, 1993:433). *Action line* pages in the newspapers and *open line radio talk* to respond to citizens' complaints and suggestions are other measures that have been introduced (Mahmood and Mat, 1992:434f.).

7.4.1 Departmental Control

In Malaysia the departmental enterprises, which function within the organisational arrangements of a ministry, are subject to the same framework of governmental controls.[42] A research project conducted by Hill and others (1989:129-151) for the ASOSAI (Asian Organisation of Supreme Audit Institutions) analysed the system of accountability and control in the Malaysian public sector and PEs. The management of each departmental enterprise is controlled by a chief executive appointed by the head of the public service on the recommendation of the responsible minister. The same procedure is also applied for transfers. However, a chief executive can be removed from office only by the independent Public Service Commission.

In statutory corporations,[43] the management normally consists of a chairman and the board members. The board members include representatives from the Treasury, the ministry concerned, politicians and persons knowledgeable

42- Departmental undertakings are entities which organisationally are part of ministerial departments, but operate in a commercial manner (Hill et al., 1989: 2).

43- Statutory corporations are organisations which are established by or under legislation. They have more autonomy than departmental enterprises and can in many cases invest, raise capital, borrow and lend within the terms of their statutes (Hill et al., 1989:2).

in the relevant fields of activity. The appointment and removal of board members are usually the choice of the responsible minister but, in rare cases, of the King of Malaysia. The board is responsible to the minister but exercises day-to-day functions independently of government, though subject to specified controls exercised by the minister.

In PEs,[44] the members of the board are appointed and removed by the ministers concerned. However, in companies owned by statutory bodies, the appointment and removal of board members are by the corporations' management boards. The corporations' management boards are in turn, responsible to the minister or to the board of directors of the corporation which owns the company. In cases where the company is not wholly owned by the government or by a public corporation[45], the management board is also responsible to the shareholders.

The government, in helping those PEs which confront financial difficulties, also keeps a close watch on their internal surpluses. Public corporations do not submit their surpluses to the government, because such amounts are taken into account when their budgets for the following year are considered. Government companies normally return part of their annual surpluses to the government as dividends (Hill et al., 1989:133).

The ministers associated with PEs in Malaysia determine the policy decisions which affect finance. This is implemented by presenting a statement of the estimated financial results to Parliament before the commencement of each financial year.

44- These are bodies established under company law, and state or public corporations hold all or the majority of their shares.

45- These are mixed enterprises or 'joint venture' companies.

A central agency control is involved in the budgeting arrangements and accounting procedures of departmental enterprises. The Federal Treasury examines all budgets of departmental enterprises. Treasury holds a watching brief on the financial performance of the PEs, although they are independent of central control for their budgeting arrangements. However, the audited accounts of these companies are sent to the relevant minister, who monitors performance in the interest of the government.

The budgets of departmental enterprises are scrutinised by the respective ministers and Treasury before approval by Parliament. The management board of each statutory body is accountable to the responsible minister who is in turn answerable to Parliament on matters pertaining to the enterprise.

The boards of directors of PEs (companies owned by the government) are accountable directly to the responsible minister. They have complete autonomy and full powers except in matters of pricing of products in exceptional cases. PEs are not required by the government to earn a specified rate of return on capital. However, departmental enterprises financed by foreign loans are subject to the provisions of the relevant loan agreements specifying particular rates of return. For example, following the loan agreement with the World Bank in 1968, the Telecommunication Department is required to earn a rate of return of not less than 8 per cent on the value of its fixed assets in operation.

Departmental enterprises and most statutory authorities are not required to pay taxes applicable to government or other companies. Other controls which affect the pricing policies are characterised by cost differentials. It means that, for example, the cost of providing telephone services to rural subscribers is subsidised by urban subscribers while that of the residential subscribers is subsidised by business subscribers. No subsidies are paid to either departmental enterprises or PEs. However, subsidies are paid to some statutory authorities. PEs do not provide free or discounted services to the government, the services provided being charged at the same rates as those to other consumers.

7.4.2 Organisational Control

The Ministry of Public Enterprises was established in 1974 to monitor and co-ordinate the policies, programs and projects of 8 major PEs at the Federal level and 13 at the State level. The Ministry of PEs approves the annual budgets of all Federal PEs under its jurisdiction. But all other PEs remain under the sponsorship of their respective ministries. The Implementation and Coordinating Unit (ICU) which acts as a coordinating machinery for the ministers, continues to coordinate the policies and activities of all PEs by serving as secretariat of the executive committee of the National Action Council (NAC) which supervises the implementation of development programs.

PEs are controlled by boards of directors. The various boards operate effectively free from political interference in all cases. Where appropriate, the presence of a government appointed member of the board of directors tends to ensure that individual boards do not exceed their powers or, if they do, the minister concerned is soon informed.

7.4.3 Legislative Control

The legislature in Malaysia operates a number of controls in relation to PEs. All statutory bodies are required by statute to submit their accounts for audit within six months of the end of the financial year. However, these provisions are not applicable to PEs (government owned companies). These companies enjoy complete autonomy, but are subject to the normal process of parliamentary debate which promotes the accountability of PEs. Ministers may be questioned in Parliament on any matter within their particular area of responsibility, and the answers are required to be given accordingly.

In summary, the privatisation program in Malaysia was accompanied by a program of managerial and administrative reform initiated in 1985. Since then, Malaysia's PEs have utilised a reorganised system of administration and accountability. The cultural spirit of the administrative staff has been influenced through the Islamic communication principles which dominate the society. Dissemination of rules and circulars to the staff has also strengthened the sense of serving the society. At the same time, PEs have fully utilised new techniques and principles of accountability, and applied a variety of available methods. This has been consistent with the objective of clean, efficient and trustworthy policy in which a new work ethic and a new attitude to service is to be established. This policy gives priority to the improvement in productivity and quality of work, apart from increasing the motivation of the work force.

Summary

The privatisation and liberalisation process in Malaysia has been motivated more by economic pragmatism than ideological considerations, although social and cultural imperatives and the necessary warranties for their achievement have not been ignored in this process. These features of the reform initiatives led to an image of Malaysia as a unique country and an example for developing countries.

The first phase of privatisation established the program in the centre of macro-economic policy-making, and has been complementary rather than a challenge to the NEP. Progress has been moderate, but the program so far has had a threefold impact. First, it has acted as a brake on the expansion of PEs and set limits to the role of the state in the economy. Secondly, it has had an impact as a component of the "Malaysia Incorporated" policy and enforced the idea of the NEP. Thirdly, it has demonstrated the principles to be followed in future privatisation schemes.

Malaysia has demonstrated a strong political will to undertake the privatisation of more than 800 active public enterprises in a systematic fashion. It is the only country in the Asia-Pacific region which has a master plan for privatisation. Nevertheless, progress has been slow though steady. The moves toward corporatisation and partial privatisation have been the main features of reform with the protection of the special interests of the Bumiputra and labour other significant concerns.

Privatisation posed special problems for Malaysian policy-makers because of the inherent tension between the dual objectives of unleashing the energies and resources of the private sector on the one hand, and the desire to protect and promote Bumiputra interests on the other. Most of the enterprises selected for privatisation were natural monopolies (such as the airline, the municipal water supply, the toll road, electricity, and the telecommunications company); selling them did not change their monopolistic status. However, partial privatisation, wide distribution of shares to the people, the participation of Bumiputras, and the establishment of regulatory bodies and safety clauses for consumers and labour were factors helpful in avoiding social tensions. The trade-off between efficiency and social equity in the process eased the way for implementation and lessened internal political and social tensions. The government has resisted the temptation to drop either objective. The benefit of this kind of thinking can be seen most clearly in the way the government has always insisted that economic performance be considered as a means to social enrichment rather than as an end in itself.

CHAPTER 4

PUBLIC ENTERPRISE REFORM IN IRAN

While the rationale for the establishment of PEs in Iran was similar to other developing countries, factors associated with a popular revolution make it different. The functions of government under the Islamic system are broad and profound. They include the provision of material as well as spiritual standards of life for the nation. Therefore, policy-making for reform in PEs is more complicated in this environment than under a secular system of government. This is especially true when an instrument of privatisation, such as selling public assets to the private sector, is considered as the key option for reform, as this may widen the gap between the poor and the rich in society.

As with Malaysian public enterprise reform, questions have to be answered in relation to the socio-political and economic environment of Iran; the role and the performance of PEs; the motives for privatisation; the way the system of policy-making works; the way privatisation is implemented; the results and problems of privatisation; and the consideration of effective alternatives other than privatisation.

This chapter is devoted to answering these questions. The analysis includes the rationale for the emergence of PEs, their role and structure (Section 2); motives for reform in PEs (Section 3); the policies formulated to implement the reform in PEs (Section 4); implementation of reform (privatisation) policies

(Section 5); and the performance and outcome of reform initiatives in PEs (Section 6). Administrative and managerial reforms in PEs are also addressed as an alternative to privatisation (Section 7). In order to have a wider perspective, before proceeding further with the issues mentioned above, it is appropriate that the socio-political and economic environment of Iran is examined (Section 1).

1 Socio-Political and Economic Environment

The day for the triumph of revolution in Iran arrived on 11 February 1979, when the revolution, which was led by a broad coalition of popular forces such as ex-peasants, residents of the shanty towns, students and street salesmen, felt real. It was as Vakilizad (1992) stated, an urban revolution, but religiously oriented and linked to traditional values from the rural past. Following a referendum, a new government was established and the Islamic Republic was declared on 1 April 1979. The resolution of the demonstrations, such as those of 11 September 1978, underscored goals such as social justice, an end to exploitation, termination of dependency on super-powers, elimination of oppressive profiteering, and cultural reconstruction (Amirahmadi, 1990:300; Vakilizad, 1992). The Constitution was to include these goals of the revolution.

Predictably, political, economic and ideological goals were included in the 1979 Constitution, and the government became responsible for implementing the Constitution in order to achieve these goals.

1.1 Social Environment

The Islamic Republic of Iran (IRI) covers an area of 1,648,000 square kilometres.

It is about five times larger than Malaysia. The population approached 61 million (in 1993), mostly young, with at least 42 per cent below 14 years of age. The average population growth rate has been high, about 3.28 per cent during the period 1987-91. However, the growth rate decreased to 1.6 per cent in 1992 (Table 4.1)(Research Group, No.2, April 1994:4; Weekly Letter of the Chamber of Commerce, No.10, January 1993:7).

Table 4.1 The Growth Rate of Population in Iran During 1982-92.

Year	1982-86	1987-91	1992
The rate of Population Growth	3.9%	3.28%	1.6%

Source: For year 1992, Research Group, No.2, April 1994; for 1982-91, *Paper of the Iran Chamber of Commerce*, No.10, January 1993, pp.5-13.

Ethnic divisions are Persian 51 per cent, Azerbaijani 25 per cent, Kurd 9 per cent, Gilaki and Mazandarani 8 per cent, Lur 2 per cent, Baloch 1 per cent, Arab 1 per cent and others 3 per cent. The country is 99 per cent Muslim: Shiite Muslim 95 per cent, Sunni Muslim 4 per cent, with Zoroastrians, Jews and Christians making up the remaining 1 per cent.

1.1.1 Culture

The culture of Iranian society is predominantly, influenced by religion. Iranian Muslims get the explanation of the commandments of law and new phenomena by following the teachings of clergymen who practise religious jurisprudence (Mujtahideen). Matching the laws and new social, economic and political phenomena with the religious commandments is on the basis of the holy book (Qur'an), tradition (the manner of the prophet and his twelve successors), consensus of the scholars and reason. Society, in this culture, is advised to follow the best and rational attitudes and mandates. Thus, everyone is free to choose his or her Islamic path based on his/her own perception of the most authoritative higher scholars (Mujtahideen).

The activities of the government and society operate within an Islamic framework. As a result, an Islamic government is not entitled to legislate arbitrarily. It implements the divine laws and helps people to understand and follow them. In matters which are not specified in the Islamic *fegheh (shari'a,* jurisprudence) it has the right to legislate, but not to pass laws which are inconsistent with the spirit and instructions of Islam. The belief is that Islam is the best guarantee of social justice and public welfare (Noori, 1985:12). In this framework every communication and activity is allowed if it is not against the Islamic law.

The government is entitled to adopt or attempt to initiate models deeply rooted in native culture, national characters and religious ideals. The dominance of Islamic laws has been spelled out in the Constitution of the Islamic Republic of Iran (IRI). The Constitution encompasses the goals and strategies of the Islamic government. It has been created to lead the society to act in an Islamic way of life. The subsequent Islamisation of the state concerning law, justice, and education has had a profound impact on Iranian society.

1.2 Political Environment

The Islamic Republic is politically independent and perhaps one of the best examples of non-aligned countries in the world (Amirahmadi, 1988:234). Iran has officially been an independent country throughout history. However, implementation of the capitalist growth model between the 1950s to 1970s generated adversity leading to dependency, poverty, income and spatial concentration, uneven sectoral development, cultural destruction, denationalisation and dictatorship (Amirahmadi, 1988:225). In 1979, the monarchy of the Shah was overthrown and the country secured its independence from political dependency on the superpowers.

The Constitution of the IRI was approved in a referendum held in December 1979. It was accepted in its entirety by the majority despite disagreements over certain details (Amirahmadi,1990:300). It was revised in 1989 to expand the powers of the presidency and to eliminate the prime ministership. On the basis of the Constitution, the legal system of the government codifies Islamic principles.

1.2.1 Structure of Powers in IRI

The notable bases of the IRI system are nation, leader, and three powers (judiciary power, executive power and legislative power) (Appendix E).

The role of the nation in the structure of the system is critical. An active and broad participation of individuals of the society in the process of social development has been provided for in the Constitution. The aim is to achieve the goal of the emergence and blossoming of man's inherent capacities.

According to the Constitution, all members of the society are to participate in the decision-making process on which the destiny of the country depends. It is the people who elect:

(i) the President who is the chief executive of the IRI;

(ii) the representatives of the Majlis- Shouray-e-Islami (Islamic Consulative Assembly: Parliament); and

(iii) the representatives of the Assembly of Experts.

The latter institution is responsible for appointing the leader or the successor of the leader. Thus the people are legally entitled to participate in major decision-making directly and indirectly.

The Leader or the leadership council is the highest position in the Iranian leadership structure. On the basis of the Constitution of the IRI, a leader should have the following qualifications and conditions:

- (i) scholarship, as required for performance of decree issuing (Mufti), in different fields of *fegheh* (jurisprudence);
- (ii) justice and piety, as required for the leadership of the Islamic Ummah (Muslim community); and
- (iii) the right political and social shrewdness, courage, administrative facilities and adequate capability for leadership (Article 109).

The duties and powers of the leadership are also broad. Parts of these duties, according to the Article 110 of the Constitution, are:

- (i) defining general policies of the IRI after consultation with the Nation's Exigency Council;[1]
- (ii) supervision over the proper execution of the general policies of the system;
- (iii) issuing decrees for national referenda;
- (iv) assuming supreme command of armed forces;
- (v) appointment, dismissal and acceptance of resignation of:
  (a) the foghaha (jurisprudents) on the Council of Guardians;
  (b) the Supreme Judicial authority of the country;
  (c) the head of the radio and television network of the IRI; and
- (vi) resolving problems which cannot be solved by conventional methods through the Nation's Exigency Council.

The Leader may delegate parts of his duties and powers to any other person.

After the office of leadership, the President is the highest official in the country. The Constitution specifies the powers and the duties of the President in

[1]– Nation's Exigency Council is the highest position of decision-making in case of problems which can not be solved by conventional methods. An example of these problems is the difference between the views of the Council of Guardians and the Parliament on vital issues.

Article 113: "His is the responsibility for implementing the Constitution and acting as the head of the executive, except in matters directly concerned with the office of leadership."

Article 60 defines the function of the President. Functions which are to be exercised by the President include those functions of the executive, except those directly placed under the authority of the leadership. Article 60 states:

> The function of the executive, except in the matters that are directly placed under the jurisdiction of the leadership by the Constitution, are to be exercised by the President and the ministers.

On the basis of Article 57, the powers of government in the IRI are specified in the legislature, the judiciary and the executive powers which function under the supervision of the Leader who is *Waly al amr* (in charge of Ummah, Muslim society).

Legislative power is vested in a unicameral Majlis (Parliament). Executive power is vested in the Leader (cleric; faghih), the President and Cabinet. Judicial power is vested in the Supreme Court. These powers are independent of each other.

1.2.2. Factions and Tendencies in Iran

Officially there is no political party in the country. However, three factions and many tendencies may be distinguished and they have major impacts on the process of policy-making. Domination by any one faction may create a critical change, at least, in the way of interpreting and executing the law.

These factions are referred to as conservative, radical and pragmatist. These terms are not entirely fitting, but have been chosen because of a lack of better terminology. Most members of the factions come from traditional middle-class backgrounds, although their supporters include members of both the rich and the poor classes. Different factions subscribe to different types of economic policy and development strategies. They also have different interpretations of Islamic fegheh (jurisprudence).

Conservative Faction

The conservative faction is supported by wealthy merchants, and some high-ranking member of the clergy. This faction is referred to as *liberal* based on their views regarding foreign relations and economic liberalisation. This faction is mostly advocated by the members of *Tehran Combatant Clergy Association*. They support a private enterprise system accompanied by some degree of public participation and administrative decentralisation. They are also opposed to cooperatives and planned industrialisation, but favour the development of agriculture and expansion of services. It is interesting to note that farming, small trading and service activities depend on big merchants and middlemen to market their commodities.

The so-called conservative faction has opposed some reforms in domestic economic policy. They opposed the land reform bill, an increase in direct taxes, a limit on the private sector and policies designed to fight profiteering and inflation, the urban land reform laws, the labour law, free schooling and the bill for nationalisation of foreign trade (Amirahmadi, 1990:243). This faction is opposed to public planning, public ownership and public management of the economy. They are against price control, rationed markets and subsidies. Finally, they are against those articles in the Constitution that contradict their own perception of the economy including Article 43 and Article 44. These articles emphasise social justice and tend to prevent the domination of capital.

However, the faction supported economic adjustment and reconstruction of the economy after the eight-year war with Iraq (1980-88). Their view is that the private sector should be offered fiscal and monetary incentives to take risks and introduce initiatives. They favour wage control, devaluation of the "Rial" (Iranian currency) to the level of the black market rate, the closing of loss-making PEs, and sales of nationalised industries to the private sector. The faction also advocates free trade and openness to the international economy. They are supporters of privatisation and advocate economic adjustment policy. They place an emphasis on privatisation as the sale of public assets to the private sector (divestiture). The open-door advocates oppose extensive government intervention in the economy. The faction follows a model of capitalist economy conformed to their point of view as interpretive of Islamic teachings.

Radical Faction

The opposite tendency to the conservative faction is the so-called radical or revolutionary faction. It is supported by most revolutionary organisations, the lower to middle-ranking clergy and many higher religious intelligentsia. This faction is also supported by the traditional middle and lower privileged people in the urban centres and rural areas. The *Combatant Clerics Association*[2] is one of the advocates of this faction.

[2]– "Combatant Cleric Association" is a different association from "Combatant Clergy Association"

The so-called radical faction advocates public ownership and management of large enterprises, central control and planning of the economy and nationalisation of foreign trade. They are not, however, against free markets or small private holdings. Radicals advocate land reform, taxation and other socio-economic reforms, which are normally rejected by the conservative faction. The faction also supports institutions established by revolution, cooperative establishments and planned industrial development (Amirahmadi, 1990:244). They remain sympathetic to the agriculture sector (for consumption rather than export), but are opposed to the expansion of the services sector. Members of this camp are also for a self-reliance strategy and against free trade and complete openness to the international economy. They are opposed to the divestiture of PEs to the capitalists, although they advocate managerial reform and the equitable distribution of wealth. They defend the Constitution and its articles, particularly those concerning the economic system. They supported the 1989 revision of the Constitution because it did not call for changes in articles concerning the economic system or matters of social justice. They follow the socially-based concepts of the Islamic economy.

Pragmatist Faction

The pragmatist tendency is positioned between these two groups. It gets most of its support from such social groups as the religious intellectuals, the new middle-class privileged and the technocrats. Their basis of support is, however, much wider and includes a broad range of groups and institutions. They maintain that a mixed approach is the most appropriate for the IRI. They favour a controlled market economy that is guided and regulated by state planning and supported by limited public ownership and management. They put a great deal of value on the complementary role of the privately organised cooperatives.

The followers of the pragmatist tendency headed the movement for the revision of the Constitution. They wanted, and got, a centralised decision-making institution under a powerful presidency.

Since the end of the war, the pragmatist tendency has gained considerable influence and taken steps in the direction of consolidating its hold over government power and policies. Following the 1993 election, the pragmatists headed by President Rafsanjani formed a coalition with the conservative faction and excluded the radicals, including those who are influential in society.

1.2.3 Islamic Government

The Iranian government is an Islamic-based system. This government is perceived to be the result of the first Islamic revolution in modern history and thus is expected to have some characteristics which are specific and unique (see Chandra Muzaffar,1987:35-37). In order to have a better understanding of the social environment under which reform in PEs are to be implemented, this section examines the specific characteristics of the Islamic government. The rationale for the Islamic government and the distinction of this government from other political systems are also examined in the following paragraphs.

From an Islamic point of view, the establishment of a government is necessary for the prosperity of the society. The establishment of an Islamic state is said to be for implementation of the Islamic Law. Algar (1990:37) maintains that if a system of law or government lacks executive power, it is clearly deficient. This system of law and its associated executive system are consequently considered to be for the establishment of a system of social justice. This has been depicted in the words of Imam Ali, the successor of the Prophet Mohammad, when he said:

> I accepted the task of government because God has demanded from the scholars of Islam a pledge not to sit silent and idle in the face of greed and plundering of the oppressors, on the one hand, and deprivation of the oppressed, on the other hand (Nahjul-balagheh, Sermon 3; see also Algar, 1990:50).

Islamic government is considered to be a just government and necessary for a healthy society. According to Noori (1985:15), in Islamic belief, honest and capable leadership will give good direction even to a society with corrupt citizens. If there are good pious people at the head of affairs, the society is protected and directed on the path of progress. Islam attributes the corruption and degeneration of societies to evil and corrupt leadership. To substantiate the significance of leadership in an Islamic society, Imam Ali states that:

> If a man is given control over the lives and property of the people and charged with enforcing the laws, a miserly and worldly person will be tempted to steal and waste public money. If he is tyrannical and callous, he will exploit people without caring for their well-being. He will side with the rich and powerful and treat the rest unjustly, if he is greedy for wealth and power. If he accepts bribes, he will trample upon the rights of others (Noori, 1985:16).

The Islamic government is not a theocratic government as some have termed it. The difference is that in a theocratic state, rulers are regarded as representatives of Divinity to justify their rule, but in an Islamic government the rulers are required to enforce the Divine Law and are forbidden to deviate from it under the influence of their personal desires (Noori, 1985:14). An ideal Islamic government involves a code of conduct which regulates and organises mankind in both its spiritual and material life.

A Self-Reliant, Provider and Facilitator State

The provision of facilities for self-sufficiency and self-reliance in scientific, technological and other similar areas is held to be a duty of government. For this purpose, the government has the duty of directing all its resources to the following goals in order to attain the specified objectives of the IRI:

- (i) the creation of a favourable environment for the growth of moral virtues based on faith and piety and the struggle against all forms of wickedness and corruption;
- (ii) raising the level of public awareness in all areas through the proper use of the press, mass media and other means;
- (iii) free education and physical training for everyone at all levels and the facilitation and expansion of higher education;
- (iv) strengthening the spirit of inquiry, investigation and innovation in all areas of science, technology, and culture by establishing research centres and encouraging researchers;
- (v) the complete elimination of all forms of despotism and the prevention of foreign influence; and
- (vi) the elimination of all forms of despotism and autocracy and all attempts to monopolise power (Article 3 of the Constitution).

Articles 29, 30 and 31 also point to the duties such as providing social security, education and welfare. In Article 29, the duty of the government is to provide social security as the following:

> ... to benefit from social security with respect to retirement, unemployment, old age, disability, absence of a guardian and benefits relating to living standard, accidents, health services, and medical care and treatment provided through insurance or other means, is accepted as a universal right. The government must provide the foregoing services and financial support for every individual citizen by drawing, in accordance with the law, on the national revenues and funds obtained through public contributions.

Article 31 points to providing facilities and necessities of life for every Iranian individual as a right:

> It is the right of every Iranian individual and family to possess housing commensurate with his needs. The government must make land available for the implementation of this article, according priority to those whose needs are greatest, in particular the rural population and the workers.

The public sector plays a critical role in the economy and activities of the community of Iran; other sectors, especially the private sector, play a supplementary role to the public sector (Article 44 the Constitution).

Accordingly, duties of government in IRI could be categorised as providing: economic infrastructure, various collective goods and services, maintenance of competition and economic development, protection of natural resources and stabilisation of the economy.

The Islamic State Vs the Theory of Public Choice

In explaining the state under the Islamic Republic of Iran, public choice theory is inadequate (Hosseini, 1990:171). The Islamic state is different from a profit-seeking club formed by self-interested individuals whose aim is to maximise their economic gain, as in the public choice theory of the state. No separation of politics and religion is recognised in Islamic belief. This is clearly exemplified in the manner of the prophet of Islam, as he was both legislator and executor of divine directives.

In the theory of public choice, individuals who need collective action are considered to establish a state for pursuing economic goals, while the Islamic ideal state executes divine law for the sake of maintaining Islam (Hosseini, 1990:177).

This procedure is considered to be for the prosperity of the society and humankind as a whole.

Ideological individualism cannot be the basis of the Islamic Republic. The Islamic leadership is a two-phase system, Islamic in character and at the same time based on the votes of the people. The leader first needs to have acquired the characteristics and merits set out by Islamic jurisprudence (Shari'a). Secondly, he needs to be chosen either directly by the people (like the late Imam Khomeini) or by the Assembly of Experts, who are selected by the people (Amid Zanjani, 1993:6). This system of leadership is designed to promote the prosperity of the society without dependence on a specific organ or class. Adherence to Islamic law, not the mere social contract as the public choice theory asserts, provides the guarantee for the prevention of the transformation of the state into an organ of class rule. In an ideal Islamic state, both citizens and leaders are faithful Muslims. The supreme leader is a just Faghih (jurisprudent) who is worthy of being the true follower of the prophet and the Imams.

The tools of public choice theory and its political roots cannot be applied to the Islamic government. In the context of an Islamic government, policy-making, economic activities and social justice are specified concepts which demand a different interpretation.

Policy-Making

In the area of policy-making, an Islamic government acts based on specific principles. Policies tend to protect material and spiritual borders. The slogan of "Neither East nor West" originally meant "Neither Communism nor Western Capitalism". It is indicative of the Islamic system of government as a different system from these systems. However, it should not be interpreted in isolation from the world, as the Islamic government is considered to be part of the family of nations of the world. Foreign policy in the Islamic system of government is to be based on good, fair and just dealings with all countries irrespective of their standing on the world stage. The policy is based upon its principles of universal justice and fair dealing, where it should not act unjustly towards others, nor should it permit them to be unjust towards the Islamic government and society (Noori,1985:45)

The significant quality of Islamic anti-Westernise sentiment arises as a reaction to existing and past foreign intervention. According to Amirahmadi (1993:16):

> foreign intervention is seen by Muslim intellectuals as having caused cultural decay, economic decline and political corruption.

The rationale for the rejection of foreign influence has come from the Constitution which has consecutively been indicative of the will of the nation. This is the reason for saying that:

> the central fact of post-revolutionary Iran is that no power on the earth could induce the Iranians to submit again to foreign domination (Askari, 1994:63).

Policy-making in the IRI is seen as the active pursuit of consistent objectives.

Economy

The economic system of the IRI is not based on a totalitarian communism nor the *laissez-faire* policy of capitalism. Islam is receptive to business and to profit. The right of individuals to property is recognised, but limited and conditioned by the public interest. According to Islamic teachings, there is a trade-off between individual rights and those of society. For example, private monopoly of trade and industries is not allowed (Mojtahid, 1992:1).[3] In cases of collusion, an Islamic government is allowed to specify a price or limit a trade activity or make a direct investment. According to Mansoor-Nejad (1993:12) the basis of economic development and economic activities in an Islamic government are Islamic values and teachings. Islamic values in these areas find expression in a concern for justice, for the underprivileged and in measures to protect the country's economy from domination by foreigners.

In an Islamic economic system, the forces of supply and demand should work freely in the determination of prices in all markets. However, the market force is not the only factor determining prices in an Islamic economy. For example, the owner of goods is not allowed to sell the goods at any price simply because they are in short supply, especially if they are essential commodities. The owner of goods is required to demand no more than the cost and a just amount of profit for the work and effort.

There is an example narrated by Imam Sadeq, one of the most prominent Imams and the founder of the Jafari Shi'ite in Islam. Imam Sadeq had given money to someone to trade for profit. The man came back to Imam Sadeq with a 100 per cent profit. The man explained that the profit was due to the shortage of specific goods in the market and high demand. Recognising this, Imam Sadeq took his money back and refused to take his share of the profit. He stated angrily that obtaining legitimate benefit was more difficult than fighting in a battlefield

[3]– Quoting from Imam Khomeini, *Tahrirol Vassileh*, Volume 2, p.626.

(Motahari, 1987:112-115). Throughout history, Muslim traders have followed this principle. Market forces have not been central in price determination.

Harming people in an economic activity is prohibited. There are circumstances such as hoarding and collusion in which state intervention is justified. The objective of such intervention is not to prevent freedom of trade but to secure the spread of accurate information in the marketplace. The aim is also to regulate or organise economic activities to protect economic freedom without harming either buyers or sellers.

Private ownership of property is respected by an Islamic government provided that all income is commensurate with the work involved in obtaining it (Presley and Sessions, 1994:586). Wealth should not be obtained by immoral and forbidden instruments and methods of collecting. For example, to fulfil this principle, the Iranian Government is obliged by the Constitution to intervene against immoral ways of obtaining wealth. Therefore, Article 49 proclaims:

> The government has the responsibility of confiscating all wealth accumulated through usury, usurpation, bribery, embezzlement, theft, gambling, misuse of endowment, misuse of government contracts and transactions, the sale of uncultivated lands and other resources subject to public ownership, the operation of centres of corruption, and other illicit means and sources and restoring it to the legitimate owner; and if no such owner can be identified, it must be entrusted to the public treasury. This rule must be executed by the government with due care, after investigation and furnishing necessary evidence in accordance with the law of Islam.

Islamic law respects the right of investors in their wealth and properties. Nonetheless, capital is not considered as a dominant factor of the economy; the workforce is regarded as at least equally valuable. The Islamic government is committed to placing the means of work in the hands of the workforce to achieve balance between the claims of labour and capital. The second part of Article 43 bears on this subject. It emphasises placing the means of work at the disposal of everyone who is able to work but lacks the means. It can take the form of cooperatives through granting interest-free loans or access to any other legitimate means. An ideal outcome results neither in the concentration and circulation of wealth in the hands of a few individuals or groups, nor turns the government into a dominant employer.

In interpreting this section of the Constitution, Ayatollah Beheshti, one of the most prominent scholars and the ideologue of the Constitution, states:

> What an Islamic economy is concerned about and struggles against, is the domination of capital. We should destroy the undue domination of capital over the workforce, whether this domination is by the governments as large capitalists or by the private capitalists.[4]

He explains that by the policy of giving the instruments of work to the labourers, they will neither be exploited by governments such as Communist governments nor by individual capitalists. Consequently, the liberty of humans to choose jobs will be secured in this manner. It is interesting to note that the government in South Korea has constituted a similar rule for the privatisation of profitable and monopoly enterprises.[5]

Economic independence forms the basis of the economic policies in IRI. The objective is to terminate unnecessary reliance upon foreign powers that have dominated the economy, turning it into a consumer society. According to Noori (1985:47), the objective is to act so that international cartels and foreign interests

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[4]– "Some Aspects of the Points of View of Martyr Ayatollah Doctor Beheshti" *Jahan-e-Islam*, No.620, 21 July 1993, p.7.

[5]– More information can be found in Chapter 2, under the title of "People's Capitalism" policy. See also Song (1991:183-184).

do not determine the nation's fate. To prevent foreign domination of the economy, lavish and wasteful consumption of products is prohibited. Therefore, the self-perpetuating production for consumption and consumption for production are also rejected in an Islamic culture. According to Mirbagheri and Doai (1993:12), the evils of capitalism are avoided in Islam through imposing obligatory taxes on the wealth of the citizens, constructive planning, balance between private and public financial sectors, control of inflation, elimination of interest and proper distribution of wealth.

Social Justice

Social justice is the core of an Islamic government. From an Islamic point of view, justice and equality do not imply equal poverty or riches, but it calls for the creation of equal opportunity for individuals (Presley and Sessions, 1994:585). Thus, it is obligatory on an Islamic government to guarantee a sponsoring level to its citizens, which is a minimum level of food, clothing, shelter, medical care and education.[6]

The leaders of a government should strive to bring about social justice and to lead their nation towards the fulfilment of high human ideals. The Qur'an says:

> O, Men of faith, stand out firmly for justice, as witnesses to God, even against yourselves or your parents or your relatives, or [whether it is against] rich or poor.[7]

The significance of social justice is such that the Qur'an refers to the aim of

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[6]– Qur'an, Chapter 2 Verses 275-9.

[7]– Qur'an, Chapter 4, Verse 135.

sending the prophets and the Books and the Balance as the upholding of social justice:

> We sent aforetime our apostles with clear signs, and sent down with them the Book and the Balance that men may uphold justice.[8]

One of the five pillars of the religion is *Justice*, for which attempts have been made to establish a just Islamic state throughout history. In the Iranian Constitution all economic and social activities have been established on the basis of social justice. The government has been obliged to fulfil and monitor the implementation of these measures accordingly.

Some duties of social justice in Article 3 of the Constitution are:

(i) the abolition of all forms of undesirable discrimination and the provision of equitable opportunities for all, in both the material and intellectual spheres;
(ii) creation of the correct administrative system and elimination of superfluous government organisations; and
(iii) planning a correct and just economic system in accordance with Islamic criteria, in order to create welfare, eliminate poverty and abolish all forms of deprivation with respect to food, housing, work, health care and the provision of social insurance for all.

In this article the Islamic government has a heavy duty of providing social welfare and economic facilities to the community. On the basis of this conception of the function of the state some steps have been taken to relieve the problems of under-privileged people (see Chapter 4, Section 2.4.1).

1.3 Economic Structure and Environment

1.3.1 Economic Structure

The economic structure and activities of the IRI are divided into three sectors. These sectors are explained in Article 44 as public sector, cooperative sector, and

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8- Qur'an, Chapter 25, Verse 57.

private sector. It is also recommended that economic activities be based on systematic and sound planning.

The public sector includes all large-scale industries, foreign trade, major minerals, banking, insurance, power generation, dams and large-scale irrigation network, radio and television, post, telegraph and telephone services, aviation, shipping, roads, railroads and the like; all of these will be publicly owned and administered by the government.

The cooperative sector includes cooperative companies and enterprises concerned with production and distribution in urban and rural areas, in accordance with Islamic criteria.

The private sector consists of the activities concerned with agriculture, animal husbandry, trade and services that supplement the activities of the public sector and cooperative sector.

The major role of the government and the supplementary role of the private sector are emphasised in the Constitution. The role of the cooperative sector is considered as striking a balance between public and private sectors and providing a substitute role of government in the community.

1.3.2 Economic Environment

Iran is a rich country in terms of its natural and economic resources. It has vast oil and gas reserves in addition to such materials as chromite, copper, bauxite, marble and other minerals. Skilled labour is plentiful and relatively cheap. The country is, however, dependent on oil revenue. Oil Production fell from six million barrels a day under the Pahlavi regime (Shah) to less than two in 1980-81.

Production has now risen to 3.6 million of which 70 per cent is exported (Askari, 1994: 52, 55). This reduction is maintained to protect the reserve resources of oil for future generations. Revenue from oil represents at least 85 per cent of the foreign currency of the country.

The average annual growth of GDP during 1989-91 was 8.3 per cent which was higher than the plan target rate of 8 per cent (Rafeeuddin Ahmad, 1993:24). However, the trend of the GDP growth was diminishing and the average growth rate of GDP at the end of the first five-year development plan (FFDP) was 7.2 per cent.[9]

Industries

Iran started industrialisation in the 1960s. The rate of growth in industry was around 11 per cent a year in the first half of the 1960s and accelerated to 14 per cent towards the end of the decade. In the 1970s, in particular after the sharp rise of oil prices in 1973-4, Iran could finance large industrialisation programs without foreign exchange constraint. According to Paukert (1981:30), the industrialisation policy supported the construction of large-scale modern factories, but small-scale labour intensive manufacturing was neglected. It seems large industries were more dependent on foreign materials, while labour intensive industries were less dependent on foreign material, but more dependent on the ability of the creative internal industrialists.

In 1991, Iran's industrial sector (which includes oil) accounted for only 20 per cent of GDP (Askari, 1994:55). Among the most important industries are

[9]–The Report of the Governor of the Central Bank of Islamic Republic of Iran (CBIRI), *Keyhan Havai*, No.1095, 24 August 1994:11.

petroleum refineries, petro-chemicals, textiles, cement and other building materials, food processing (particularly sugar refining and vegetable oil production) and metal production (steel and copper). The crisis of the eight-year war impeded many economic activities, including industry. Since the end of war, industry has been boosted significantly. Value added in the industrial sector in 1991 grew by 20.6 per cent compared to 15.9 per cent in 1990.[10]

Agriculture

Before the Islamic revolution, the performance of agriculture was not satisfactory. Portion of Iran is arid and there was a lack of water to irrigate cultivable lands (Paukert, 1981:30). Since the revolution, attempts have been made to utilise most of the cultivable lands. Despite the high rate of population growth, output of agricultural production has been considerable (regarding the population growth rate, see Table 4.1). Total agriculture land amounted to 16,872,000 hectares of which 4,620,000 hectares were irrigated and 5,676,000 under dry-farming. The average growth of the agricultural sector was 5.6 per cent until 1993, which was higher than the 5 per cent shown in the first five-year development plan. Principal products are wheat, barley, rice, pulses, other grains, sugar beets, fruits, nuts, cotton, dairy products, wool and caviar. The country is not yet self-sufficient in food.

Agriculture is still the main source of GDP in Iran. The share of agriculture in GDP in 1990 was 27.8 per cent; mines 0.6 per cent; industry 15.4 per cent; petroleum 21.2 per cent; trade, restaurants and hotels 10.7 per cent;

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[10]– *Iran Commerce*, No.1, 1993, p.32.

transport, storage and communication 7.5 per cent; services, real estates and professional services 12.1 per cent; and public services 8.2 per cent.[11]

Exports and Imports

Export commodities are petroleum (85-90 per cent of total exports), carpets, fruits, nuts, and skins. Export partners are Japan, Turkey, Italy, Netherlands, Spain, France and West Germany. In 1991, exports declined by 5 per cent due to the decline in the international price of oil. However, the growth rate of agricultural products was 24 per cent (Rafeeuddin Ahmad, 1993:25).

Imported commodities are machinery, metal works, foodstuffs, pharmaceutical, and technical services. Import partners are West Germany, Japan, Turkey, United Kingdom and Italy. Imports of IRI recorded a fast growth rate of 22.8 per cent in 1991. Imports by the private sector grew by 24.7 per cent and those of the public sector had a growth rate of 21.7 per cent. This increase in imports occurred after the implementation of the economic adjustment policy of the FFDP, and resulted in a trade deficit in 1991.

1.3.3 Five-year Economic, Social and Cultural Plan

In 1989, the FFDP (1989-94) was introduced. The plan aimed to restructure the economy. The plan inspired new dynamism in the economy and the industrial sector in particular.

The FFDP for economic reconstruction was, first, prepared by the last Prime Minister, Mirhossein Mousavi. The President made significant changes in a number of policies, quantitative targets and areas of emphasis. The trend has been

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11– *Iran Commerce*, No.1, 1993:33.

a move from a radical mode towards a pragmatist and liberal tendency. In particular, the plan tended to move the economy towards a mixed and semi-open economy with a more powerful private component. It considered an extensive sale of nationalised and public industries to the private sector and freedom for the public as well as private agencies to enter contracts with foreign corporations.

The FFDP comprised a variety of economic, social and development objectives. Among the general objectives of the FFDP were the construction and reconstruction of the productive and infrastructural centres and war-damaged centres. Economic growth for increasing production per capita, productive employment, reduction in economic dependency with an emphasis on agricultural strategic production and the control of inflation were other general objectives of the FFDP.[12] For example, some of the general aims of FFDP were:

(i) reconstruction of the production and infrastructural capacity of the war-damaged areas;
(ii) producing economic growth in terms of increase in production per capita; productive employment; and decrease in economic dependency with emphasis on self sufficiency of agricultural productions and control of inflation;
(iii) attempts to maintain Islamic social justice; and
(iv) reform in organisation and management of the executive and judiciary system of the country (the Law of FFDP, General Objectives:25).

The major objective of the FFDP was economic adjustment. It included privatisation, liberalisation of the economy and foreign trade, removal of price controls, enforcement of a single parity rate for hard currencies, promotion of exports etc.

[12]–President Rafsanjani, "The Objective of Development Plan" Friday Prayer Sermons. *Keyhan Havai*, No. 990, 22 July 1992, p.9.; *Law of the FFDP*, 1990; Ebrahim Razaghi (1993:77).

Extensive privatisation and deregulation of PEs were also included in the FFDP. The objective was to encourage greater participation of the private sector in industrial investment; and to reduce the government's role in such matters as ownership, administration of industrial and economic institutions and price controls, and instead confine government activity to supervisory and monitoring functions (Arab-mazar, 1993:48). The plan gave more autonomy to ministers and PEs to self-funded management of their affairs. It also made it easier for certain enterprises to directly enter into contracts with foreign companies and to use their credit (Note 29, the Law of FFDP). Tourism entered the new plan as a high-priority sector and a new source of foreign exchange. The expectation was to reduce the budget deficit and inflation and redirect money supply towards productive activities and away from trade and brokerage (Razaghi, 1993:75-77).

The plan was introduced to settle economic and social problems of the country. It aimed to solve the dependence of the economy on oil exports and the importation of industrial materials. The FFDP included a wide spectrum of development plans ranging from war compensation to the largest possible expansion of the country's infrastructural sectors (Razaghi, 1993:77). The point, here, is the inconsistency between the priorities of the goals of the FFDP.

In summary, reform in Iranian PEs has a peculiar character of its own. This is especially so when privatisation programs are examined in the socio-economic and cultural context of Iran. Iran's political structure is based on a popular revolution which also created the foundation of the Constitution and influenced policy-making procedures in many significant areas. Economic activities are based on the Constitution and directed to attaining the principle of economic independence. The government has the role of provider and facilitator and is committed to guaranteeing social justice and a minimum standard of living for all individuals. The FFDP was created as an economic and social development plan to relieve the problems of war-damaged areas after the war with Iraq. It was also aimed at restructuring the economy and initiating momentum for economic development as well as social justice. The privatisation of PEs was part of the FFDP to improve the productivity of these establishments, as they were assumed to be in need of such a reform. The next section examines the role and performance of PEs in Iran.

2 The Role and Structure of the Iranian PEs

Iranian PEs are major involvements of the government. The main reasons for the increase of government involvement were the exodus of owners, managers and foreign technicians, outstanding debts and increasing dependence of private enterprises on government funds and thus their nationalisation (Rahnama and Nomani, 1990:241). As a result, some of the larger private industrial businesses came under government supervision after the revolution in 1979.

The Islamic government has also been given a tremendous responsibility for the economic and social welfare of the nation. In order to fulfil this, the government is required by the Constitution to control important parts of economic activities. PEs, as instruments of economic policy, also obtained a significant role to achieve the objectives of economic development.

However, the movement towards privatisation has been in conflict with the Constitution's concept of the role of the state and the significance of the role of

PEs. The economic and managerial problems of some PEs may have been a reason for the new reform policy of the government. This section analyses the structure and the role of PEs in Iran. The analysis considers the rationale for the establishment of PEs. The performance of PEs and the factors associated with the performance of PEs in the post-revolutionary period are also examined.

2.1 Rationale for Development of PEs

The first Iranian PEs growth period was during 1922-42. In the beginning of the Pahlavi regime, there was intervention in all economic activities as a means of exerting the sovereignty of government. Administrative, military and commercial institutions were established. Monopolies and PEs developed and many factories, industries, infrastructures and productive companies were established during this period.

One of the factors encouraging the expansion of the PEs was political. In the early 1970s, there was an increase in the oil price which was accompanied by an increase in government expenditure. Some assembly industries and companies were established. Through the expansion of PEs, the Pahlavi regime was able to consolidate its power. A small number of dependent investors who dominated the vital wealth of the country, helped strengthen the power of the Pahlavi regime (Boloorian, 1993:50). This also expanded the bureaucratic system of administration.

The increase in the oil revenue also resulted in an increase in the salaries and wages of the staff and workers. As these increases were not accompanied by an increase in national production, it resulted in inflation and increases in commodity prices. Consequently, imports were increased to respond to the increased demand and the lack of supply. This resulted in more dependence on foreign products. The development of administrative systems also occurred in this period. The trend of the growth of the number of PEs by 1979 is shown in Table 4.2.

Table 4.2 The Number of PEs During Different Years by 1979.

Year	1942	1949	1962	1973	1979
Number of PEs	21	28	58	100	161

Source: Plan and Budget Organisation (PBO), 1993, p.2.

The reasons for the creation and development of the PEs in Iran during this period have been categorised as follows:

(i) to improve the process of economic development and growth;
(ii) to create manufacturing employment;
(iii) to change from an oil-dependent economy to non-oil economy;
(iv) to create new sources of revenue for the government;
(v) to assist the stability of the prices and protection of the consumers;
(vi) to protect the domestic industries;
(vii) to compensate for the market failure in heavy investments; and
(iix) to produce, distribute, and imports of some specified goods by government (Plan and Budget Organisation (PBO), 1993:4).

These activities were aimed at economic and social improvement of the country.

2.1.1 Expansion of the PEs After 1979

In 1979, the Revolutionary Council nationalised twenty-seven privately owned banks and fifteen insurance companies. The government's justification for the nationalisation was first, the heavy domestic and foreign debts of some banks, especially the development banks, and secondly, the risk of the outflow of funds to accounts abroad (Rahnama and Nomani, 1990). In large industrial establishments, government supervision became increasingly unavoidable due to the departure of the owners, outstanding debts and increasing dependence on government funds. This also applied to firms which were closed or unable to continue their operations and needed government help.

On 14 June 1979, the Revolutionary Council approved a measure for the appointment of one or more managers to all enterprises whose owners were absent. This also applied to enterprises which had closed or were unable to continue their operations and had asked for government assistance. The next step was to pass the law for the protection and expansion of nationalised private industries including:

(i) strategic industries such as metals, chemicals, ship building, aircraft manufacture and mining;

(ii) industries belonging to fifty-three individuals and families who had illegally acquired their wealth through relationship with the former regime;

(iii) industries whose liabilities exceeded their net assets; and

(iv) those which, despite their solvency, were indebted to the government (Rahnama and Nomani, 1990:242; Ehteshami, 1993:219).

The law also obliged the government to acquire the ownership of those industries within the framework of *Islamic Law*. This included: all large-scale and large industries, foreign trade, major minerals, banking, insurance, power generation, dams and large-scale irrigation networks, radio and television, post, telecommunication services, aviation, shipping, roads, railroads, and the like (Constitution, Article 44). These establishments are identified by the Constitution as strategic economic infrastructure. Except banking and insurance institutions, others were previously state-owned enterprises and placed under the control of government.

Eleven per cent of the industries and productive units of the country came under the control of new institutions, foundations, the Iranian National Industries Organisation (INIO), and Iran Development and Renovation Organisation (IDRO). The INIO took control of 464 production units with a workforce of 177,000 (Kazemi, 1992b:15). Then, 110 units out of these 464 were transferred to IDRO in the Ministry of Heavy Industries and the Ministry of Mines and Metals. According to the Economist (1993:54), the Bonyad-e-Mustaz'afan (Foundation for the Oppressed) also controls nearly 1,200 companies.[13]

According to Ehteshami (1993:219), the initial nationalisation should be understood as a stop gap measure motivated by an urgent need to bring back productivity as well as order and management to a large and abandoned section of the economy. The last measure was an attempt at providing a rescue package for those enterprises in deep financial difficulties. Therefore, the scope of the PEs sector has become broad and large. Most of them are involved in a wide range of activities and control important parts of the economy. The proportion of the current budget received by PEs is shown in Table 4.3.

Table 4.3 Total Budget and the share of PEs During 1985-93 (to IR million).

Year	1985	1986	1987	1988	1989	1990	1991	1992	1993	94
Total Budget	6551	6917	7465	7426	9008	8398	12773	18788	28912	
PEs	3444	3562	4032	3888	5049	4455	7389	11094	17386	
Total Per cent	52.5	51.5	54	52.3	56	53	57.8	59	60	58

Source: Adapted from Report of PBO, 1993: 5; Kamyar, 1994:11.

2.2 Role and Structure of Iranian Public Enterprises

The Iranian PEs include three types of organisations (Bollorian, 1993:48). First, enterprises that were required under the law to maintain their financial accounts in accordance with commercial standards, such as those involved in

13- Another statistic refers to 800 companies operating in 7 economic divisions of activities ranging from production to tourism (Mehdizadeh, 1994:49).

telecommunications, electricity and water organisation. PEs established under the Companies Act are included in this category. Most of them are under the control of a Ministry.

Secondly, public corporations and statutory bodies that are government-owned and established by the government. This group includes companies under the control of INIO, the Ministry of Commerce, IDRO, insurance companies, banks and so on.

Thirdly, enterprises which are similar to private enterprises and operate under commercial law. These are establishments under the control of foundations such as the Bonyad-e-Mustaz'afan (Foundation for the Oppressed).

2.2.1 The Performance of Iranian PEs

An increase in the number of employees of the PEs was accompanied by a reduction in the relative productivity of manpower. For example, between 1977-87, the professional, technical and scientific workforce more than doubled while, at the same time, per capita productivity and efficiency of manpower increased only 1.4 times (Vakili, 1992:63). Even during the war with Iraq, the number of employees in the production sector increased by 20 per cent. Nonetheless, the GDP was reduced by 8.5 per cent in the same period. According to the official reports, the reason was that the employees in most government offices spent only about one hour a day on productive work (Amirahmadi 1992a:17; Iranzadeh, 1994:21).

Meanwhile, a statistical sampling test of the efficiency of the workforce in PEs showed a rate of about 2.45 hours per day or even less. This report suggests that the efficiency of the workforce in PEs is less than 50 per cent (compared with a standard efficiency of six hours for the workforce) (Vakili, 1992:63). Therefore, more than half the workforce are redundant, based on a standard measure of efficiency.

Another piece of research conducted by PBO on 250 PEs, ten banks and two PEs, indicated that three fifths of these enterprises were profit-making, returning an average of 14 per cent on investment per year (Boloorian, 1993:50). Research conducted by INIO, regarding the financial performance of its enterprises for the years 1978-88, reveals the following results of profit and losses as set out in Table 4.4.

Table 4.4 Profit and Losses of INIO (IR millions).

Year	Profits/Losses
1978	13377
1979	- 13866
1980	- 41249
1981	- 52581
1982	- 24190
1983	12536
1984	31248
1985	17557
1986	6037
1987	7939

Source: Kazemi, 1992a in *Paper of the Iran Chamber of Commerce*, No.3, June 1992, p.22.

The table of performance of the companies under the control of INIO indicates that during 1979-82, these companies were non-profitable. The major reason was an abrupt change of ownership and management of these enterprises. Other reasons were political agitation; repayment of the previous debts and interests to the banks; and the problems resulting from intervention of the banks as new owners (Kazemi, 1992b:21). The analysis indicates that the reasons for the losses included ambiguity of ownership and a lack of managerial control and efficient monitoring of the companies.

During 1983-7, these enterprises became profit-making. However, the rate of growth of profit varied among industry sectors. Food and pharmaceutical companies were more profitable than companies involved in the production of cement and textiles goods (Kazemi, 1992b:22). The reason for the profitability of companies in this period was an appropriate allocation of foreign exchange to import their raw materials from other countries. Political stability and the relative removal of problems regarding management and ownership were also amongst the other reasons for performance improvement. The report from PBO gives comprehensive information about the total performance of the PEs during 1978-93 Table 4.5. The report shows the government gains and payments from and to the PEs.

Table 4.5 Government's Payments and Gains of the PEs (IR millions).

Year	Government's Payment	Income (tax + dividend)	Net gains
1978	7694	18717	174023
1979	96465	149983	5358
1980	123057	199782	76725
1981	18469	470	-17999
1982	218202	11567	-206635
1983	205888	183247	-22641
1984	104903	209294	-104391
1985	352132	153871	-198261
1986	166021	176946	-10925
1987	62772	193543	-130771
1988	97789	112813	-104976
1989	204481	65911	-138570
1990	202173	74625	-127548
1991	373443	84590	-288853
1992	286223	307916	21693
1993	263135	263517	382

Source: Adapted from PBO, 1993:6.

On the basis of Table 4.5, the net gains of the government during 1981-91 have been negative. However, this does not prove the inherent inefficiency of PEs, especially when it is considered that the war with Iraq began in the second half of 1980 and stopped the positive process of the net gains of the government. In 1981, the sharp reduction in the allocated financial resources of these PEs to 15 per cent of the resource allocated in year 1980, was the major reason for the reduction of the government's gains from PEs. The end of the war, in 1988, was the beginning of the relief of these problems. The positive results of the years 1992, and 1993 indicate the beginning of a new period for PEs.

On the other hand, the report about operational profit or losses of these PEs gives another indicator. It shows that PEs during 1984-93 - except in the years 1985 and 1991 - achieved operational profits (Table 4.6), albeit the proportion of the profit to income was small.

Table 4.6 Operational Income and Costs of the PEs During 1984-93.

Year	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993
Income	2244	2466	2805	3175	3226	3825	4142	5420	8453	13130
Costs	2058	2679	2758	2965	3177	3717	4084	5594	8231	12199
Profit (losses)	186	-213	47	210	49	108	58	-174	222	931
Profit or loss to income (%)	8.2 %	-	1.6 %	6.6 %	1.5 %	2.8 %	1.4 %	-	2.6 %	7.1%

Source: Adapted from PBO, 1993:8.

2.2.2 The Effective Factors Influencing Performance of PEs

Two types of internal and external factors can be considered as effective factors influencing the efficiency of the work-force in PEs.

Internal Factors

Internal factors include issues which are pertinent to the management of these PEs. They are also associated with technology, materials and production systems which are difficult to change in the short-term.

After the nationalisation of some major industries and companies, there was the problem of a lack of managers. Some managers were dismissed or left the companies because of nationalisation and some managers did not wish to cooperate with a new managerial system. This left the new government with the problem of administering huge companies.

As a result, managing a comprehensive PE structure and creating a system of accountability to the appropriate authorities are issues which the government has been tackling since the Islamic revolution. The government tried to tackle these problems by finding trustworthy and faithful management staff (Latifi, 1992:22). The new management group was chosen by transfer from other public institutions, the promotion of existing staff at middle or operative levels of management, and newly employed managers. These approaches to choosing managers lessened the huge problem of government administration of the various kinds of companies under its supervision.

Most of the management positions were assigned to young managers. The revolutionary environment gave young revolutionary managers a special status. Other reasons included their honesty and the general consensus concerning the ability of these groups to control the organisational environment. They were managers at the time of crisis and their sincerity was judged to be most advantageous in the settling of immediate problems. Nonetheless, Kazemi

(1992c:26) and Boloorian (1993:50) noted typical features of weaknesses in the management of PEs.

These were:

(i) lack of technical experience and managerial knowledge: only 26.2 per cent of managers were familiar with new technology;

(ii) lack of autonomy or accountability of managers, so that either their authority was not enough to manage a system well, or they had autonomy without accountability which resulted in decisions made without considering their financial consequence;

(iii) lack of clarity of the status of management in the administrative system; and

(iv) lack of motivation for managers and workers towards profit-making. There was no relationship between profit-making and the salary managers and workers received.[14]

Training employees and recruiting educated managers in some PEs occurred rather late. This slowed the progress of the enterprises compared to what was planned originally. Boloorian (1993:51) refers to other features of managerial problems in PEs, such as the ambiguity of objectives and the lack of an independent system of performance monitoring.

For example, one of the areas of management problems is that of settlement of budgets. The settlement of the budget and management of expenditures within the planned budget has not been achieved for 15 years in some

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[14]-Cross subsidy is where an enterprise varies its prices so that, within its overall functions, profitable activities subsidise unprofitable but desirable activities (see Emy and Hughes, 1991:447-8).

PEs (Boloorian, 1993:52; Gharabaghi, 1994:8). As a result, there have been opportunities for some managers to act wilfully without feeling accountable to the community for their performance.

There are instances where the full capacity of resources are not utilised. About 20-25 per cent of the lands for agriculture are utilised, but only 21 per cent of the water resources and only 51 per cent of the capacity of industries are utilised (Savali, 1993:11).[15] These examples indicate the lack of resource management in Iran.

Technological problems have also been factors reducing the efficiency of PEs. Machinery and equipment was not replaced during the eight-year war. Nonetheless, value added by the industry sector increased during 1980-89 (Table 4.7), whereas a decrease was expected in this sector because of the war-time problems.[16] This suggests that there was a faithful workforce in this sector, while the problems associated with the shortage of technology and equipment remain paramount.

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[15]- Utilisation of the industries was less than 40 per cent in 1990 (Amirahmadi, 1990a:9).

[16]- Farshad Moemeni, a report presented in the Seminar of "Culture and Development" Tehran 10-17 August, 1993.

Table 4.7 Value Added and the Growth of Industry Sector (IR billions) (Based upon the Constant 1982 Prices).

Year	Value added in Industry Sector
1982	996.7 (9.6%)
1983	1115.3 (9.7%)
1984	1252.3 (10.8%)
1985	1225.9 (10.56%)
1986	1148 (11.6%)
1987	1275.6 (12.7%)
1988	1301.8 (14.1%)
1989	1417.9 (14.9%)
1990	1643.8 (15.4%)
1991	1981.9 (16.9%)
1992	2104.8 ((16.9%)

Source: Research Group of Parliament, No.1, April 1994:17.

However, the efficiency of the social and governmental services suffered a marked decrease during 1981-91, which affected the efficiency of other sectors. Table 4.8 illustrates these changes.

There is a need for effective management, particularly in industries and PEs, in order to optimise productivity, minimise costs and thus to improve efficiency. According to Kazemi (1992b:23), lack of consistency between the current prices and the real cost of public goods and production for social reasons, soft budgeting and the lack of a system for performance appraisal also interfered with the efficiency of PEs and publicly owned companies.

Table 4.8 Indicator of Work Efficiency in Social and Public Services Based upon the Constant 1985 GDP.

Year	Indicator of Work Efficiency
1981	124
1982	116
1983	109.4
1984	94.3
1985	100
1986	87
1987	71.4
1988	59.9
1989	54.8
1990	59.3

Source: Organisation of National Efficiency, Plan of National Statistics, cited in *Paper of the Iran Chamber of Commerce*, No.2 April 1994:29.

External Factors[17]

External factors influencing the performance of PEs in Iran have included structural changes, economic, cultural, social and demographic. In an Islamic society, the significance of discipline, principle and cooperation is high. Nonetheless, these characteristics are mostly disregarded in the workplace environment (Vakili, 1992:87). There are some cultural remnants of the imperial regime as well as an economic dependence left behind from that situation.

For example, in spite of the government support in providing currency for PEs, this did not result in the desired output. Moridi (1992:18, 26) asserts that PEs were subjected to administrative bureaucracy to obtain their quota of currency but were not able to utilise it efficiently.

The lack of resources, the dependence on foreign materials and the economic sanctions of other countries against Iran, were part of the external

[17]- External factors, here, refer to factors other than those associated with the internal organisation of the PEs. These are either related to cultural, social and economic factors, or to those of dependence on foreign material for industries.

pressures on the country. The war with Iraq placed a further burden on the operation of PEs and was an obstacle impacting on their performance.

For example, under-utilisation of industrial capacity was estimated to be about 40 per cent in 1989 (Amirahmadi, 1990:9). This had resulted from a number of conditions inherited or imposed on the country by the war, the decline in oil revenue, its dependency on external resources and managerial incompetence.

On the other hand, the Iranian PEs, like those of many other developing countries, were not established for the mere aim of profit-making. In their creation, other aims such as social, economic and welfare were taken into consideration. The need is to precisely classify the commercial and non-commercial PEs and to deal with them separately on this basis. In this respect, the Law of FFDP (Note 32:18) has required the government to distinguish between the profitable activities of PEs and their social and supportive activities to make them accountable. The commercial and non-commercial activities of PEs have also been distinguished in the privatisation program (see Chapter 4, Section 5.1.1).

2.3 Trends towards a Major Change

The FFDP indicates a major policy shift in social and economic matters in the post-revolutionary period. In order to have a clear understanding of the changes, the era is divided into two periods, pre-plan and post-plan periods, i.e. before 1989 and after 1989.

2.3.1 The Post-Revolutionary Period: Before 1989

Before 1989, the leadership attempted to transform the post-revolutionary economy to create a large, independent, equitable and mixed economy.

Economic sovereignty was to be achieved by means of a self-reliant strategy. Even before the war and the destruction of the Iranian oil installations, oil production had been cut back to reduce the dependency of the economy on this export commodity and on the world market. Industries which were more than 55 per cent dependent on inputs to the world market were working with substantially reduced capacity. Instead, attempts focused on reviving agriculture and promoting small-scale productive units by means of various credit and price support policies (Amirahmadi, 1988:236). A parallel policy of import substitution and protectionism was also followed in the hope of stimulating domestic production of certain durable and non-durable consumer products.

The mass media was used to convince the people that national independence could not be achieved without an acceptance of hardship in the short-run, and that sacrifices had to be made in the standard of living. It also denounced the western pattern of consumption as non-compatible and harmful to the goal of self-sufficiency.

The goal of social justice was to be achieved by means of certain reforms and changes in national priorities. The health services provided to rural residents and a type of social security to the elderly (known as Tar-he-Rajai) helped to expand the government's power over the rural areas of the country. A Seven-Member Council was formed to prepare a Land Reform Bill. In addition, about one million hectares of land were distributed among peasants' families and hundreds of peasants obtained some large areas of high quality agricultural land (Vakilizad, 1992:42). A Housing Foundation was created to provide housing for the poor, particularly in urban areas. The Plan and Budget Organisation (PBO) was directed to allocate national resources more equitably throughout the provinces. The "Reconstruction Crusade" was established to provide rural areas with electricity, water, provisional roads, schools, health clinics and housing among other social and infrastructural services. Modification was proposed in the tax system both to make it more progressive and to prevent excessive concentration of wealth in the hands of a few people.

By 1988, the virtual absence of foreign debt was a bright spot on the economic horizon (Askari, 1994:54; Zaman, 1994:10). The government had exercised such strict fiscal discipline during the war that the country paid its military bills as it went along. This lack of external debt could have opened the door to rapid economic reconstruction and expansion after 1988. These efforts were the response to demands for national independence, social justice and democracy and were based on the perceived role of an Islamic government.

However, this self-reliant strategy has been changed to a strategy of diversifying the sources of dependency. Equity concern was balanced with a concern for efficiency. The mixed economy objective was to be achieved through the creation of a leading public sector, a subordinate private sector and a balancing cooperative sector.

2.3.2 The Post-Revolutionary Period: After 1989

The year 1989 was a turning point in the process of social and economic change in Iran. Since 1989, the trend has been towards suspending, reversing or modifying most of the policies which were attempted during 1979-82. These changes were taken under enormous domestic and international pressure.

However, the changes which took place after 1989 were a continuation of the movements which had begun earlier. According to Amirahmadi (1988:238), pressure began building up for the revision of the concepts of self-reliance, social justice and a balanced mixed economy in the beginning of 1983. The policy of diversifying the sources of dependency on exports and imports, which the government had begun, was only marginally successful because the world market had taken control of the price of oil (ibid., p.239).

A number of nationalised industries were sold to the public or returned to their original owners (re-privatisation), and the role of the cooperative sector in the economy remained weak and ambiguous. Modern technology became acceptable to planners and policy-makers.

The private sector has been gradually expanded at the expense of the public sector in the mixed economy. The pragmatist government's plan built an economic structure in which the role of the private sector expanded while that of the government was confined to basic and strategic sectors and activities. This meant that planning continued to be considered a major tool for economic management.

The critics maintained that the plan's liberal openness to international trade, investment and borrowing would exacerbate Iran's dependency, make it a debtor nation, worsen domestic socio-economic inequalities and increase the influence of Western culture (Amirahmadi, 1990:255). The FFDP has also been criticised for its unconditional support of the private sector and for its reliance on privatisation.

In summary, the role of PEs in Iran is significant in as much as they have been created to maintain economic, social and political objectives. After the revolution, this role was expanded due to the huge domestic and foreign debt of private enterprises and their nationalisation. The performance of these PEs is affected by managerial problems. These problems of management were mainly compensated for by finding trustworthy and faithful managers during the first ten years after revolution. However, the eight-year war with Iraq saw the situation deteriorate as it affected the financial and operational side of PEs. The analysis of the performance of these PEs does prove that factors either inherited or imposed on the economy have been the cause of the inefficiency in these establishments. The trend towards privatisation was not merely because of their performance, but also for external reasons. The next section examines the motives for privatisation.

3 Privatisation Motives

The Iranian government has been implementing its privatisation policy since 1989. The FFDP, which was the first of its kind since the revolution, was adopted in March 1990 and called for the transfer of many government controlled enterprises to the private sector.

The privatisation program was built around selective privatisation of the productive public sector, de-regulation of certain sections of the economy, limited import liberalisation and controlled financial liberalisation. The government intended to move further in the direction of a market economy. This was to be aided by the kind of stabilisation or structural adjustment policies prescribed by the World Bank and IMF. Here, the specific motives for the Iranian privatisation program are examined. These motives include internal, external and ideological factors.

3.1 Internal Factors

Privatisation was promoted as a solution for the problems of financial and fiscal pressures, especially those associated with reconstruction of war-damaged centres and the reform of the economic structure. The internal motives for the privatisation program, which are examined here, are financial, managerial and economic.

3.1.1 Financial Factors

The financial motive for privatisation was the transference of the burden of PEs to the private sector. The head of the Plan and Budget Organisation (PBO) stated that the aim of privatisation was to transfer a burden of nearly 300 huge companies to the private sector. These companies accounted for approximately 20 per cent of GDP and 60 per cent of government receipts and payments in the budget (Banker, 1991:46). The privatisation program was also introduced as part of the package of fiscal policies in order to address the economic problems of inflation and money supply.

The FFDP and the reconstruction of war-damaged areas were used as opportunities to announce privatisation. The government sought to reconstruct the economy and part of the $1000 billion damage after eight years of war.[18] Some post-war expenditure would be financed by foreign loans during the FFDP period (1989-94).

[18]–The cost of war damage has been assessed at $592 billion in 1987, equal to 19.5 years oil revenues of the IRI (Amirahmadi, 1992b). However, the government estimate is about $1,000 billion.

3.1.2 Managerial Factors

Privatisation was also considered as a solution to the problems of economic inefficiency and a means of slowing the growing bureaucratisation of the administration. Mohsen Nourbakhsh, the Minister of Economic and Finance Affairs, declared that he decided to privatise some 500 companies out of 800 in state ownership (Evans, 1991:79). He suggested that they had to reduce the role of government in economic activity as much as possible.

From the managerial viewpoint, PE reform has been applied as a means of reducing problems such as inefficiency, non-effectiveness and lack of responsibility in PEs. Some problems of inefficiency and lack of a work ethic were considered in some PEs (Amirahmadi, 1990). Extravagance and wastefulness and lack of motivation were apparently identified.[19] The private sector maintains that the "Bureau of Accountancy", which is responsible for auditing PEs' accounts, does not have sufficient instruments to examine the operational performance of PEs.[20] They point to cases of corruption and a lack of operational accountability. According to Kamyar (*Keyhan Havai*, No.1095, 24 August 1994, p.11), during the FFDP, 4,987 cases of managerial offence and 42,156 cases of breaking the law have been reported, besides 6,532 cases of tax evasion.

Ali Kamyar, MP and the head of the Divan-e-Mohassebat (Bureau of Accountancy), stated that from 2,400 companies under the control or ownership of the government, only 1,800 companies are active and they make a loss of IR790

[19]– Interview with the vice president of the Office of Economic Survey of the Central Bank of IRI, August 1993, Tehran.

[20]– Interview with the head of Chamber of Commerce, Industries and Mines, 9 September 1993, Tehran.

billion (about $300 million) every year.[21] He stated that the losses are due to the payment of subsidies by the government (soft budget) and the weak management of these companies. He added that there were no statistics available for the performance of the 600 new PEs established by the government. PEs accounted for 58 per cent of the total budget in 1994. In 1994 (Iranian year of 1373 beginning 21 March 1994), the budget of the 16 major companies was added to the budget bill for the first time and comprised 80 per cent of the total credits of the PEs. The government's priority is to finance budget deficits using taxes and the oil revenues.

Finally, it is feasible that the government could increase the net profit of PEs to at least IR5,400 billion (about $2billion) by exerting a more stringent monitoring system on PEs (*Divan-e-Mohassebat*, 22 January 1993, p.3). However, these are structural and managerial problems in the economy which need to be taken into consideration.

3.1.3 Economic Factors

It was felt that reform was not only required but also essential in order to solve the structural economic problems of the public sector and PEs. The major structural problems with the economy are dependency on external materials, reconstruction of war-damaged areas, and dependency on oil-export revenue as the main export commodity.

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[21]- The statistics of the PEs have been published in different classifications. This figure of 2,400 is the latest total statistic of the PEs which include 800-1200 PEs belonging to the Bonyad-e-Mostaz'afan (Foundation for the Oppressed) and 770-800 PEs which were targeted for privatisation by the executive authorities of the privatisation program, and there are 600 inactive PEs. One of the managerial issues that the government faced was that it did not have the correct number of PEs.

Privatisation was adopted as a reform alternative to solve the aforementioned problems. The previous Minister of Economic and Finance Affairs stated that the objective of privatisation was to further utilise the country's existing potential.[22] Nonetheless, domestic economic pressures in addition to political and ideological pressures for privatisation in Iran outweighed the managerial reasons for reform.

3.1.4 Political Factors

The election of 1992 was a turning point in acceleration of the privatisation program. In the election of 1 April 1992, a coalition of the so-called pragmatist faction and the conservative faction won the election and gained the majority of representatives in Parliament. They did not have any major problems in Parliament in pursuing their reform initiatives except in determining the extent and the degree of privatisation (*Paper of the Iran Chamber of Commerce*, No.3, June 1993, p.58).

Privatisation in Iran was a pragmatist approach which sought systematic change. It was aimed at shifting the whole system towards a market economy and away from reliance upon the government. However, there was a need to move in compliance with the Constitution and to follow the procedures it prescribed. The public interest, the radical faction's attitude and certain other factors also had to be considered. It was predicted that the earlier self-reliant development strategy would become extremely hard to manage, while the success of the alternative open policy would depend on the leadership's attitude towards Iran's uneasy relationship

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[22]– Mohsen Nourbakhsh, *Keyhan Havai*, 19 May 1993, p. 31.

The decision to grant a loan to Iran for specific projects was welcomed by free market supporters as a sign of international acceptance of the Islamic Republic's policies. This took place while the policy-makers in Iran were keeping quiet about their dealings with the World Bank and IMF, because of the negative ideological and political attitudes towards such dealings among the public.

Ahmad Amin (1993:56) maintains that "If a person wishes to be trusted by those whom he hopes to get money from, the first step is to gain and publicise the confidence of the major lender." In a capitalist environment this is logical. However, for a country which is among the principal contributors to those bodies, and is able to draw on its full rights at the World Bank and IMF, it is inappropriate behaviour. Moreover, the size of the loan was to be $850 million.[23] It was about 1 per cent of the total amount of $85 billion expenditure of the FFDP.[24] It seems that if there was a saving of only 1 per cent, there would be no need to surrender to the prescriptions of the foreign institutions.

What are the political objectives which those two bodies are following? This question arises as it seems naive to believe that their policies are politically neutral. Coinciding with the recent project, came the voice of American officials expressing disapproval of the policies of the Islamic Republic.[25] It is claimed that

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[23]– Mohsen Nourbakhsh, the Governor of the CBIRI, in an interview announced that the total amount of the loans received for the project from the World Bank was between $500-600 million, which is less than the amount which previously was to have been received (*Ettela'at International*, No.184, 3 February 1995:3)

[24]– Mortaza Alviri, the head of the supreme council of free trade zones, *Keyhan Havai*, No.1074, March 1994, pp.12-14.

[25]–These projects were the construction of a dam to prevent flood in the province of Sistan and Baloochestan, and the project for sewerage to drain floods and surface water in Tehran. Both projects were approved in spite of the disapproval of the USA (Nourbakhsh, *Keyhan Havai*, No.984, 10 June 1992, p.10).

with the West (Amirahmadi, 1988:227). In spite of the efficiency and managerial problems associated with PEs, there were no urgent financial and fiscal deficit pressures behind the reform program.

3.2 External Factors

3.2.1 The Role of the World Bank and IMF

Privatisation in IRI is part of the program suggested by the IMF as a condition for providing loans to reconstruct the economy after the war. However, a change of economic policy in Iran favouring private enterprise required a change in relations with the outside world.

Since 1989, contacts with the World Bank and IMF have taken place regularly (Ahmad Amin, 1993:56; see also *The Middle East*, July 1992, p.34). The international bodies wished to gain some experience about the real intention of the Islamic government. They wished to know more about Iran's economic structure and policies. As a rule, the prime mission of these bodies included attempts at ensuring that the rule of market mechanisms within the country and free trade with the outside world were on the agenda. Therefore, the intention and direction for change has been influenced by these bodies
(Amirahmadi, 1992:8, 16-18).

As far as the World Bank and IMF are concerned, a clear economic picture includes an economy with no subsidies, a perfectly free floating exchange rate and minimum obstacles to international trade (Ahmad Amin, 1993:56). Although the sum total of loans seems quite small and the Iranian economy is very far from being able to meet these conditions, the political will to comply with them has become firmer.

the World Bank has made the decision irrespective of this or that country's influence. Ahmad Amin (1993:57) states that this is the explanation much loved by the World Bank and IMF which insist on their impartiality. They claim that only the economic situation is considered and nothing else. Finally, the Americans blocked any rescheduling of Iranian debt at the IMF in November 1993 and prevented Iran using its special drawing rights (SDR) (Kustschera, 1994:21). This removed any ambiguity concerning the political objectives of those two bodies.

What was the reason for providing loans to Iran? Iran could enjoy the money and the expertise of the Bank in specific projects. This was an opportunity for the other investors to find out if it was a good idea to enter the Iranian economy or not. They were concerned about the security of their investments and the profit to be earned. They demanded that the Iranian government and business community should provide an attractive environment to get foreign participation. However, the concern is that an attractive environment to foreign participation may require the sacrifice of the goals of the IRI and the public interest.

Government and its Relation with the World Bank and IMF

The impact of the World Bank and IMF on decision-making of the economic adjustment policy has been publicly denied in Iran. The Minister of Economic and Finance Affairs states "these policies are results of our specialisation, then these policies had been approved by the World Bank and IMF."[26] This expression may be regarded as merely a form of self-justification. Other economic decision-makers repeated the words when they faced questions about following the international

[26]– Dr. Mohsen Nourbakhsh, "Report of the Third Seminar on Monetary and Foreign Exchange Policies" *Zamineh*, 25 August 1993, p.25.

prescription. The reason may be that the government does not want to be seen as giving way to foreign pressure in its decision-making.

The IMF has completed a report on the Iranian economy and the government is quietly implementing the IMF's recommendations for normalising the economy. Subsidies are being eliminated for most commodities, price control is being lifted, the Rial is devalued substantially and the size of the government is to be further reduced (Amirahmadi and Entessar, 1992:136). The government wishes to extend its on-going cooperation with the World Bank, IMF and the Asian Development Bank (ADB). One idea in respect to the real aims of international institutions, suggests that their recommendations are aimed at achieving full economic utilisation of resources.[27] This opinion points to the wasteful consumption of an equivalent of $10 billion on fuel energy per year in the country. Denying the relation with the World Bank and IMF, however, was a ploy to avoid negative political reaction.

Intervention by the international institutions is unpleasant.[28] This is especially so when they recommend measures which have cultural, social, political and economic drawbacks for the country. Intervention in areas such as import liberalisation, financial liberalisation and so on have been detrimental to the economy, as the following analysis shows.

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[27]– Interview with M. Bahonar, (MP) Member of the Plan and Budget Commission of IRI's Parliament, 31 July 1993, Tehran.

[28]–Ahmad Tavakoli, (Presidential candidate in 1993 election), *Keyhan Havai*, No. 1033, 2 June 1993, p.9.

Prescriptions of the World Bank and IMF

Following advice from the World Bank and IMF, the government implemented a stabilisation and structural adjustment program. The goal of this program was to revive the country's imperfect capitalism, "normalise" the economy and put it on the path to sustainable growth. The advice of the World Bank and IMF points to eight sets of *gaps*, as follows: (i) economic management gap; (ii) technological gap; (iii) foreign exchange gap; (iv) fiscal gap; (v) savings-investment gap; (vi) liquidity-GDP gap; (vii) human capital gap; and (viii) supply-demand gap (Amirahmadi, 1992a:8, 16-18).

The areas of prescription include both major structural and policy-related matters. The economic management gap refers to culpable lapses in economic responsibility in the public sector and the resulting economic mismanagement. The emphasis has been placed on expanding the private sector along with market forces (ibid., 16).

The technology gap, along with mismanagement, is at the core of the country's inefficiency and low productivity. Amelioration of these problems requires investment in research and development, specialisation in certain export-oriented industries and maximum utilisation of national resources.

The foreign exchange gap refers both to negative trade balances and a large outflow of capital from the economy compared with inflow. The government's fiscal reform and privatisation policies aim at reducing private liquidity and thus inflation. The effects on prices so far have been in the direction of higher inflation as price controls have been relaxed (ibid.).

The fiscal gap refers to the government's huge budget deficit and the consequent public debt. As a result, the government is eliminating most subsidies. This is finally impacting on the poor (subsidies are basically on food, heath care, and education). They are also reducing allocations for PEs, trying to make them more independent and efficient. The problem is that productive branches such as manufacturing, mining and agricultural enterprises are also targeted for cuts.

The savings-investment gap refers to the low level of savings available for productive investment. The government is attempting to correct this problem by promoting the use of private, public and foreign savings to finance national investment. The prescription for correction of the problem is using foreign savings as industrial inputs or direct foreign investment. However, increasing domestic savings, improved productivity and profitability are the major requirements. The Iranian government intends to use a combination of incentives and structural adjustments (Amirahmadi, 1992:16).

The liquidity-GDP gap points to the existence of too much money in the hands of private individuals and institutions compared with the available supply of goods resulting from very distorted income distribution. The government hopes to remedy the problem with policies that direct private investment away from non-productive activities towards more productive activities. A condition for success here is that productive investments must be made more profitable than non-productive ones. Monetary and fiscal measures such as controls and incentives to create differentials in profit rates in favour of productive investments are being introduced by the government. These measures include concessional loans, low utility rates and accelerated depreciation for machinery purchased (ibid.).

However, the adjustment between the real rate of return on investment (ROI) from productive activities and the gain from non-productive activities is obtained at a great cost. This is the cost the nation has to pay in the form of concessions to the private sector in the privatisation policy.

The human capital gap refers to Iran's lack of an adequate skilled workforce and distortions in labour markets. Education expansion, technical training and vocational education have been emphasised in the FFDP.

The supply-demand gap refers to the economy's aggregate imbalance between production and consumption. This leads to such problems as inflation and high import bills. This problem is associated with the foreign exchange gap and the savings-investment gap. One factor of the supply-demand gap is industrial capacity utilisation of less than 40 per cent (ibid.). The government intends to close this gap by depressing demand, a recessionary measure. A more efficient economy requires enhancing economic management to promote the supply side of the economy. To settle these problems structural adjustment was recommended by the World Bank and IMF.

Most multilateral agencies, including the World Bank and IMF, follow market-oriented policies which impose economic pressure on the post-revolutionary society of Iran. The World Bank and IMF recommendations, which have strongly pressed for the implementation of privatisation, have met with opposition inside the country.[29]

[29]– Interview with the head of the Iran Chamber of Commerce Industries and Mines, 9 September 1993, Tehran.

Economic Adjustment Policy

To tackle the economic problems, a package of economic adjustments was introduced. This package was set up in the FFDP. The policies were chosen so that the goal of liberalisation would be achieved. Adjustment policy in Iran, according to the private sector, is "compatible with economic liberalisation which in practice brings about welfare and well being."[30] They further suggest that those whose conduct is in line with principled economic activities should not be anxious about economic adjustment, since adjustment policy complements principled and rational economic liberty. These concepts of economic adjustment conform to what international organisations such as the World Bank and IMF have prescribed, although some Islamic concepts are also included. For example, the Iran Chamber of Commerce reports that "whenever we talk of economic freedom, we mean directed freedom compatible with Islamic and national objectives."[31] However, it does not mention how, in practice, objectives such as social justice and national development are to be maintained.

In order to remove the problem of the technology gap, the government has introduced measures such as the following: (i) an export-oriented strategy; (ii) promotion of foreign investment; (iii) selective trade liberalisation; and (iv) devaluation of the domestic currency (Amirahmadi, 1992:8; Rudnick, 1994:270-1).

In trade liberalisation, for example, the governor of Bank Markazi (the Central Bank: CBIRI) announced that after 1993, importers of goods and services

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[30]- *Paper of the Iran Chamber of Commerce*, No.6, May 1992, p.1.

[31]- *Paper of the Iran Chamber of Commerce*, No.6, May 1992, p.2.

will no longer need to obtain a permit from the Central Bank for their required foreign exchange.[32] Banks, therefore, were obliged to put at the disposal of importers all of the necessary foreign exchange required for their goods and services. This was while the import of essential products was the responsibility of the government. The imports of $4859.9 million in 1989 increased by 8.9 per cent beyond the target set in the FFDP. In 1990, they increased to 63.3 per cent above the figure shown in the FFDP and in 1991 to 154.1 per cent (Research Group of Parliament (1994), No.3, April, p.5; See also Section 5, Financial and Trade Liberalisation). This is while industrial countries were imposing various tariff and non-tariff barriers on developing countries.

According to the report of the United Nations Development Plan (UNDP), developing countries lose about $40 billion annually in lost export revenues due to tariff and non-tariff barriers (Hazeen, 1994:30). This is much more than all the loans and other aid that the poor countries may get from anywhere in the world. It is ironic that while Iran's and other national markets are opening, global markets remain restrained.

The result of trade liberalisation in Iran was a further devaluation of the domestic currency. The demand for foreign currency for imports increased in spite of devaluation of the currency. Financial liberalisation was expected to decrease demand for foreign currency compared to the past. However, trade liberalisation which was followed by financial liberalisation greatly affected the economy. This was so harsh an impact that after a short time the Central Bank was compelled to withdraw the policy, and again strict regulation of imports and exports was

[32]– *Iran Exports*, No. 23. May-June 1993, p.25.

undertaken. The Exchange Market Regulation Committee met under President Rafsanjani (27 May 1994) in order to limit the demand on foreign exchange and control exchange fluctuations (*Keyhan International*, 2 June 1994:11). These were mostly restrictions on the import of goods and consequently the exit of foreign exchange.

Devaluation of the domestic currency was undertaken in order to unify the rate of foreign exchange. Previously foreign exchange for the importation of goods and services was obtainable at three different rates. The official rate was for imports of essential goods through a government procedure. There was a floating rate for special cases and a free rate could be obtained in the black market. In spite of the advantages of the announcement of a unified rate for foreign exchanges, this policy was not successful. It soon changed to a double rate of exchange, the floating rate of the currency and the black market price. The reason was failure to take into account the specific conditions of the country in according to the demands of the World Bank and IMF.

The disintegration of the policies of adjustment of foreign exchange rates was accompanied by the expansion of imports through an open-door policy (Kheirkhahan, 1992c:8). This apparent contradiction in policy resulted in an increase in the demand for foreign exchange, and an increase in the rate of foreign exchange, in spite of control of the supply of foreign exchange by the Central Bank. Implementation of these prescriptions created the negative effects of increasing balance of payments (BOP) deficits and substantial capital outflows.

To close the foreign exchange gap, besides hoping for the continuation of oil revenue as the main source of revenue, the government considered fiscal reform and privatisation of PEs (Amirahmadi, 1992a:8). Privatisation of PEs in this case was chosen to respond to the internal pressures caused by the foreign exchange gap and fiscal problems. These policies aimed at reducing private liquidity and inflation. The traditional approach of decreasing imports and relying on the creative abilities of the people was neglected in this plan.

One of the policies regarding PE reform was the policy of self-management of these enterprises. Based on this policy, public enterprise expenditure should be funded from internal sources (Haghi, 1993a:45). This policy is consistent with the policy of commercialisation and the move towards the marketisation of PEs. However, the government did not consider the policy of enhancing the efficiency of these PEs and managerial reform to decrease costs.

On the other hand, self-management and autonomy of PEs is assumed to be achieved by increasing the prices of goods. This policy imposes the cost of inflation on the people. Self-management, in this manner, will not be achieved because of the impact of inflation on production factors. This causes the self-perpetuation of price increases. According to Haghi (1993a:45), allowing PEs to get loans from the banks for financing their expenditures in the 1993 budget plan, indicates the failure of the self-management policy.

3.2.2 Ideological Pressures

Ideological pressures arise from the pressure from the world economy and its institutions to force IRI to follow the global economy to the point of giving up its independent economic policies.

These ideological pressures are in open conflict with the nature of the society of IRI. Changing and/or misinterpreting the articles of the Constitution are some of the marks of submission to external ideological pressure. Attempts to change the Labour Law in order to provide more suitable conditions for domestic and/or foreign investors are also responses to the same outside pressures. This conflict may prove costly for the IRI.

Attempts have been made to reconcile the implementation of privatisation with Islamic ideology. The point is that the direction of justification is towards privatisation in the way the international agencies prescribe. For example, one of the advocates of the so-called conservative faction attempted to open the way for expanding privatisation by maintaining that even those strategic PEs which have to remain in the control of government - based on the Constitution - should be privatised (*Keyhan Havai*, 5 August, 1992, p.8, 14).[33]

Attempts have also been made to reduce reaction to the consequence of following ideological pressures. One of these attempts points to the Imam Khomeini's recommendation of people's participation and the handing over of some economic activities to the people. Tabarestani (1993:30) maintains that:

> there is some truth in this version of events, but what remains unexplained is whether *the late Imam* would, on the basis of his position, have supported everything that is being done under his name in Iran these days?

The reaction of the present leader of IRI, Ayatollah Ali Khamene-i and his letter to the President concerning economic reforms does give a clear answer.[34]

On the other hand, there was concern by the leaders as well as the people about the process of privatisation, and its unwanted ideological pressure on social

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[33]– This article is under the title: "Religious Justifications for System of Ultra-Capitalism".

[34]– See Section 6 of this chapter.

and cultural values. For example, the Islamic Associations of Students in Europe (April 1992:23) maintains that economic projects or prescribed programs of the World Bank for Third World Countries have mostly resulted in creation of an elite class of government authorities and exacerbation of class gaps in society.

As a result, organisations such as the World Bank and IMF are being seen as instruments of destructive economic policies, best to be avoided (Ahmad Amin, 1993:55, Islamic Associations of student in Europe, 1992:23). The theme of self-sufficiency is seen as morally valid and perfectly feasible. But the damage to the economy caused by internal and external factors such as the war gave an opportunity to the opponents of the then government to criticise its policies of social justice and self-sufficiency.

From this point of view, economic power is a significant factor in as much as it is associated with national strength. Rezaeian (*Keyhan*, No.14768, 16 May 1993, p.2) maintains that from the viewpoint of national strength, care must be taken to guard against the Western capitalist economic system's attempts to extend the influence of its economic culture on Iran. For example, the World Bank suggests that some changes should be made in the legal articles of the Constitution in order to make a more appropriate environment for foreign investment (Mehdizadeh, 1994:51). According to Tavakoli (*Keyhan*, 25 May 1993, p.6), this type of intervention by international institutions, undermines national strength.[35]

Other examples of foreign ideological intervention are to push the government to take actions which favour foreign interests, but which ignore the desires and interests of the nation.

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[35]– Ahmad Tavakoli, In Presidential campaign of 1993.

For example, in an article Smith (1992:40) says that:

> The government expects that in elections dated for 10 April, voters will oust the few remaining radicals in the Majlis, the nation's Parliament. Such an outcome would settle Western nerves. It could also help end the remaining international sanctions - which in turn could unleash an unparalleled economic boom.

In another statement she said that:

> Many western bankers and businessmen are still nervous that Rafsanjani's perestroika may somehow be derailed, perhaps by a fundamentalist backlash (Smith, 1992:43).

Such foreign intervention will make the nation nervous even if based on goodwill.

Another example of intervention is recommendations regarding enduring difficulties of inflation and other consequences of IMF style reform. Smith (1992:43) recommends that "the government must persuade its people that short-term pain is necessary to assure long-term growth." This prescription is reiterated by those who are dealing with privatisation implementation in Iran. For example, Khamoushi (1992:5) in justifying the social and economic difficulties emanating from the economic adjustment policy, points to a fruitful result which will be obtained in the future: "the suggestion is that those who bear the problems and sacrifice today, will obtain the benefits of their sacrifice in the future." However, in Iran, such comments are considered as intervention in another country's affairs, which constitutes undue or inappropriate foreign influence.

These ideological pressures are undermining the ideals of social justice and consequently weakening national strength. Social justice and rejection of foreign influence are the main points in conflict with foreign ideological pressures.[36]

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[36]– See Chapter 4, Section 1 "Socio-Political and Economic Environment in Iran".

Table 4.9 indicates the extent of different types of pressures for privatisation. The extent of the pressures can be ranked as low, moderate and high.

Table 4.9 Comparison of the Different Types of Pressure and Time Dimension for Privatisation in Iran and Malaysia.

Type of Pressure	Malaysia	Iran
Internal Pressure	Moderate	Low-Moderate
External Pressure	Moderate	High
Ideology of Market Orientation	Moderate	High
Time Dimensions of Pressure	Moderate-term	Short-term

Source: Regarding Malaysia Gouri et al., 1991:22; Gouri, 1991b:118-121.

The time dimension of pressure shows that privatisation was viewed as a medium-term measure in Malaysia while it was prescribed as a short-term measure in Iran.

In summary, managerial and economic factors are crucial internal motives for privatisation. Dependency on oil-export revenues was an economic problem that the FFDP was directed to remedy. Privatisation was part of the program suggested by the World Bank and IMF, while the government was supposed to solve the problems independently, with the support of domestic material and human resources. The prescriptions of the World Bank and IMF were also in conflict with social, cultural and economic principles of the Iranian community, as reflected in the Constitution. These factors created ideological pressures which threatened to undermine the social justice and economic independence of the country. The next section examines the policy-making process for privatisation programs in Iran.

4 Privatisation Policies in Iran

Policy-making is the strategic stage in the process of any privatisation program, and for effectiveness it demands consideration of key factors. In fact, privatisation is governed by its objectives. Meanwhile, privatisation objectives justify the modalities of privatisation. Safeguards and safety clauses are measures to help society's acceptance of privatisation. These interactions between key environment factors create a sensitive environment for the policy-making process, and need comprehensive insight by policy-makers. Otherwise, their policies may fail and cause damage to the economy. Privatisation policy-making in Iran is no exception.

This section examines the objectives of privatisation in Iran and related policies. Policies concerning foreign participation, private sector participation, the capital market and its status in the privatisation process are examined. Safety clauses and their related policies are also analysed.

4.1 Privatisation Objectives and Policy Framework

The principal objectives of privatisation in Iran are specified in the letter of approval by the Assembly of Ministers dated 9 February 1991 (Iranian date 29-2-1370). They are as follows:

(i) improving the efficiency of economic activities;
(ii) reducing the size and the role of the government in economic activities;
(iii) optimally utilising the capacity of the country's resources; and
(iv) maintaining economic stability.

The objective of privatisation and the new liberalisation program was described by the President as follows:

> to turn Iran back into a market economy by privatisation of nationalised companies, promoting the stock exchange, and encouraging foreign and local private investors (Timewell, 1992:24).

The significant objectives, however, are efficiency improvement and economic stability. To achieve these objectives there is a need to examine such arrangements as the investment environment (foreign and domestic), the capital market and the private sector's capability to participate in the privatisation program.

4.1.1 Foreign Participation

After the Islamic Revolution, foreign participation and investment were limited by the Constitution. This presented two legal barriers. The first was Article 81, according to which "granting of concessions (licences) to foreigners for the formation of companies or institutions dealing with commerce, industry, agricultural services or mineral extraction is absolutely forbidden" (Constitution, 1990:58). This Article reflects the suspicious attitude among Iranians concerning the intervention by foreigners in general, and foreign and multinational corporations in particular, in the vital economic affairs of the country (Jafarzadeh, 1993:68).

The early history of foreign investment in Iran was an unsuccessful experience. In the pre-revolution period, during the period 1947-78, 276 cases of foreign investment in technology transfer had taken place. Furthermore, 1,850 foreign companies were formed. Of the total foreign investment, 9.7 per cent was to relieve the technological bottleneck and 6.7 per cent of the companies involved were to provide technical manpower to Iran. None of these obligations were fulfilled.[37]

Secondly, foreign investment is not in conformity with Islamic principle. This is based on a Quranic verse which says: "God will not grant the unbelievers any way of domination over the believers". This is called *naf-ye-sabil* (Rejection of the way of influence).[38] Accordingly, the government's foreign policy has to consider the above points involved in the Chapter on Foreign Policy in the Constitution.[39]

These legal barriers have continued to create a lot of discussion in the country between factions and groups. A variety of interpretations has been made to ease the way for foreign participation and investment programs. For example, according to an interpretation of the articles by the majority of members of the *Showra-ye-Negahban* (the Council of Guardians), contracts where one party is a ministry, a government agency or public enterprises, and the other party is a private foreign company, contracts are not considered international contracts and are not subject to article 77 of the Constitution. These foreign companies are allowed to register their companies in Iran (Valibeigi, 1993:808; Jafarzadeh, 1993:71). Legal justifications for other legal obstacles have not been attempted. Such political manoeuvres have been successful so far. However, these pragmatic

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[37]– "Foreign Investment: Economic Motor or an Obstacle?" *Keyhan Havai*, No. 1008, 25 November, 1992, p.18; "The Analysis of the Impacts of Foreign Investment" *Free Zones*, No.18, July 1992, pp.16-17.

[38]– *Qur'an*, Chapter 4, verse 141.

[39]– These Articles are from 152 to 155 in the Constitution.

solutions have undermined the original principles upon which the Islamic economic system of IRI was supposed to be established.

Foreign investment takes place within the framework of the *Law and Regulations for the Attraction and Protection of Foreign Capital* approved in December 1955. Under this Act, foreign investors enjoy full protection and are permitted to repatriate net profits and enjoy the same treatment as domestic individuals and institutions (Iran Chamber of Commerce, Industries and Mines: 1993).

Nonetheless, the Act of 1955 is not consistent with the clear text of the Constitution of 1979. Indeed, the restriction on foreign investment in the Constitution is considered as one of the obstacles to economic adjustment policy.[40] There have not been, however, major attempts to utilise the domestic potential to compensate for the lack of foreign investment. Instead, attempts have been made to nullify the Constitution by making some contradictory decisions based on the interest group's interpretation of the Constitution.

Foreign borrowing in Iran is subject to the approval of Parliament. Article 80 of the Constitution proclaims that the taking or awarding of loans or grants-in-aid, domestic or foreign, must be approved by the Majlis (Parliament). This indicates how sensitive is the question of borrowing, as it increases Iran's international debt and leads to a substantially higher debt-service burden. Thus foreign borrowing is considered an issue subject to decisions made in Parliament, so vital is it to the fate of the IRI.

40– *Paper of the Iran Chamber of Commerce*, No. 45, January 1993, pp.2-4.

On the other hand, the country may need foreign assistance and investments to meet its development needs. Nonetheless, it cannot afford to do so in every form and at any cost. Some foreign borrowing was predicted for the implementation of the FFDP. According to note 29 of the plan, the government was authorised to embark on buy-back[41] transactions up to a ceiling of $10 billion (*Law of the FFDP*, 1990:17). This was allocated for the requirements of the industrial and mining sectors in order to utilise their potential capacity and machinery (Behkish, 1991:39).[42] The aim was to develop industries and keep debt within manageable limits. A limit of $17.5 billion was predicted in direct foreign borrowing.

Direct foreign borrowing in the form of short-term loans is a matter of concern in Iran. These are credits that are awarded by the financial and monetary markets to pay the prices of the commodities bought by a country (Rahbar, 1993:15). Their repayment term is very short and cannot be transformed into long-term investment in production. The providers of these loans are only concerned about obtaining a sufficient guarantee for returning the principal and the interest. This type of short-term finance is the worst type of debt for investment.

The World Bank has given loans to some projects of less economic significance. These projects include the reconstruction of the Bank-e-Markazi (Central Bank), buying administrative instruments for the *Azad (open) University*

41- Buy-back is applied where a supplier agrees to be repaid in the product of the buyer. Therefore, the buyer has the advantage of securing the project without incurring any direct financial debt.

42- Mehdi Behkish, is an economist and the General Secretary of the Chamber of Commerce, Industry and Mines.

and some municipal sewerage plans.[43] The amount of borrowing was $250 million for reconstruction of the Gilan area's earthquake, $150 million for Azad University, $77 million for sewerage and 57 million for the Sistan Dam (*Keyhan Havai*, No.1064, 5 January 1994, p.11, No.1058, 24 November 1993, p.15, No.984, 10 June 1993, p.10; Research Group of Parliament (1994), No.4, May, pp.10-11). These projects could be funded through domestic sources.

Finally, there is the problem of foreign capital management. The extent of capability in the management of foreign capital needs to be considered before any decision-making about foreign borrowing or foreign investment. Some economists in Iran maintain that the need for capital is not enough to give license to any and every foreign investor. The first requisite, they argue, should be the preservation of national resources, and the explanation of all available avenues to avoid any further deterioration of the economy (Chini-chian, 1992:19).

Free trade zones are now areas provided for foreign investments. Three free trade industrial zones are in existence, including Kish Island, Qeshm and Chahbahar. These free trade zones enjoy legal and protective benefits such as income and wealth tax exemption for a period of 15 years.

4.1.2 Private Sector

The role of the private sector in Iran has been depicted in the Constitution as supplementary to the economic activities of the state and the cooperative sector

[43]– Editorial, "The Consequence of the Guided Influence" *Keyhan Havai*, No. 1061, 15 December 1993. p.1,9.

(Article 43). One reason for this role of the local private sector[44] was a distrust of the capitalist system as a whole, as it lacked any consideration for the public interest. Another was the relation that some local bankers and capitalists had with certain foreign capitalists before the revolution. Countervailing experience of good capitalists was ignored.

However, in the FFDP, the share of the private sector in the total fixed capital formation was predicted to be 60 per cent. The intention was to make the private sector's interest the highest share in the economic plan of the country. The private sector in the field of agriculture already enjoys the highest share (Iran Commerce, No.1, 1993:31).

The private sector in Iran practises tax avoidance. There is a wide gap between government expenditure and revenues through taxes from the private sector. This discrepancy between tax and income exists more in the private sector than in the PEs. For example, in 1991, the tax revenue from 300 PEs was IR149 billion, while from thousands of private companies it was IR336.5 billion, and from millions of private jobs, including 822,300 private workshops and factories, only IR156.1 billion (Razaghi, 1993:78). Non-government workers, traders, businessmen, profiteers etc. pay less than 1 per cent of their income to the government, while government employees pay between 15 to 25 per cent of salary in taxes (Dareini, 1994:30). This indicates that the system lacks an equitable

[44]–The private sector in Iran usually means the merchants, traders, and middlemen who are involved in distribution, purchasing or selling goods and commodities. It also includes some entrepreneurs of factories. It rarely includes the industrialists and the professionals and the people who earn money by working, such as farmers and so on. Therefore, it applies to the owners of capital rather than to workers in the other types of private jobs.

income tax policy, and suggests that the government cannot rely on the tax revenue it will obtain from the private sector after privatisation.

Table 4.10 Comparison of the Debt and Liquidity of the Private and Public Sectors and the Role of the Private Sector in the Economy of Iran (IR billion and the percentage).

Title/ Year	1989	1990	1991	1992
PEs Debt to the Bank System	13251 (20%*	14683.4 (10.8%)	16092.2 (9.6%)	
Private Debt to the Banking System	7479.2 (17.8%)*	9697.5 (29.7%)	13156.9 (35.7%)	18248.6 (38.7%)
Money Supply (Liquidity) of the Private Sector	15687.6 (23.8%)*	18753.3 (19.5%)	22969 (22.5%)	28620 (24.6%)
Money	(7758.1) (14.5%)*	(8987.2) (15.8%)	11195.2 (24.6%)	13635.8 (21.8%)
The Rate of Increase in the Prices of Goods	28.9	17.4	9	19.6

Source: Ebrahim Razaghi (1993:77-83).
* Percentages show the rate of growth of the specified factor.

The private sector has received a significant amount of loan funds from the banking system. Thus, the debt of the private sector to the banking system increased during the four years of the plan. It grew by 38 per cent and increased to IR18,247.3 billion during the FFDP (see Table 4.10). It has increased by 2.4 times during the four years,[45] and is more than 63 per cent of the liquidity of the economy (IR28,826.4 billion) (*Iran Commerce*, No.1, 1993, p.33). Meanwhile, the private sector had taken full advantage to increase its wealth from opportunities provided after the revolution and during the war.

Before the revolution, 100 families were considered billionaires, in Iran Tumans (a Tuman equals 10 Rials). By 1988, the number had increased to about 1,000. This wealth, however, was largely kept in liquid form, not only because of

[45]- According to Mohammad Khan, Minister of Economic Affairs and Finance, the amount of liquidity of the private sector has increased 2.5 times during FFDP, and the growth of the liquidity was 30 per cent in 1994 (*Ettela'at*, No.179, 27 January 1995).

political uncertainty, but also because liquid assets brought significantly higher profits in the wartime economy. The result was uneven sectoral development, with production sectors suffering the most (Amirahmadi, 1990a:10; Madani[46] in *Salam*, No.590, 8 June 1993, p.11).

The private sector has shifted its liquidity to profitable investments in services and trade or kept it in various liquid forms which has caused inflation problems to the economy. According to Amirahmadi (1990:11), the reason for the increase in prices is on the one hand, lack of consistency between investment in productive activities and thus the supply of goods, and on the one hand, the increase in demand for goods and commodities.

The prices of commodities during 1989-92 increased by 76 per cent, though price stability was necessary for the encouragement of investment in the production area (Razaghi, 1993:80). Stability of prices also motivates savings and deposits in the banking system. It is also a factor in national integration and the decrease in social class distinctions that is necessary for economic development. Inflation and the increase in prices of goods and services have been consequences of the increased liquidity of the private sector.

The private sector was awarded loans, by the banks, to invest in productive investment. These were among the concessional loans offered to the private sector as part of the government's regulation and encouragement of production, manufacturing and infrastructure activities.

46- Amir Bagher Madani (member of academic staff of the Faculty of Economics in University of Dr Shahid Beheshti, Tehran-Iran.

Nonetheless, the private sector was reluctant to engage in productive investment and preferred to invest in non-productive but lucrative venues.[47] The economic environment during the war produced some rich people who used their wealth to obtain speculative gains.[48] Their activities disturbed the pattern of investment in the economy (Razaghi, 1993:80; Dareini, 1994:30).

Most groups within the private sector have some expectations of government support before investing in manufacturing activities. They expect to get more concessions for entering into manufacturing investment and look to getting international aid with government guarantees. For example, the head of the Iranian Chamber of Commerce, Industries and Mines maintains:

> Since governments in developing countries need loans and credits from the international institutions, this prevents these loans getting to the private sector.[49]

Therefore, his suggestion is for devising a mechanism by which private institutions obtain international credits directly with guarantees from the banking system, if needed. It is also suggested that international credit for technological projects should be absorbed by the private sector only.

These institutions expect to be allowed to participate in drawing up rules and regulations for privatisation. They support a financial market created by

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47– The expectation of the private sector is that foreign investors will invest in the country. The amount of investments predicted and agreements signed by foreign companies totals $10 billion, in the FFDP (*Iran Commerce*, No.1, 1993:52).

48– For example, those who got foreign exchange at concession price of US$1= IR70, to import raw material to produce goods, have sold their products at a free market price of 1,400, and achieved windfall wealth (Mohammad Khan, *Ettela'at*, No.179, 27 January 1995, p.2).

49– A. Khamoushi, *Paper of the Iran Chamber of Commerce*, No.4, July 1992:4.

government financial assistance and demand that new subsidies be awarded to them by the government. These subsidies include selling industrial enterprises at a very low price, supporting monopolies in the marketplace, removing wage control as required by the "Labour Law" and thus increasing pressures on wages, appropriate low tax policies and cheap credits (Elyassi, 1993:93). Private sector groups expect the government to ignore its duties towards society, and to act in their favour in absolute terms.[50]

It appears that these high expectations of the private sector especially traders, arise from:

(i) their vulnerability and their reluctance to enter productive activities, thus minimising the risk of low profit;

(ii) their windfall revenues from unproductive activities in distribution; and

(iii) the power of the conservative faction in Parliament in the fourth parliamentary period and the support of their coalition pragmatist faction partners.

The private sector does not have as its mission the securing of the public interest. Experience has shown that as long as the possibility of obtaining easy and immense profit without paying tax is available, the money supply of the private sector will not be directed towards manufacturing activities. This is one of the reasons why the government has not so far achieved the aim of inducing the private sector to invest in manufacturing activities.

Private sector activities need to be disciplined, and those projects which are against the objectives of the FFDP need to be regulated. Amirsheghaghi (1994:24)

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[50]– *Paper of the Iran Chamber of Commerce*, No.4, July 1992:3.

cautions that removing the system of control and monitoring will result in the direction of capital towards profitable distributive service jobs rather than to the development of productive activities. It will lead to domination of the economy by the minority capitalist group. The result will be control and monitoring by dealers and brokers instead of the government. Policy-making in a market-based economy needs to protect the public interest as well as the private sector mechanism.

4.1.3 Capital Market

The capital market in Iran (Bourse of Negotiable Papers) was established in 1966. The aim of establishing the Bourse was to harness private capital and direct it to industrial and productive investment. Acceptance of companies, government bonds, treasury bonds and bonds for the expansion of property presented the Bourse with an opportunity to expand the volume of transactions. Consequently, the appropriate fluidity or availability of cash for bonds and shares was created.

In 1976, the Bourse organisation was accepted as a member of the World Bourse Federation in a session held in Tokyo, Japan. Preliminaries of co-operation with other countries' organisations were entered into to encourage the exchange of views and to use each other's experience.

In general, between 1967 and 1978, about 55 per cent of transactions made in the Bourse involved shares and the remaining 45 per cent were bonds (Golsharifi, 1992:8). The volume of transactions made at the Bourse amounted to 8 per cent of the GDP and the number of companies listed on the Bourse increased to 102.

The Bourse of Negotiable Papers was not as active before the Islamic revolution. Reasons included the existence of a dependent economy, and access of big companies to enormous bank credit which made the issue of negotiable paper unnecessary. As well, there were important monopolies in industries and trade which earned huge income and accumulated capital. The lack of public awareness of such transactions, a lack of incentive in the private and public sectors for the mobilisation of capital for production, which had roots in the structure of the capitalist-dependent economy of Iran before the revolution, were other factors contributing to the failure of the Bourse.

Capital Market After 1979

During the Islamic Revolution in 1979, there was a recession in the volume of share transactions in the Bourse. Transactions of shares of banks and insurance companies were suspended in the Bourse after the nationalisation of those enterprises. Seventy-nine companies suspended listing in the Bourse, following the Act of "Protection and Development of Industries." The war also imposed restrictions on the activity of the Bourse.

Bourse transactions grew after the end of war in 1989. The government made attempts to revitalise the Bourse for economic development purposes. In 1990, the number of companies listed increased to 130, including 31 conditionally accepted companies.[51] Nonetheless, the Bourse is relatively undeveloped compared with the Malaysian Capital Market. Table 4.11 compares the capital market activities of Iran and Malaysia.

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[51]– *Sanat-e-Rooz (Today's Industry)* December, 1992:8 ; Timewell, 1992:24.

Table 4.11 Comparison Between Iranian and Malaysian Capital Markets in 1990.

Status/Country	Iran	Malaysia
Number of Companies (1990)	130	282
Volume of Transactions (to million dollars)	343	10,871
Market Price (billion dollars)	1.7	48.6
GDP (billion dollars)	21.1	40.6
Volume of Transactions (GDP)	1.5%	27%

Source: Taghvai (1992:15) in *Sanat-e- Rooz (Today's Industry)* December, p.15.

However, the private sector is now permitted to set up mutual funds, unit trusts and securities houses (Rundick, 1993:269). These are non-bank credit institutions, which have received permission to undertake all banking operations with the exception of opening current accounts.

Privatisation and the Bourse (Tehran Stock Exchange)

Tehran Stock Exchange (The Bourse) is the main executive device for the privatisation plan. Privatisation is still in an initial stage. The majority of units which have been privatised are consumer goods manufacturers. However, the second phase of the plan, which has already been approved by the authorities, envisages the privatisation of the infrastructural sector, including petrochemicals, oil, and public utilities such as water and electrical power (Rudnick, 1993:272; see also *The Oil and Gas Journal*, No.36, September 1993:4).

The government has offered shares of some government-affiliated organisations for sale. These include the INIO, the IDRO, and the Bank of Industry and Mines. About a quarter of the 400 companies due to be privatised through the Stock Exchange have so far approached the Bourse.

However, a developed capital market has yet to emerge. Organisations such as INIO, IDRO and the Bank of Industry and Mines, individually issued part of their shares to the private sector. Furthermore, the evaluation system of shares needs a more substantial mechanism. The volume of shares offered also has an effect on share prices. Therefore, in some cases shares have been sold at a price higher or less than their real value. For example, there was a case of selling shares at a price in excess of their real value which resulted in a crisis in the Tehran Stock Exchange. Many people returned their shares to sell them in the Stock Exchange. To relieve the crisis, banks were advised by the central bank to buy shares offered by shareholders.[52] The absence of a developed capital market would mean that privatisation would have to be carried out by using the least efficient method, i.e. selling in bulk to individual private sector or institutions without issuing shares to the public at large. This became critical when the government obliged PEs to sell shares to the value of IR1,050 billions in 1993.[53]

One of the important factors influencing the volume of share trading was the increase in imports of manufactured commodities which were already being produced by manufacturers inside the country. In the foreign trade sector, quantitative import restrictions were reduced except for agricultural products and certain goods banned on social and religious grounds (Rudnick, 1993:267). This created a negative effect on selling locally produced goods and was one of the factors leading to a reduction of the demand for industrial shares. Therefore, the

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[52]– Interview with M. Sinai, on the Stock Market on 9 September 1993 in Tehran; Interview with M.S. Beziani, director of privatisation sector of INIO, 16 August 1993 (Iranian date 25-Mordad 1372), Tehran.

[53]– *Hamshahri*, No. 181, 11 August 1993, p.8.

share offer of companies was high and the price low, and the industrialists were discouraged from being involved in the purchase of shares. It appears that this policy favoured the traders and brokers. They benefited, on the one hand, from the imported goods and commodities and, on the other hand, they could purchase these shares at very cheap prices due to the bankruptcy of some manufacturing industries.

It was claimed that the imports of commodities were to complete investment and technology transfer. Instead, there was an increase in imports of consumer goods and manufactured commodities. The total value of imports during the four years of the plan was $77.3 billion (Rundick, 1993:273).

Another blow to the prospects of the shares of the Iranian PEs for privatising the manufacturing sector was the devaluation of the Rial. Devaluation of the domestic currency increased costs incurred by companies which used foreign exchange for the purchase of some of their materials. These companies faced problems in providing foreign exchange for their activities. On the other hand, the costs of production were high and there were not enough customers for their products. Therefore, the shares of such companies would not have been attractive because of a lack of profitability.

4.2 Privatisation Safeguards

Safety clauses need to be instituted and reinforced to protect internal industries, consumers, workers and managers as part of PE reforms. In this section, the provision of safeguards concerning workers, consumers, domestic producers and social justice in the privatisation program are analysed.

4.2.1 Workers

In the implementation of privatisation there is concern about the dismissal of workers and their rights. In response to the concern about the firing of workers, the government's policy has been declared to be the creation of new jobs. The government has also promised to insure that economic adjustment does not cause a significant movement towards the firing of workers.[54] Nonetheless, some of the redundant workers and staff are retired by giving them more concessions than would normally be offered. Some experts and experienced workers are encouraged to accept voluntary retirement.[55] This creates problems for industries which lose their active workers. It also causes the government to bear a burden without positive results.

It has been proposed that in the privatisation program, 33 per cent of the shares of the enterprises be set aside for the workers and staff. The shares price has to be preferential based on the average of the book value and the real value of the shares.[56] The ceiling or the number of shares is equal to IR1000,000 (about US$330). With the devaluation of the domestic currency, this preferential price does not make any considerable difference to the workers, as the rest of these shares are transferred to the workers and staff after seven years.[57] However, there are restrictions as to workers' voting rights based on shares. A deadline was

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54- "Interview with the President" *Jomhoori-e-Islami*, No.4048, 25 May 1993, p.15.

55- Farshad Moemeni, in Seminar of Culture and Development, Tehran: 28 August 1993; Interview with Director of the Office of Public Assets in Kerman Coal Company.

56- Interview with the Chief of Ownership and Share Department of IDRO, 6 September 1993, Tehran.; *Approval Letter of the Assembly of Ministers*, No. 5283, 19 June 1991.

57- Interview with M. Bezyani, Director of Privatisation Sector of INIO, 16 August 1993, Tehran.

also set requiring that the workers buy their share entitlements within a specified time and thereafter the shares can be sold to other applicants. Other significant points about privatisation policy-making and the workers are discussed below.

Labour Law of IRI

Labour law concerns the quality of the relationship between the workers and the entrepreneurial environment. It is a law which considers the workers' interest in the society of IRI. The current labour law was approved in November 1987, after five years of disputes between the two factions in Parliament (Rahnama, 1990:276; Labour law of the IRI, 1991). It was finally approved by the Council of Nation's Exigency in November 1991.

Based on this law, workers cannot be sacked easily at the will of employers. The law provides 30 days of annual leave and for the reinstatement of sacked workers, if their case is accepted by the appropriate courts. The worker's rights are considered in connection with retirement and in case of accidents. The Council of Workers is provided in the law with power to impose considerable sanctions. One of the principles of the Labour Law is the right of intervention by the government to prevent exploitation and abuse by employers.[58]

On the other hand, there is an argument that the law causes some difficulties between workers and employers (Savali, 1993:9). It is also said that the law does not give the managers sufficient autonomous authority to deal with employees effectively. The authorities involved in privatisation policy-making assert that the Labour Law is an impediment to the effective implementation of

[58]– Articles 96-106 of "Labour Law of the IRI" Approved in November 1990.

privatisation.[59] The new movements towards the reform of PEs and privatisation have produced calls to repeal the law. This is in spite of the fact that no other safeguard has been provided to protect the interests of the workers in the privatisation environment.

4.2.2 Consumers

Privatisation policy-making in Iran has not included any major safeguards for consumers. However, some statements have been made in this respect in order to reduce the problems of the people on lower incomes and the under-privileged. The President's policy was that the government would attempt to increase productivity as well as the wages of these people (*Jomhoori-e-Islami*, 20 May 1993, P.17). Promises were made that some services to the public at subsidised prices would be continued. Mohsen Nourbakhsh, the Minister of Economic and Finance maintained that for the purpose of wealth distribution and providing services, such as education at a lower price, the government has to concentrate on those activities that the private sector might not provide (Evans, 1991:79). Regarding the government's obligations to the public interest, he stated that the government would create a framework to achieve social and economic goals. He suggested that although the government has been pursuing privatisation, the principal and significant industries remain in the hands of the government (*Euromoney*, 1991:106).

However, effective consumer safeguards were not formulated for privatisation. Thus consumers are experiencing problems in adjusting to the

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[59]– Interview with IDRO, INIO and Iran Chamber of Commerce.

"economic adjustment" program. Nonetheless, the procedure of policy-making to compensate for the pressure on under-privileged people is making slow progress. The *Paper of the Iran Chamber of Commerce* (No.10, January 1993:4) states that the government intends to give 1,581,000 families about 80 per cent of the minimum official wage for workers. These policies need the establishment of a specified regulatory and monitoring system which has not been accomplished yet. Consumers are facing pressures concerning an inflationary increase in the prices of goods and services due to the economic adjustment program. However, the increase in prices in 1991 is considered by the private sector as "normal". The *Paper of the Iran Chamber of Commerce* states: "as this increase in prices is related to the adjustment of the single rate of foreign exchange, it is not inflation. It is an element of confining demand and decreasing the inflationary pressures."[60] In another statement, the Chamber of Commerce maintains that although the economic adjustment policy has created pressures on deprived people, these problems are an inevitable consequence of the policy.[61] This statement indicates the lack of any active policy to face these problems. In response to rising prices of essential goods and frustration among the common people, Larijani (MP) said that "the ailing economy is under surgery and we should expect some blood to be shed."[62] He called for patience and said that the concerned officials were "looking into the problem of the common people." Other assurances came from

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60– *Paper of the Iran Chamber of Commerce*, No.6, September 1992, pp. 11-17.

61 – Interview with the head of the Iran Chamber of Commerce, Industries and Mines, 9 September 1993 (Iranian date, Shahrivar 1372), Tehran.

62– Dr. Muhammad Javad Larijani (MP), *Free Zones*, Vol.2, No.20, October 1992:5.

the private sector. They mentioned that economic adjustment makes people who are experiencing difficulties nervous today, whereas they should be able to acquire the fruits of their sacrifices in future.[63] Justification of the consequences of the economic adjustment takes a long time.

However, there is an argument that the adjustment policy favours the rich.[64] There is no explanation about how consumers can adjust their expenditures to cope with this adjustment policy. The issue is that as prices are determined by market mechanisms, they tend to increase due to the gap between demand and supply. The result is a continuous decrease in the purchasing power of the people.

A question is raised concerning the removal of subsidies which allowed goods and products to find their real price. The question is, how can society carry the pressure of inflation and make itself compatible with the global economy? More precisely, how can a society with an average monthly wage of $70 conform to the global economy with an average of $2,500? In answering this question, the President pointed out that wages will rise to the same level, while the under-privileged and those who earn no wages will benefit from universal social security.[65] Implementation of the stated policy is more difficult and problematic than even turning back to the previous economic system.

63- *Paper of the Iran Chamber of Commerce*, Editorial, No.3 (38), May 1992, pp.1-2.

64- Hojjatul-Islam Mohtashami's interview (leader of the Combatant Clerics Association), *Salam*, No.573, 17 May 1993, p.4,14.

65- President Rafsanjani in a question-and-answer session at the Amir Kabir Industrial University, *Keyhan International*, 9 June 1994, p.3,14.

The safeguards to protect people from the consequences of the policies include implementation of a social security system.[66] Based on these policies, all individuals (including the under-privileged and rural people) will enjoy these advantages. Discussions about the form of implementation of these provisions has taken a long time. However, the consequences of this policy may become a substantial burden for the government. The administrative system of the country is another matter of concern for the implementation of this policy.

Finally, the protection of consumers has not been definitely provided for, while anti-trust and anti-monopoly law do not exist in IRI to protect consumers (Zamineh, March 1993:27).

4.2.3 Social Justice

In an Islamic system, policies are always supposed to be formulated on the basis of social justice. Therefore, the privatisation policy cannot be an exception. It can be argued that this trend towards privatisation leads to increased inequity and economic exploitation of the deprived classes and is contradictory to the earlier strategies of the post-revolutionary period. Those were strategies which placed emphasis on the productive role of the public sector in the IRI. The earlier strategy was also built around an emphasis on central planning, import substitution and control of domestic and external finance.

In the trade-off between equity and economic aims, equity has been neglected. The private sector's belief is that social justice is obtained by the creation of efficiency through establishing a competitive environment and

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66– Massoud Roghani-Zanjani's interview (the head of the Plan and Budget Organisation), *Rasalat*, No.2128, 22 May 1993, p.15.

preventing monopoly.[67] This competitive environment has not been achieved yet (Mojtahid, 1993:6-10).

Privatisation as a strategy is especially risky for those governments whose support base lies mainly in the marginalised section of the community, i.e. the urban and the rural poor. The leader of the IRI has frequently pointed out that the deprived masses are the backbone of the divine government and the Islamic system (*Keyhan International*, 11 June 1994:1,2). The deprived people of the community have been the major factor in the consolidation of the IRI, as well as a factor in suppressing any opposition to its rule. In the course of completing privatisation, it may be the case that the physical survival of this section will be threatened. As privatisation without social safeguards is most likely to hit these sections the hardest, given the social foundations of the IRI, it will intensify the government's vulnerability. It will, at least, result in political damage for the government and damage to the mission of the IRI.

Some steps have been taken by the leadership system of the country to prevent the aforementioned problems. Ayatollah Khamene-i, leader of the IRI, has instructed that in formulating plans for the country, the main issue is to eliminate poverty and deprivation, and to protect the oppressed and deprived people from the side effects of the oppression from the era of imperial regimes and the dominance of foreigners (*Paper of the Iran Chamber of Commerce*, No.3 (38), May 1992:2). In addition he advised that all economic production, reconstruction

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[67]- Interview with the head of Iran Chamber of Commerce Industries and Mine, 9 September 1993 (Iranian date Shahrivar 1372), Tehran; Interview with M Nabavi (MP), member of the Commission of Plan and Budget of Parliament of IRI, 29 July 1993 (Iranian date Mordad 1372), Tehran.

and economic recovery plans must be directed towards this objective, since only by doing so can the government's plan be considered as right and acceptable.

One important difference between privatisation in Iran and other developing countries including Malaysia, is that Iran claims to represent an Islamic government wishing to establish social justice and others do not. In this relationship, the leader of the Islamic revolution placed an emphasis on the point that "increase in material wealth is not our mission. Our mission is establishment of social justice, since in an unequal society increase in wealth creates a privileged group."[68] The message from the leader of the IRI is concerned with the deviation of the FFDP from the principal aims of the IRI.

On 20 December 1993 in a letter to the President, the leader of the IRI called for consideration of social equity in the second five-year development plan (SFDP). In the first part of the letter he pointed out that the policy-making task of the SFDP should be consistent with social justice. In order to ensure that, he instructed policy-makers to take into consideration the following points:

(i) resources and national assets are allocated ideally;
(ii) a true income-oriented taxation is exercised;
(iii) the economically under-privileged classes of the society (Mustaz'afan) are better protected by the public sector and judiciary services;
(iv) the under-developed areas of the country and rural areas get a more responsive government protection in all areas, especially in employment, health, public education and cultural services;
(v) appropriate policies and devices are adopted to prevent anything that will tend to contribute to overnight accumulation of the wealth;
(vi) employment opportunities are created by identifying indigenous talent and in conformity with regional priority programs; and

[68]– Ayatollah Khameneh-i, *Salam*, No. 584, 30 May 1993, p.3.

(vii) social security services cover a wider segment of the population with improvement in their quality.[69]

This instruction is an implied criticism of the lack of co-ordination of objectives in the FFDP. The message of the leader indicates a need to fulfil the social justice aims of the IRI established in the Constitution.

Summary

Policy formulation in connection with privatisation was inadequate for the following reasons. First, policies were not sufficiently consistent with the requirements of the social and economic environment and with finding community acceptance. Secondly, there was negligence about the instruments for the world of privatisation amongst the policy-makers. Thirdly, pressure was put on selecting radical modalities for the sale of assets to the private sector. Fourthly, the safety clauses and equity measures were not attractive enough to ensure acceptance by the majority of the community. Regarding foreign participation, attempts were made to break the barriers and to give absolute permission to foreign investors. Provisions of the buy-back system and establishments of Free Trade Zones were the main attempts to find appropriate alternatives compatible with the Constitution. An appropriate policy to encourage the private sector entrepreneurs to invest in infrastructural and productive activities has not been formulated yet. The trade liberalisation policy was not in line with the aim of privatisation and caused a reduction in the value of the shares of domestic industries. Therefore, in the first period of the privatisation program, there was policy failure. However, it is hoped

[69]- The letter of the leader has been published under the title "Leader Cautions the President" *Keyhan International*, No.14, No.3753, 21 December 1993, pp.1-2.

that sound and comprehensive policies are established for the privatisation program during the SFDP. The next section examines the privatisation implementation in Iran.

5 Privatisation Implementation in Iran

5.1 Institutional Arrangements

The institutional arrangements for the management of the program of privatisation were established under the responsibility of the first Vice President. A commission is responsible for undertaking policy-making, planning and monitoring privatisation. According to the Approval Letter of the Assembly of Ministers (19 June 1991), this commission comprises of the following authorities:

(i) Vice President who also supervises the commission
(ii) Minister of Finance and Economic Affairs;
(iii) Minister of Industries;
(iv) Minister of Heavy Industries;
(v) Minister of Work and Social Affairs;
(v) The head of the Plan and Budget Organisation (PBO); and
(vii) The Governor of the CBIRI.[70]

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[70]- In the SFDP which will be implemented from 1995 (1374 Iranian year), with some changes the Commission will comprise the following authorities:

1- The President of IRI, as the head of the Commission;
2- Minister of Economic and Finance Affairs;
3- The head of the Plan and Budget Organisation (PBO)
4- The Governor of the CBIRI;
5- One of the Industrial Ministers, by the choice of the board of Ministers; and
6- Two experts and specialists, by the choice of the board of Ministers.

Two Members of Parliament (MPs) will attend as observers, by the choice of the Parliament. The secretariat of the Commission of Privatisation will be in the Ministry of Economic and Finance Affairs, under the Economic Council. *Keyhan Havai* "The Parliament Approval of the SFDP", No. 1097, 7 September 1994: 24,25).

The Deputy Minister of Economic and Finance Affairs in PEs has responsibility for the classification and the identification of procedures for transferring PEs to the private sector. The secretariat of privatisation has been established in the Ministry of Economic and Finance Affairs under the Economic Council (PBO,1993:15). The secretariat is required to be the headquarters of the privatisation program. The Office for PEs in PBO is responsible for providing theoretical and methodological procedures for the implementation of privatisation. Public enterprises were prioritised based on the degree of their independence from government functions.

On 19 June 1991, the first declaration of the government was publicised in which the intention to privatise the privatisable PEs was announced. Methods of transferring, the extent of the participation of workers, and the methods of disbursement of the proceeds were also revealed.[71] In the approval letter of the Board of Minsters, 391 PEs were identified for privatisation in two stages.

The management of the transition process would be undertaken by some of the managers of the PEs in Iran. Organisations such as INIO and IDRO were to implement privatisation of their assets. The secretariat is in charge of monitoring the activities of the privatisation committees during the SFDP (Nourbakhsh, 1993:4).

5.1.1 Privatisation Action Plan

To prioritise areas for privatisation, a plan has been designed in the office of PEs

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[71]– Interview with H. Khoshpour, Office of PEs of the Plan and Budget Organisation (PBO) of Iran, September 1993 (Iranian date Shahrivar 1372); *Approval letter of the Assembly of Ministers of the IRI*, 19 June, 1991 (Iranian date 29-3-1372).

of the Ministry of Economic and Finance Affairs. Organisations such as INIO, IDRO, Ministry of Heavy Industries and Ministry of Labour and Social Affairs participated in designing this action plan. According to the FFDP, strategic enterprises were to remain in the hands of the government.

The President announced, in an interview, that only PEs over which the government is committed to have control under the Constitution, will remain in the control of the government.[72] However, he mentioned that in these cases they would give some parts of the companies or the functions of PEs to the private sector after obtaining permission from the Council of Guardians.[73] As well, a policy of preventing the establishment of new PEs was included in the budget plan of 1994.

In order to determine which were the strategic PEs and which ones were eligible for privatisation, some quantitative measures were devised.[74] These referred to factors such as the extent of dependence on the government, the extent of investment and the return on investment of these PEs, new investments, the number of personnel within the PEs, the need for foreign exchange, supply elasticity for their products, demand elasticity for their products, market monopolistic situation, economies of scale and the area of activity.[75]

72- "Interview with the President" *Jomhoori-e-Islami*, No. 4047, 24 May 1993, p.3.

73- "Interview with the President" *Jomhoori-e-Islami*, No.4048, 25 May 1993, p.14.

74- Strategic PEs are to be in the hands of the government on the basis of the Constitution. However, only those main PEs have been named in the Constitution. This classification was to clarify those other ones which include the term "strategic".

75- Interview with the director of the office of PEs in the Ministry of Economic and Finance Affairs, 1 August 1993; Interview with H. Khoshpour, Office of PEs of the Plan and Budget Organisation (PBO) of Iran.

The measures and the related scores are shown in Table 4.12.

Table 4.12 Measures of Eligibility for Privatisation and Their Associated Scores.

No.	Measures	Rank	Score
1-	Investment (0-10)	High investment Medium investment Low investment	9-10 3-8 0-2
2-	Return on investment (0-10)	high Medium Low	7-10 3-6 0-2
3-	New investment (0-5)	Sufficient Insufficient	4-5 0-2
4-	Employment (0-5)	Proper with technology Low High	4-5 1-3 0
5-	Need for foreign exchange (0-10)	Low High Government paid	8-10 0-3 0-3
6-	Supply elasticity (0-5)	High Low	5 0
7-	Demand elasticity (0-5)	high Low	5 0
8-	Government assistance (0-5)	No Yes	3-5 0
9-	Type of the market (0-30)	Monopoly Oligopoly Competitive	15-30 1-15 0
10-	Economies of scale (0-5)	High Medium Low	5 3-4 0-2
11-	Ownership (in origin) (1-5)	Private Public	4-5 1-3
12-	Other Measures (0-4)	Possibility of separation of the activities (Yes) (NO) Possibility of separation of the market (yes) (No) Other measures	3 0-2 3 0-2 0-4

Source: Adapted from the Ministry of Economic and Finance Affairs(1993), pp.25-26; PBO, 1993:12; Interview with the director of the office of PEs in Ministry of Economics and Finance Affairs.

PEs were assessed based on these measures and were given a score. Those companies scored between zero and thirty points were assigned to be privatised in the first stage, and a list of these was provided and approved by the Board of Ministers (PBO, 1993:12).

On this basis, 391 companies out of a total of 770 PEs were nominated for privatisation in two stages (Table 4.13). Meanwhile, 80 companies were identified as strategic and not to be privatised.

Table 4.13 Action Plan for Privatisation in Iran

No. of PEs surveyed	770
Strategic PEs based on Constitution	80
To be privatised in the first stage	391
To be privatised in the second stage	299

Source: Approval Letter of the Assembly of Ministers, 19 June 1991.

Candidate companies which are to be floated on the Tehran Capital Market need to undergo some legal and other forms of restructuring prior to privatisation. PEs are required to have the following characteristics:

(i) be in the form of corporations;
(ii) capital should be at least IR3 billion;
(iii) shareholders' rights should be at least 20 per cent of the total assets of the company; and
(iv) the company should not be loss-making.[76]

There are also procedures for PEs to be listed on the Tehran Stock Exchange. After being listed on the Stock Exchange, the share price is identified based on profitability rather than assets. PEs which have not been accepted at the Tehran Stock Exchange can be sold through a tendering process by their boards of directors.

5.1.2 Application of the Proceeds

A policy as to the use of the proceeds obtained from the passage of PEs to the

[76]- Interview with Chief of Ownership and Shares Department in Industrial Development and Renovation Organisation (IDRO) of IRI, 6 September 1993 (Shahrivar 1372), Tehran.

private sector has been identified. The Assembly of Ministers has approved in seven cases the application of the proceeds as follows:

(a) repayment of existing debt (of these PEs or Companies);
(b) repayment of any debts incurred in the process of reconstruction of these enterprises;
(c) overcoming a shortage of resources in available PEs which are not able to be privatised (based on their approved budget);
(d) completing such productive projects as would prepare favourable conditions for the privatisation of enterprises not yet able to be privatised;
(e) implementing such necessary productive projects which the private sector is not ready to undertake or without which a PE is not ready to be transferred to the private sector; and
(f) settling to the treasury.[77] (Approval Letter of the Assembly of Ministers, 19 June 1991; PBO:1993:14).

These were policies to encourage PEs to be transferred to the private sector.

5.2 Privatisation Procedures and Modalities

The privatisation program consists of sales of equity shares as well as deregulation and facilitating private sector activities for greater efficiency.

Shares of enterprises have been offered either through the Tehran Stock Exchange or through direct negotiations. These are supplied to the Tehran Stock Exchange and can be purchased by the people. Therefore, purchase of shares of an enterprise is either by tender through the enterprise, by negotiation or by floating on the Tehran Stock Exchange.

Negotiation is one of the procedures for privatisation. It may take months to complete the transaction. The final decision is also made in the Tehran Stock Exchange. After agreement on the estimated value of the specific enterprise by

[77]– However, in SFDP all proceeds from share sales will go to the treasury which will then decide how much should go to underdeveloped regions and how much to the seller of the shares.

negotiation, the case is passed to the Tehran Stock Exchange and the enterprise is sold by a tendering process. It is usually the share price agreed in negotiation that forms the price in this type of tendering. However, if there is a better price, shares will be sold to the best offer. This method of shares offer is disputable for managerial reasons, and therefore has been confined to some specific cases in the SFDP.

There has been doubt about the soundness of the method of negotiation. First, negotiation for transactions of millions of shares with a single buyer has a high risk of collusion and corruption. Secondly, for the reason of sensitivity about the purchase of a considerable proportion of shares (up to 67 per cent of shares), the single purchaser usually does not offer an appropriate price. Thirdly, there is a considerable difference between acceptable proposal and the real value of the enterprises (a bid of over 50 per cent of the price is acceptable for negotiation). Fourthly, there is a difference between the way of determining the value of the PEs. For example, INIO has been tougher than IDRO in determining prices.[78] Therefore, the purchasers prefer to purchase cheaper enterprises of equal quality. Finally, attending the Tehran Stock Exchange after negotiation is seen as a way of transferring the responsibility of the negotiators to the Tehran Stock Exchange.

Selling shares by negotiation has raised scepticism. An example is selling of 67 per cent of the shares of the Aluminium Company of Arak to one investor. This was sold to a single individual by instalments. There were complaints by some other individuals about the procedure and the conditions of sale. It was not

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[78]- Interview with Chief of Ownership and Shares Department in IDRO, 6 September 1993, Tehran.

announced, in the tender document that it was to be sold by instalments. After discussion in public, in newspapers and in court the case was sent to Parliament to be examined. Parliament examining the complaint in this case, confirmed the claim of the group of candidates that the condition of purchasing by instalment had not been made known to all buyers who had attended the Tehran Stock Exchange but only to the one successful buyer in negotiation.[79] Members of Parliament after examining the complaints were not satisfied with the answers of IDRO on this aspect.

5.2.1 Liberalisation

Liberalisation and deregulation have been advanced as a form of privatisation in Iran. Liberalisation has been undertaken in two forms. First, the method of licensing to private sector or industries to enter the area previously reserved for PEs. Privatisation of the airlines system is one of the examples of this form. It was approved by the Showray-e- A'li-e-Hamahangi (Supreme Council of Coordination) that licenses be given to private companies. This had previously been considered as prohibited by the Constitution until the Showray-e-A'li-e-Barname' rizi (Supreme Council of Planning) recognised that it was acceptable (*Sanat-e-Haml va Naghl*, No. 118, April 1993:26-7).

Another example is an attempt to give licenses to establish private insurance companies. This is despite the fact that the Constitution requires that insurance activity be under government authority. However, an attempt has been made to get permission from "the Council of Guardians" or apply the "Act of

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[79]– *Keyhan Havai*, No.1052, 13 October 1993, p.24.

Establishment of Central Insurance" which has recognised the establishment of private insurance (*Hamshahri*, No.134, 14 June 1993:14). The Act had been approved in the years before the revolution in 1979. Another form of liberalisation is financial liberalisation.

Financial and Trade Liberalisation

One of the modalities of the privatisation program was financial liberalisation. It was one of the prescriptions of the IMF for implementing structural adjustment policy (See Section 3). The development of financial liberalisation in Iran began in early 1991. The first step was a decision to release the rules for allocation of currencies to enable banks and exporters to retain earnings and to use them freely. The second step was the government decision to lift all barriers on imports.

In order to fulfil this policy, the governor of CBIRI announced a full convertibility of Rial (Iranian currency). Importers were promised that they would be able to purchase all the hard currency they need at the new rate of $1- IR1648. On the presentation of proper documents, banks would sell foreign exchange to Iranians studying abroad and patients going overseas for treatment. Anyone else would be free to buy up to $5,000 in hard currency. About $2-3 billion of $6 billion reserves set aside to support the currency after devaluation (see *The Middle East*, No.224, June 1993:27-30). How could a limited supply of foreign exchange respond to an unlimited demand for foreign exchange? This meant that banks were faced with a huge demand from importers eager to import by taking advantage of the floating rate of exchange. The liberalisation of the financial sector has led to a cash-flow crunch. With the best reform intention, the dropping of monetary controls in 1991 led to an explosion of imports that could not be controlled

(Timewell, 1993:44). Consequently, severe payment delays emerged in the summer of 1992, damaging fragile international relations. Table 4.14, illustrates the process of financial liberalisation and its consequent impacts on the Iranian economy.

Table 4.14 Financial Liberalisation and the Consequences on the Economy of Iran.

No.	Financial Liberalisation and the Consequent Stages:
1-	Liberalisation of Financial Sector
2-	Dropping Foreign Exchange Control
3-	Huge Pressure to buy Foreign Currencies
4-	Increase in Imports
5-	Deficit in Balance of Payments
6-	Delay in Repayment of Debts

Timewell (1993:45) narrates from Kashan (a deputy governor and expert in the CBIRI that in spite of the fact that the government was aware of the possible problems, it did not want to restrain the liberalisation trend. The government decided to go ahead and it hoped that demand from the banks would decline in time.

The banks' ability to pay their obligations at the floating rate was wishful thinking. It resulted in a crisis which developed in June 1992. As part of the liberalisation of the banking system, CBIRI transferred responsibility for opening letters of credit to commercial banks. Therefore, the banks started to use the central bank's funds to fund commitments they had made themselves. The consensus is that "the problem was caused by a technical shortage resulting from bad management of reserves by the bank" (Dyer, 1992:82). In this case a batch of letters of credit, together with unexpectedly advanced development plans, worsened the demand on foreign currency are flaws in the system and on an opportune time this program could be sabotaged.

Financial liberalisation was accompanied by a severe devaluation of the domestic currency (Rial). The Rial was devaluated from a dollar as the official rate of IR75 to IR1648) (Rashidi, 1993:20). This policy, in spite of the advantage of creating a real price for goods and services, has had some drawbacks. First, devaluation of the domestic currency was expected to create an increase in exports. However, achieving this objective requires elasticity between traditional exports and the demand for these commodities. Non-oil exports are mainly carpets, pistachio and handicraft industries which do not have this characteristic.

On the other hand, devaluation of the domestic currency might have been assumed to impose a decrease in imports and thus help increase domestic production and decrease consumption goods. Nonetheless, it may decrease the imports of equipment for use in domestic industries with the consequence in reduced quantity of manufactured goods. Devaluation of the domestic currency may also worsen the terms of trade, i.e. the relation of the export goods to import goods based on a specific foreign currency. Therefore, it causes the problem of having to sell more to gain a specified amount of imported goods.

Devaluation of the Rial did not decrease the demand for foreign currencies based on the above facts. The elasticity of demand in relation to the increase of the foreign exchange rate was not observed (Rashidi, 1993:19). Therefore, it resulted in the creation of a black market for foreign exchange. This occurred while the Minister of Economic and Finance Affairs, Mohammad Khan, emphasised that the exchange rate lever was used to limit demand for foreign currencies and to cure the balance of payments (*Keyhan International*, 2 June 1994:11). Therefore, the government was obliged to increase the rate of the foreign exchange again (to $1= IR1750) in 1994 to prevent capital outflow from the country.[80] The important point is that attraction of foreign short-term capital to the country, by devaluation of the domestic currency, means selling the equity and assets of the country to foreigners at a cheaper price. Financial liberalisation required consideration of its potential impact on foreign trade, demand and supply of foreign exchange and transferring of capital.

5.2.2 Alternative Modalities for Privatisation

The most common modality applied for reform of PEs in Iran is divestiture. Non-divestiture alternatives and the vast range of alternatives which spread from divestiture to reform without changing government ownership or managerial reform have not been considered seriously. Some forms of contracting out in services have been implemented and there are reports of implementing this feature of privatisation in the mining of coal, to encourage exploration and extraction of coals.[81] Management contracting has been applied in the following cases:

(i) management of water utilisation, construction and maintenance to the private sector (*Ettela'at*, No.1991, 17 May 1993:4);

(ii) distribution of electricity to the private sector (*Rasalat*, No.2118, 1 April 1993:15); and

(iii) management of some of the activities of the Ministry of Roads and Transportation (*Rasalat*, No.2194, 14 August 1993).

However, these contracts were not based on the aim of improving efficiency. The

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80- In 1995, the official rate of foreign exchange increased to $=IR3,000.

81- Interview with M. Ebrahimi director of the Office of Public Properties in Kerman Coal Company, 28 August 1993 (Iranian date 1993), Kerman.

Memorandum of Understanding (MOU) which includes some efficiency measures has not been applied in these contracts.

The reasons for ignoring privatisation modalities other than divestiture, may be two-fold. First, it may due to the lack of awareness of possible alternatives, or their clear perception, if some alternatives exist. Most of the Iranians who are involved in privatisation are educated people and have relationships with other countries and sources of knowledge about different alternatives. For example, Elyassi (1994:94) pointing to other alternatives maintains that privatisation can be more effective and efficient when applying other alternatives such as those maintaining public ownership. He suggested that those alternatives are not anti-privatisation and can be applied while co-existing with other alternatives. Zarrin Ghalam also points to alternatives without transferring ownership and says "privatisation is not necessarily a change of ownership."[82] Some forms of marketisation while maintaining the ownership of the government may produce a better result in some cases.

Secondly, the lack of application of other alternatives may stem from an ideological resistance inside the country. Those who are committed to the ideology of market force mechanism, do not utilise any other alternatives except those which are based on the transferring of ownership of the PEs. Prescriptions of international institutions, such as the World Bank and IMF, support following the modality of divestiture and selling assets to the private sector. They prescribe, for Iran, those modalities which were applied in Russia, East Germany and Chile. Therefore, those supporters of the international institutions do not consider a

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[82]- Interview with the Vice President of the Office of the Economic Survey of the CBIRI.

selective type of privatisation based on the specific environment of the country. The types of seminars and coordination they arrange in Iran indicate this fact.[83] Other advocates of privatisation in the form of divestiture are those interest groups who think about their own benefit from this type of privatisation. They ignore any other type of privatisation and reject other types of reform especially those which maintain public ownership. For example, they maintain that they do not recognise any other alternatives, and (if there is any alternative) these alternatives are deceptive.[84] They suggest that only the owners of capital have anxiety about their wealth, not any other groups. These are points about property rights which disregard the fact of separation between the agent and owners in modern economies.

Modalities of privatisation in Iran was mostly related to the internal, external and ideological pressures. The choice of modalities was, in part, related to the success of the privatisation program. Table 4.15 depicts the extent of different types of pressure for privatisation on Iran compared to Malaysia.

Table 4.15 Correlation Between Pressures and Choice of Modalities of Privatisation.

Country	Internal Pressure	External Pressure	Ideological Pressure	Modalities of Privatisation	Success of Privatisation
Malaysia	Moderate	Moderate	Moderate	Partial Divestiture	Moderate
Iran	Moderate	High	High	Divestiture	Low

Source: Regarding Malaysia, Gouri, 1991b:118-120. Regarding Iran it is the author's evaluation.

83- e.g. the seminar which was held in College of Economic and Finance Affairs under the supervision and direction of the Economic Development Institute (EDI) of the World Bank, Washington, D.C.

84- Interview with the head of Iran Chamber of Commerce, Industries and Mines, 9 September 1993.

5.3 Implementation in Practice

Practical steps for privatisation have been taken since 1989. Hundreds of industries have been transferred to the private sector. The INIO announced that they have privatised 131 companies with proceeds of the sales amounting to IR911.3 billion (about $400 million).[85] Fifty five companies out of 131 companies were sold through the Tehran Stock Exchange. Twenty of them were sold through tender. Twenty five companies were sold by negotiation. Thirty one companies are finalising submission of their documents (Table 4.16).

Table 4.16 Privatisation Activities of the INIO during FFDP.

No. of companies submitted	Procedure	Value
131 companies totally	Three procedures	IR911.3 b. $400 million
55 companies	Tehran Stock Exchange	IR486.3b.
20 companies	Tender	IR116.1b.
25 companies	Negotiation	IR144.1b.
31 companies	Not defined	IR164.7b.

Source: Adapted from Report of the Governor of the INIO, Banki in *Hamshahri*, No.463, 16 August 1994, p.4.

The purchasers of PEs consist of the private sector, managers and workers and public institutions. Eighty-eight per cent of enterprises have been transferred to the private sector and individuals, 6 per cent to the managers and workers and 6 per cent to public organisations and institutions (Banki, 1994:4). These companies are amongst 440 companies under the INIO of which 173 units were supposed to be privatised during the first stage of privatisation. Nonetheless, the proceeds from privatised companies are very low. Table 4.17, shows the pattern of distribution of shares to the community.

[85]– Interview with Dr M Banki, Deputy Minister of Industries and the General Governor of the INIO, *Hamshahri*, No.463, 16 August 1994:4.

Table 4.17 The Pattern of Distribution of the Shares to the Community.

Distribution of shares to:	Proportion
Private sector and individuals	88%
Managers and workers	6%
Public institutions and organisations	6%

Source: Adapted from Banki, 1994:4

On the basis of Table 4.17, workers and managers have not obtained the 33 per cent of shares planned and approved by the Board of Ministers.

Another organisation associated with the privatisation program is IDRO. This organisation was supposed to offer the shares of 56 units under its control to the private sector by 1993. Only eight companies out of 56 companies could offer their shares through the Tehran Stock Exchange. Therefore, other procedures of privatisation such as negotiation and tender have been applied. In 1991, shares of four companies under the control of IDRO were offered to the private sector through the Tehran Stock Exchange. In this year four companies have been privatised through direct selling of shares. In 1992, seven companies were sold to the private sector through the Tehran Stock Exchange and three companies transferred through direct negotiation and tender (Table 4.18). Shares of nine companies from IDRO were swapped with shares of companies from other PEs.[86] By March 1994, in bilateral deals, IDRO has obtained IR 240,000 million ($140 million) from the sale of shares of 50 factories through the Tehran Stock Exchange. The extent of the shares transferred is from 10 per cent to about 80 per cent of the shares under the IDRO control.

[86] Davood Mesgarian Haghighi, Experience of IDRO and the Activities Expected with Privatisation. A paper presented to the Seminar of Senior program: Analytical Survey of Privatisation, 9 May 1993 by EDI the World Bank and College of Economic Affairs, Tehran.

Table 4.18 Privatisation by IDRO

Procedure / Year	1992	1993
Tehran Stock Exchange	4	7
Direct selling of shares	4	
Negotiation and tender	-	3
Swap with other PEs	-	9
Total	8	19

Shares offers to the workers and managers have not conformed to the policy of the Board of Ministers. The number of companies which have made shares available to the workers is about 80 units, whereas 248 companies were supposed to be privatised and thus transfer 33 per cent of their shares to the workers (*Political Economic Ettela'at*, 1993, pp.109-115). A report by IDRO indicates that the shares which have been transferred to the workers are from 0.001 per cent to 26.6 per cent of the shares of companies in seventy productive units.[87] In other words, the program of transferring ownership to the workers has been slower than the planned program.

Transferring mines to the private sector is part of the privatisation program of the government. A total of 220 mines have been transferred to the private sector by the Ministry of Mines and Metals (Table 4.19). Regional companies have been wound up and their staff have been transferred to the private sector.[88]

Table 4.19 Transfer of Mines to the Private Sector

Transferring to:	No. of Mines
Consumer industries	40
Mines co-operatives	105
Private sector	75
Total	220

Adapted from the Chamber of Commerce, Industries and Mines, No.5,6, August, September 1993, p.58.

87–IDRO, *A Report to Seminar of Analytical Survey of Privatisation*, Tehran May 1993.

88– A report from Ministry of Mines and Metals, *Chamber of Commerce, Industries and Mines*, No.5,6, August, September 1993:58.

Some other organisations are undertaking privatisation or restructuring their associated companies. For example, Iran's Bonyad-e-Mustaz'afan (Foundation for the Oppressed) decided to privatise some of its properties. The decision was announced on 9 March 1990 to sell productive, commercial and other properties to the private sector in order to participate in macro-economic investment (*Keyhan Havai*, No.1057, 17 November 1993:8).

The Ministry of Jihad-e- Sazandegi (Construction Crusade) in implementing its privatisation program has taken the following steps:

(i) transferred fishery affairs to the employees;
(ii) contracted out construction affairs with the private sector;
(iii) transferred construction of roads in city areas to the Ministry of Roads; and
(iv) sold out large store-freezers (freezer warehouses) to the private sector by tender.[89]

The third case is transferring an activity from a Ministry to another Ministry. The reason was for the division of functions based on specialisation and reduction in variety of the functional areas of the Ministry of Jihad-e-Sazandegi.

In summary, the privatisation action plan identified 391 PEs to be privatised. Eligibility for privatisation was based on a variety of economic measures. Application of proceeds was mainly to assist the privatisation program. The main modality of privatisation was divestiture of assets through offering shares on the Tehran Stock Exchange. Negotiation was one procedure for selling PEs which produced some negative reactions in the first stage of privatisation. Financial and trade liberalisation had impacts on the privatisation program and on

[89]- Interview with Mr Mohammad Ali Homayouni, in Ministry of Jihad-e- Sazandegi (Construction Crusade) of Iran, February 1994 (Iranian date Bahman 1372), Melbourne.

the economy as a whole. The next section evaluates the results and the consequences of privatisation implementation in Iran.

6 Privatisation Evaluation

The privatisation program can be evaluated on the basis of its results and problems. In Iran, it was accompanied by slight success, but much more trouble. The success seems to be associated with factors other than privatisation and the effects of the package of "adjustment policy" reforms. However, the problems were mostly related to the adjustment policy prescribed by the international institutions. The results announced are those dealing with the reconstruction of the war-damaged areas, the area of production and GDP growth, and utilisation of industrial capacity.

6.1 Privatisation Results

6.1.1 Privatisation Objectives and Performance

The process of privatisation was expected to contribute towards the relief of structural, economic and social problems of the country. Improving the efficiency, effective utilisation of resources, and reducing the size and the role of the government were among the objectives to be achieved.

One of the internal problems which was a motive for privatisation implementation was reconstructing the war-damaged areas. The progress of reconstruction of 10 cities and 1,200 villages in war damaged areas has been considered successful.[90] However, this achievement was mostly related to the FFDP program rather than privatisation.

The proceeds from privatisation are not considerable nor productive in terms of applying those proceeds to productive investment. This explains why a popular member of Parliament says that he agrees with the sale of 90 per cent of the public industries subject to the investment of the proceeds to the productive industries.[91]

Privatisation, in practice, is not following the aims of efficiency and managerial improvement, at least not directly. There is no enthusiasm to offer shares to professionals such as industrialists or even managers and workers. A World Bank report also asserts that the management system of the privatised enterprises has not been changed or related to the output of the organisation (Mehdizadeh, 1994:52). The report points out that efficiency was not improved as planned, and investment growth has not conformed to the plan. Neither did privatisation greatly affect GDP, as its extent was limited. Therefore, the growth of GDP is necessarily related to factors other than privatisation.

For example, one of the effective factors for GDP growth was utilisation of the existing industrial capacities, which increased from 50 per cent in 1989 to 70 per cent in 1991 (*Iran Commerce*, 1991:52). The Deputy Head of the PBO, Mahroo, announced that the average growth rate for industries during the FFDP was 11.6 per cent (*Keyhan International*, 27 July, 1994:8). In 1990, the average

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90- Report of the President Rafsanjani in Friday Prayer *Keyhan International*, 3 September 1994:1.

91- Hojjatul-Islam Hosseini Shahroudi, (MP, the head of the Plan and Budget Commission of the Parliament) *Keyhan Havai*, No.967, 29 January 1992:25.

rate of industrial growth was estimated to be 17 per cent while it has been higher for intermediate and capital industries.

The increase in utilisation of spare capacity and machinery occurred due to the increase in imports of raw material and intermediate goods for industries. This was, in turn, pertinent to the allocation of hard currencies to industries. The amount of foreign exchange allocated to the industrial sector rose from $3.4 billion in 1989 to $9.8 billion in 1990. During the FFDP, the $24 billion allocated to the industrial sector was more than the $10.8 billion in the planned program (*Keyhan Havai*, No.1074, 16 March 1994:12, see also 6.2.2). Indeed, the injection of hard currency into industries and imports of raw or intermediate material were the major reasons for GDP growth. To substantiate this, the growth of the GDP was harmonious with the amount of imports in the first three years of FFDP, i.e., 1989, 1990, and 1991 (see Tables 4.20 and 4.24). This, on the one hand, resulted in an increase in production while, on the other hand, it placed a huge burden on the government because of foreign debt.

6.1.2 Privatisation and GDP Growth

GDP of the IRI was said to have grown significantly during the FFDP and privatisation program. The Deputy Head of the Plan and Budget Organisation for production affairs, Mahroo, said that "the GDP in industrial, agricultural, mining and water sectors shows an average growth of 8 per cent during the FFDP (1989-1994)" (*Keyhan International*, Vol.15, No.3922, 27 July 1994, p.1).

The argument is that the GDP, which was declining by an annual average rate of 5.6 per cent during 1985-8, grew by 3.6 per cent in 1989 and 10.5 per cent in 1990 (*Rasalat*, 4 May, 1992, p.16). According to a Parliamentary report the ratio of GDP has increased during 1989-93. The growth of GDP is set out in Table 4.20.

Table 4.20 The Rate of GDP Growth During 1982-91 Based upon the Constant 1982 Prices.

Year	GDP (billion Rials)	% GDP Growth	Production per capita (thousand Rials)
1982	10335.4	-	241.5
1983	11536.7	11.6	259.6
1984	11587.1	0.44	250.8
1985	11607.4	0.17	242.8
1986	9861.7	-15	199.8
1987	10019.7	1.6	196.5
1988	9234.3	-7.8	175.3
1989	9514.6	3	174.6
1990	10664.9	12.1	189.1
1991	11716	9.86	201.6
1992	12442.4	6.2	-
1993		5	

Source: Adapted from Research Group of Parliament (1994), No.1, April, pp. 25, 17; *Keyhan Havai*, No.1095, 24 August 1994:11.

The growth of GDP for the year 1993 was announced as 5 per cent by the governor of the CBIRI. Therefore, the average growth of GDP during FFDP was 7.2 per cent based on an economic report by the Minister of Economic and Finance Affairs (*Keyhan Havai*, No.1095, 24 August 1994, p.11; *Keyhan International*, 8 October 1994, p.8). The trend of GDP growth was positive but diminishing during the FFDP. The diminishing trend of the growth of GDP was partly due to the reduction of injection of hard currency into productive industries which caused the reduction of imports of material necessary for production (see Table 4.24).

Despite the positive rate of growth, the real amount of the growth does not show a significant rise when compared to that in 1983. Compared with the year

1985, the growth rate of GDP in some years even shows negative growth.

Furthermore, this rise in production is not necessarily based on the increase in associated factors. Evidently, the increase in production was not due to the increase in investments. Investment in 1991 accounted for 13.2 per cent of GDP (Table 4.21), while it was to reach 19.8 per cent of the GDP based on the planned program. Therefore, investment did not conform to the plan and to the production growth (Salam, No.584, 30 May 1993:3). The rate of growth in investment does not explain the GDP growth (see Tables 4.20 and 4.21).

Table 4.21 Gross Domestic Investment Based upon Constant 1982 Prices (Billion Rials).

Year	% of GDP (based on 1982)	Planned Investment	Actual Investment
1989	12.8	1601.5	1216.8
1990	12.9	2112.8	1378.8
1991	13.2	2174.4	1545.6
1992	-	2169	-
1993	-	2195	-

Source: Adapted from Research Group of Parliament, No.1 April 1994:29.

The growth of efficiency of human resources and the workforce is not considerable. For example, the average growth in the efficiency of the human resources in different sectors accounted for 2 per cent while the planned growth was 6 per cent during 1988-90 (*Salam*, No.584, 30 May 1993:2). Productivity of the workforce increased between 1989-92 (see Table 4.22).

However, the increase in productivity is mostly related to the utilisation of the potential capacity of industries and total activities. During 1980-8, most industries and sectors were working at less than the planned capacity because of the war as well as the trade embargo. Injection of hard currencies and imports of raw material and intermediate goods were relevant factors in the increase of productivity after the war.

Table 4.22 Productivity of the Workforce and Total Productivity in Industries.

Year	Productivity of Industries (1982=100)	Total Productivity of Industries (1985=100)
1981	-	85
1982	100	94.3
1983	108	102.7
1984	113	100.5
1985	110	100
1986	98	84.2
1987	102	83.4
1988	103	75.5
1989	103	75.5
1990	110	81.7
1991	130	-

Source: Adapted from Organisation of National Productivity: the Plan of the National Statistics and Productivity; Sottoodeh, Aliakbar (1994:27-31).

Finally, it is hard to say that the growth rate of GDP in these years is pertinent to the privatisation policy. The number of companies which were privatised was not significant (Tables 4.16 - 4.19). Furthermore, there was not a significant change in the system of management of those companies. Therefore, privatisation has not had a significant role or effect on the performance of these enterprises. Besides, there has not been any official report about increases in efficiency or productivity related to the effects of privatisation.

However, there are reports about progress in the performance of the PEs under the control of the government. A report about INIO indicates the following results in 140 companies under the control of INIO:

(i) Investment growth 14 per cent;

(ii) Growth in utilisation of the capacity of industries 2 per cent;

(iii) Turnover growth 36 per cent;

(iv) Product per capita 33 per cent; and

(v) Net profit of 22 per cent (Banki, Governor of the INIO, 1994:4).

This report indicates growth in some economic indicators in 1993 compared to 1982. However, the report consist of those companies which are under the control of the government and not privatised, or partially privatised. The reason for the progress of these enterprises, as Banki (1994:4) reported, is the change in product mix, increase in the prices of the products and a tendency towards producing high-price products. Therefore, the increase in economic indicators cannot necessarily be considered as an indicator of efficiency growth in PEs as well as privatised companies.

6.1.3 A Big Rush and a Snail's Pace Privatisation

Is privatisation in Iran a big rush or a gradual reform in PEs? Privatisation in Iran was predicted to be implemented as harshly as in the Eastern European Bloc.[92] The result has also included consequences similar to those experienced in the rushed privatisation processes (See Chapter 2, Section 6).

Nourbakhsh, the former Minister of Economic and Finance Affairs and the present governor of the CBIRI, announced in the beginning of privatisation that they wanted to finish the privatisation of 500 companies in less than a year (*Euromoney*, November 1991:79-80). Comparing the situation of the Eastern European Bloc with IRI, he said that those countries did not have a private sector and so they had to create a private sector for privatisation. He concluded that due to having an active and clever private sector in Iran, there would be a rush of

92– Seminars which were held in Iran regarding to the subject of "privatisation" tended to prescribe a privatisation of Eastern European style. The most significant of those seminars was "Senior Policy Program: Analytical Survey of Privatisation" during 8-12 May 1993 by the help of Economic Development Institute (EDI) of the World Bank.

many interested people to buy the offered shares of the companies. Based on these predictions and prescriptions, the government planned for a rushed privatisation.

However, in the following year the performance of the privatisation process was not successful in terms of the planned program. Later, it was announced that the privatisation process did not conform to planned progress due to bureaucratic delays. Dyer (1992:84) maintains that only 100 companies out of 500 companies had been privatised during the year. Although all facilities were provided for rushed privatisation, there were problems in implementation. The expectation that privatisation in Iran would be as big a rush privatisation as occurred in the Eastern European Bloc, ignored the specific environment of the country.

What are the reasons for the snail's pace and the decline in the initial enthusiasm for privatisation? The reasons can be categorised as follows:

(i) non-existence of clear-cut criteria for selling, and indecision on pricing, evaluation, employees and so on;

(ii) inability of the Stock Exchange to deal with the selling;

(iii) limited potential of the capital market;

(iv) potential buyers being discouraged;

(v) hindering labour and production regulations; and

(vi) greater attractiveness of the distributive sector and trade as well as other service activities in terms of profitability and less risk than that of production and manufacturing (*Paper of the Iran Chamber of Commerce*, No.40, August 1992:1,2; Hassani, 1993:13).

The responsibility for planning the implementation of the privatisation is on the shoulders of the Ministry of Economic and Finance Affairs. However, it seems that the major reasons for the sluggish pace include some structural and consequential problems. These issues are examined below.

6.2 Privatisation Problems

Structural problems are pertinent to the factors which include the rationale for privatisation. These are factors which need to be settled before privatisation is implemented and include the legal framework and economic management structure in which the privatisation is to be carried out. These factors are related to the prevalent environment in Iran and without considering them privatisation implementation will be problematic.

Subsidiary or consequential problems includes those factors which are the consequence of implementation of privatisation. They are problems which consumers, workers and industrialists face because of the implementation of privatisation or the lack of safeguards in the privatisation policy.

6.2.1 Structural Problems

Legal Obstacles

Some of the legal obstacles to the implementation of privatisation include:

(i) the Constitution's provisions concerning foreign investment; (ii) the law of ownership and registration of the companies regarding foreign investment; (iii) laws regarding tax and insurance, especially those incremental taxes which are stated to be the main obstacle for large investment; (iv) the "Islamic Labour Law"; and (v) the law regarding the visas and residency of foreign ethnic groups and foreign investors.

In spite of some adjudication concerning Article 81 of the Constitution, there has not been any clear legal solution for foreign investment in the country. The Investment Supreme Council has lifted the limitation of the 49 per cent share of foreign investment. This was a condition in the Act of December 1955 and was implemented during the Pahlavi regime (Khamoushi, 1993:7). It was the law before the new Constitution was enacted and hence the other laws which are in conflict with the Constitution cannot be referred to as legal Acts.

There have also been attempts to discredit Article 81 of the Constitution. The most recent example is a statement by the head of the Chamber of Commerce that the Article of Constitution is only related to cases in which some specific concession is given to foreigners and does create a monopolistic advantage for them (Khamoushi, 1993:5-8; 1992:8). To prove the statement, he said that in the first draft of the Constitution, the prohibition of foreigners to participate in investments has been associated only with the public sector and through the government process. Furthermore, he stated that "what has been approved as an article in the Constitution was general and infinite."[93] Nonetheless, the "Council of Guardians" has not made any statement in favour of changing the law so far.

The question is how and why should the government nullify a law which clearly denies foreign investment? The reason seems to be mainly because of the pressures of international institutions such as the World Bank and IMF. After returning from a meeting of the World Bank and IMF, the Minister of Economic and Finance Affairs and the CBIRI requested the Supreme Council for Investment

[93]-In an Interview with the head of the Chamber of Commerce, in September 1993, he asserted these points.

to nullify the limitation on foreign investment to obtain loans for two projects (*Keyhan Havai*, No.980, 13 May 1992:10; *The Middle East*, July 1992:34). Paying loans for those two projects was conditional on nullifying that law. Three days after returning home, the Supreme Council for Investment approved nullifying the limitations on foreign investment.[94]

The government needs to consider alternatives which are not contradictory or problematic. There may be other options to achieve a solution. Nonetheless, appealing to an invalid old Act (the 1955 Act) cannot be the solution. Removing the condition of 49 per cent share of foreign investors involves two major problems. First, it contradicts the Constitution. If the Constitution allowed it, there would be no reason to appeal to an old Act. Secondly, nullifying that old law means that foreign investors are allowed to make 100 per cent investments in the country. This even conflicts with the above interpretation of the head of the Chamber of Commerce. When 100 per cent foreign investment can be allowed, it is clearly a concession without any conditions. The concession is thus, by any interpretation, prohibited. This explains why a Malaysian economist states that "the opposition has criticised the new policy for being more favourable to the foreigners than the Shah's policy" (Mohammad Arif, 1993:3; see also *the Middle East*, No.213, July 1992:34).

With respect to the *Labour Law* the text of the law is clear and specific. Thus, it cannot be justified or interpreted in any different purposes. Therefore, attempts are made by the private sector and entrepreneurs to force the government

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[94]- Nullifying the law of limitation of foreign investment was on 5 May 1992 (*Keyhan Havai*, No.980, 13 May 1992, p.10). The rapid approvement indicates the extent of the pressure of these two organisations. See also (Evans, 1991:80).

to change the labour law. Nevertheless, the government is unwilling to accept the responsibility for the consequences of such action. The process of privatisation by itself has created a crisis which the government is not willing to worsen. Instead, the government can specify the measurements of efficiency and effectiveness of the workforce as well as maintaining the rights of the workers based on the Labour Law.

Regulation and Competitive Environment

A competitive environment has not been achieved for several reasons. First, there is a lack of equal conditions between the people and the organisations. The relevant factors include the amount of capital, scientific, technical and executive ability, access to information about the production and distribution markets, and the lack of legal organisations for the people based on the measures offered by Mojtahid (1993:6-10). These conditions tend to be in favour of monopoly organisations.

Secondly, the process of transferring industries and PEs to the private sector may result in private monopolies. If the circumstances of the buyers are not considered, the shares of these units may be transferred to the hands of a few people and this results in a monopolistic situation. This was what happened in the case of the Aluminium Company of Arak, where 67 per cent of its shares were sold to only one individual (see Chapter 4, Section 5.2).

Thirdly, the process used in obtaining banking facilities may cause amalgamation of the capital employed and its concentration in the hands of few people. The banking system tends to give credit and loans to the rich. This results in a situation where the under-privileged people cannot take advantage of these facilities. It produces a monopolistic situation for a special group of people. Fourthly, the process of transferring land, mines and natural resources is not compatible with a competitive environment. The conditions imposed on the transfer of these resources prevent the public from obtaining shares or buying them. This also creates monopolies.

Fifthly, the conditions applied to importing and obtaining licenses do not encourage competition. These conditions favour specific groups who have obtained these licenses. The information is not equally distributed; financial resources are not equal; and access to modern technology is not equal.

Finally, access to raw materials is not equal. Therefore, the creation of a monopolistic climate is certain. The main factor which could prevent this environment being created could be policy safeguards applied to privatisation.

Problems in Economic Management

Privatisation problems are related mostly to the economic management of the country. Misconduct of economic affairs during the economic adjustment program had effects on the privatisation policy. These problems appeared in imports, control of foreign exchange rates, control of revenue and industrial investment.

One example of these problems is found in the control of imports of products similar to domestically produced products. The importation of many of these goods was forbidden. However, domestic producers have been constantly complaining about the availability of foreign made goods similar to domestic made products. The reason has been the lack of control and monitoring of staff who were in charge of approving imports of manufactured goods which are not made in the country. This affects the total value of domestic products and domestic industries. The share buyers are not enthusiastic to buy shares of industries while they have to compete with foreign products with a better quality. The shares price, in this situation, would be less than their potential value.

Management of tax revenue and other government revenues is another example. Tax and customs revenues are not fully obtained because of the lack of a control system for monitoring and accountability. Inevitably, some disorders and infringements will occur. This results in the reduction of government revenues. Financial problems of the government created by this factor, were among the reasons for the privatisation of PEs.

Privatisation implementation has also been facing mismanagement problems. Nourbakhsh, points out that implementation of the adjustment policy is faced with some malfunction of executive organisations which have affected the adjustment policy (*Zamineh*, August 1993:73). These problems happen despite the fact that the Ministry of Economic and Finance Affair is responsible for removing the factors which worsened the economic situation in the first place. A statement from an important representative of the private sector also indicates the administrative problems of the privatisation program.[95] This implies a lack of coordination and economic management in the implementation of these policies.

Offences Against the Law and Regulations

There have been offences committed against the laws and regulations governing economic affairs. Allocation of foreign exchange to specified areas was not carried out in conformity with the budget law. Foreign exchange was to be allocated only

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[95]– Interview with the head of Chamber of Commerce, Mines and Industries, 9 September 1993, Tehran.

to projects that have been approved by Parliament. However, in practice this was not carried out and there was no relation between allocated foreign exchange and what Parliament had approved. This resulted in allocation of more foreign exchange to organisations such as the Ministry of Heavy Industries than the amount which had been approved (*Keyhan Havai*, No.1047, 16 March 1994:12).

For example, on the condition that the country obtains $120 billion foreign exchange during the FFDP, imports were forecasted to be $114.3 billion, from which industrial investment in the Ministry of Heavy Industries was to be $10.8 billion (*Law of the FFDP*:17, 68). While the revenue target was not met, the allocation of foreign exchange to the Ministry of Heavy Industries was $24 billion not 10.8 billion, i.e. 122 per cent more than what was provided for in the plan. A greater problem is the fact that this increase in investments has been in consumption industries rather than in capital industries (*Keyhan Havai*, 16 March 1994:12).[96] The consumption industries which had been predicted to have a growth of 4.2 per cent during the FFDP have had a growth of 28.8 per cent, while capital industries which was supposed to have a growth of 24 per cent had only grown 5.9 per cent (Table 4.23). The fact that the growth of capital industries being 25 per cent of the planned program, and the consumption industries having a growth rate of more than six times the approved program, is more indicative of a lack of accountability and managerial responsibility than any other issues.

[96]–Interview with Hojjatul-Islam Dorri Najafabadi (Head of the Plan and Budget Commission of the Parliament and Mortaza Alviri, *Keyhan Havai*, No. 1074, 16 March 1994:12-14.

Table 4.23 The Planned and the Actual Growth Rate of Industries During FFDP.

Type of Industry:	Planned growth:	Performance:
Capital Industries	24%	5.9%
Consumption Industries	4.2%	28.8%

Source: Adapted from *Keyhan Havai*, No. 1074, 16 March 1994, p.12.

Another example of offence against the law concerns Note 29 of the FFDP law. In that Note there was a specified list of projects which were eligible to be financed through loans from foreign institutions.[97] The contracts stipulated that repayment should begin from the start of the operation of the projects. Other projects were not legally allowed to receive loans, while in practice some of them received loans and the major contracts were against the law.

Another example of offences against the law concerned buy-back contracts. These contracts were devised so as not to create financial pressure for the government. The contracts had to be arranged in such a way that repayments of the loans start from the beginning of the operation of the projects and are covered by the sale of products. However, this was not done as the law stipulated, and the repayment of the loans became the responsibility of the CBIRI (*Keyhan Havai*, 16 March 1994:13).

This offence (against the law) indicates a problem in economic management which is a matter of concern as it is associated with the privatisation process. Mismanagement in these areas can lead to corruption in spite of the sensitivity of the IRI and Islamic society in this matter.[98] The lack of an appropriate

[97]- Interview with Mortaza Alviri (Head of the Supreme Council of Free-Trade-Zone), *Keyhan Havai*, No.1074, 16 March 1994:12-14; *The Law of the FFDP* (1989-1994), Note 29: 14-17.

[98]- Some of these issues may be perceived in the recent letter from 19 MPs referring to 24 cases of irregularities in the impeachment of the Minister of Mines and Metals, Mohammad Hossein Mahlooji. He is one of the radical supporters of privatisation in its extreme forms. Some of the cases cited in the impeachment were concerning:

monitoring system has complicated the process of privatisation. A decentralised administrative system of privatisation was introduced. However, monitoring is exercised by a commission under the authority of the Vice President. Unfortunately, it has not been active and the secretariat in the Ministry of Economic and Finance Affairs was not established (INIO, 1992). There is a view that privatisation in its present stage is a government lever to push the economy in the direction favoured by planners (Rundick, 1993:275). However, there are still opponent groups both inside and outside Parliament and the achievement of long-term objectives is problematic.

High expenditures: Imports and Debts

There has been inefficient allocation of resources. The inability to manage the foreign exchange revenues became apparent when the government was faced with having to repay the loans to fulfil their commitments. The increase in imports, which resulted from financial liberalisation, created debt problems for the country. It was argued that the injection of a considerable quantity of currency had taken place to help enterprises strengthen their productivity.[99] However, official statements suggest that there was waste of resources in some non-essential goods areas. For example, the Governor of CBIRI said that "some ministers allocated

agreements with foreign companies whose role in other projects had been under criticism;the ministry's foreign purchases which could be provided from domestic sources;
contracts which have been given to the Minister's friends and relatives at unreasonable prices; and employing foreign unqualified "experts" as sub-contractors who receive salaries between $18,000 to $20,000 per month (*Keyhan International*, December 5, 1994:1,7).

[99]– Mortaza Nabavi, *Rasalat*, No. 1413, 20 May 1993:3.

foreign currencies to the non-essential cases instead of the essential" (*Salam*, No.1413, 19 June 1993:1). Rudnick (1993:276) refers to an expert pointing out that the debt was mainly the "result of over-indulging in imports of all kinds, not just necessities as in the past but also the previously banned consumer goods." Imports have risen without attention being paid to how the debt commitments will be met.

Table 4.24 Comparison of Imports of the IRI before and after FFDP ($million)

Year	1987	1988	1989	1990	1991	1992	1993
Imports	9,570	9,454	12,807	18,203	28,500	21,200	19,000

Source: For the years 1987-89, IEU (1992, p.20); for the years 1991-93; Khamoushi, 1992:2,3; *Paper of the Chamber of Commerce*, No.12 March 1993, p.9; and No.7, 8, October-November 1993; *Keyhan International*, 2 September 1994:1,7. [100].

Despite an annual average rate of about $15 billion for foreign exchange revenue, the government has been facing problems in the accumulation of capital. In addition to the problem created by the war, another major reason is the lack of balance between the volume of imports of consumption goods and the volume of capital investments. The proportion of capital goods was 10 per cent of total imports in 1989 (Kheirkhahan, 1992a:6). Much of the short-term loans received were used to finance consumption and support non-essential imports.

Some credits which were assigned for investments in strategic industries have been transferred to non-economic consumption goods. Khamooshi (1993:2) asserts that the total level of imports was not intended to meet the basic needs of

[100]- The amount of actual imports in three years of the plan (1990, 1991, 1992) based on the President's report has been more than these figures, about $30 billion each year. For 1990, it was estimated to be about $34 billion (Tavakoli, 24 May 1993:7).

people in this country and deserves justification. For example, about $1 billion worth of cars were imported into the country in 1992.[101]

The rationale for such imports of fully assembled cars was technology transfer. These imported cars were paid for from the foreign exchange resources which were supposed to be allocated to industrial investments. The steel company also created foreign exchange commitments for the government because of its expenditure of four times more than was planned.

Privatisation aimed to attract national capital directly into domestic investment and production, but instead investors directed their investment towards trade, imports of goods and their distribution. The foreign exchange adjustment policy helped traders and importers make a considerable profit. The private sector imported consumption goods on an unauthorised basis and thus maximised profit. The adjustment policies were not considered in a national framework. When the doors are open to foreign goods how can economic independence be achieved?

Liberalisation and Debt Problems

Financial liberalisation, as a part of the package of economic adjustment policies, was the major cause of increases in imports. Financial liberalisation was supposed to create a unified rate of exchange. However, the importers and traders, having considerable money supply, took advantage of this opportunity to obtain profits. This type of imports was considered as wasting scarce foreign exchange resources of the country. Some of the imported goods have come from the free-trade zones. The profit-seeking importers smuggled goods from the free-trade zones (FTZ)

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[101]– Abdullah Nowroozi (MP), Speech in Parliament, *Keyhan Havai*, No. 1059, 1 December 1993:9.

without paying customs tax. This is what has been called by the head of FTZ "a deviation from the primary goals of these establishments and the economic interests of the country" (Rezaei, 1993:8). FTZ which were established as the launching platforms for exports, changed to become an open gate for imports.

There have been delays in the repayments of the foreign debt caused by imports of goods and commodities. *Iran Commerce* (No.1, 1993:52) points out that the country's repayment of foreign debts is facing problems and a foreign debt of $30 billion has accumulated.[102] Some of the reasons that have caused delays in the repayment by the Iranian banking system to the foreign companies, according to the governor of the CBIRI, are the international economic recession, a fall in oil prices, the devaluation of the US dollar and the refusal of international monetary institutions to give long-term loans to Iran (*Keyhan Havai*, No.1053, 20 October 1993:31). Although the reasons are sensible, most of this debt could have been avoided by supporting the newly grown domestic industries and tapping the potential of a skilled workforce.

Debt is not a problem when it is used productively. The accumulated debt would be acceptable if it was used in a way that boosts export revenues or reduces the imports of goods from foreign countries. But there is no doubt that at least a portion of the borrowing were used unproductively on account of widespread economic mismanagement. The private sector has considered market demand rather than market needs while importing (Rudnick, 1993:276). Importing is a lucrative business but not for the government or the nation. It is only profitable for

[102]- The President stated that it was $27-28 billion *Keyhan International*, 9 June 1994:11.

the importer. If the government mobilised the available possibilities, there would not be an urgent need for borrowing and foreign investment.

Domestic Industries and Privatisation

The problems of domestic industries resulted from a lack of government support and the employment of inappropriate regulations. Regarding the support to domestic industries the policy must take the form of establishing appropriate tariff measures. The rate of tariff for some industries was 8 per cent which was increased to 18 per cent in 1994.[103] This policy of tariff protection of domestic production came very late when the open-door policy had made some industries bankrupt. The policy of importing in order to meet demand has been stopped recently. The argument is that in a country with a foreign currency shortage and having similar domestic production, this policy cannot achieve the desired economic goals.

The open trade policy has made trouble for newly grown domestic industries. Khamoushi (1993:2) asserts that uncontrolled imports inflicted heavy blows on domestic production as many domestically produced goods were left unsold. As a result, owners of some domestic productive companies and factories were bankrupt and a group of farmers and producers were disappointed because of trade liberalisation.[104] For example, one of the petrochemical companies closed

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[103]- Minister of the Heavy industries, "Customs Tariffs" *Keyhan Havai*, No. 1070, 16 February 1993, p.10. It has already increased.

[104]- "Internal Production Support and Irregular Import of Goods" *Keyhan Havai*, No. 1012, 23 December 1992, p.8.

down when facing the importation of similar products with lower prices.[105] The same problem faced rice farmers, the manufacturers of paper and some other domestic producers. The huge increase in imports in 1992 also caused some industries which were involved in fields such as textiles, to lose their competitiveness in the face of similar foreign commodities. This made them bankrupt or unsuccessful industries. The tariff policy has not been sufficiently applied as tariffs were lifted on a wide range of consumer goods (see Zaman, 1994:10).

The reasons for opening the market to foreign commodities could be twofold. First, enforcement of managerial reform in industries, and secondly to close these industries in favour of the foreign companies. However, as Ehsan (*Zamineh*, Vol.3, No.21, March 1993:23) maintains, import liberalisation can easily make small productive units, which are not able to maintain competition with foreign products, bankrupt. Hence, a monopoly situation is created for the MNCs or those domestic companies which are dealing with MNCs. These mechanisms of liberalisation was applied under the guise of a managerial improvement policy. It seems that the intention was to replace domestic industries since the foreign competitors naturally are interested in obtaining more market share. Rundick (1993:278) refers to an expert pointing out that prospective foreign investors are watching how potential Iranian partners adapt to the new situation, whether companies they have in mind are going to survive or not. Foreign competitors benefit from the bankruptcy of domestic industries.

105- "Internal Producers look to the Government for Support" *Keyhan Havai*, No. 996, 2 September 1992.

Advocates of the market mechanisms claim that these industries, without government subsidies, cannot survive against foreign competition. Therefore, they suggest, closing these industries will serve the nation and those of the under-privileged group of society because the government will not have to pay further subsidies to these industries (Imami, 1993:18). This reveals an apparent ignorance of the economic advantages of domestic industries and the necessity of their conditional support against foreign competition. The reasons for the inability of some domestic industries to compete against foreign products are not examined either.

There are reasons for the inability of some domestic products to compete against foreign products. One of the reasons is the lack of productivity and efficiency of the production process, some of which is related to technology and managerial factors. Another reason is often the artificially low prices of the imported goods. Foreign exporters usually use the device of "dumping" to undercut the domestic industries of the country. The responsibility of the government in this situation may include supporting domestic industries by regulations and tariffs and by encouraging them to make themselves more competitive and more efficient in a long-term plan.

The increase of imports conflicts with the privatisation process. When a PE is to be offered to the private sector, there is a need for an assured internal market for its products. Importing products similar to domestic products causes potential buyers of PEs to be reluctant, since the foreign products are often of better quality. The circumstances of a developing country like Iran are not compatible with allowing unlimited imports without any concern about their effect on domestic products.

6.2.2 Subsidiary Problems

These are problems concerned with the consequence of transferring power from government to the private sector. Some authorities are concerned about transferring assets to incompetent people. For example there is a statement that says:

> today the economic power is being transferred from the government to the people. If this power is settled in the hands of people without competence and commitment, then the stability and existence of the system will be in danger.[106]

There is also concern as to the consequences of dependence on the global economy, domination by dishonest individuals or technocrats, divestiture of public assets and the problems of consumers and workers. These issues are examined below.

Dependence on Global Economy

There is an argument that the movement towards economic restructuring and PE reform has been mainly impelled by the global economy. This argument alleges that world powers do not intend to cooperate with Iran unless they are allowed to influence its economic system, although the Islamic element in the government has, however, sought to limit external influences. Some developed countries seem not to be interested in dealing with Iran in an equal and just manner (Keyhan Havai, No.996, 2 September 1992, p.2).

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[106]– Mohsen Rezaei, in "Amalgamation of the Army Forces" *Keyhan Havai*, No.992, 5 August 1992, p.10.

Islamic groups argue that dependency on the global economy is not reasonable especially when sanctions against Iran are continuing, the establishment of a power station is under sanction by Germany and Iranian properties and assets are under confiscation in the USA. Askari (1994:54) maintains that the USA's policy has had a negative influence on Iran's attempts to gain direct foreign investment, advanced technologies and international loans.

Therefore, Iran should establish its own approach to reform. Although, in analysing the current structural adjustment policy, which includes privatisation program, Amirahmadi (1992:17) states:

> the government's current stabilisation and structural adjustment policies did not include measures to increase public participation and self-sufficiency or reduce the widening social disparities in the country. Instead, they placed a focus mainly on concentrated economic growth and the nation's reintegration into the capitalist world economy on the basis of conditions set by the World Bank and IMF.

Another criticism concerns the inconsistency between the privatisation policy as it is applied and the realities of the economic system of the country. IRI does not follow a capitalist economic system. Therefore, the market system cannot be utilised to encourage competition and an unregulated capitalist economic system is not compatible with social justice (Amirsheghaghi (MP), 1994:24; see also Chapter 1). Nevertheless, the pragmatist government may wish to abandon control of the international policy of the country, accept reintegration into the capitalist world and abide by world market rules and regulations. While the government may have accepted such an immense policy shift, it will have a hard time selling it to the Islamic radical factions, Parliament and society.

Domination of Incompetent Technocrats

There is concern about the dependence of government policy-making on the advice of incompetent professionals. The advice of professionals on sophisticated affairs such as privatisation are necessary, and it can be helpful and fruitful. However, as *the Economist* (No.7809, 1994:42) and *the Middle East* (No.224, 1993:27-30) express it, the appointment and reliance on Western educated technocrats to push through reform is a cause for concern in Iran. The concern emanates from specific situations where they try to impose Western ideological beliefs or advocate benefits for a special group while ignoring the public interest and the benefits to society as a whole.

Some technocrats, in fact, offer only one option to policy-makers, instead of showing different alternatives and having an honest consultation (Amirsheghaghi, 1993:8). On the other hand, unlike the situation in Western countries, in Iran these experts are not responsible for their professional views. In cases of failure, the planner will not be held responsible.

For example, some technocrats in Iran recommended the creation of a competitive environment by allowing imports. They do not accept any intervention by government in the export and import of goods. They do not accept the idea of economic competition limited to national framework (*Paper of the Iran Chamber of Commerce*, No.6, September 1992:21). They think about international competition, without attention being paid to the primary domestic competition among producers. In the process of privatisation, these technocrats' preferences for relying on the market forces to determine industrial winners and losers means a loss of government control over the economy. Relying on foreign institutions to draw up their policy and deviating from the Constitution are two aspects of the performance of technocrats in Iran.

Divestiture of Resources to a Small Group of the Society

Another cause for concern is the divestiture of PEs to a small number of people. There are doubts about the effectiveness of selling a PE to a few investors as a way of achieving managerial and economic goals.

On the other hand, participation of the people in economic affairs is advanced as one aim of the privatisation policy .[107] There is a reference to the advice of Imam Khomeini in which he requested the then government to allow greater participation of people in economic activities; that advice called for *people's participation*. For example, the chief of Iran Chamber of Commerce stated that the government intended to transfer all the shares of the PEs to the people by March 1994 to popularise the economy (Taberestani, 1993:24).

Apparently, many competent managers of PEs can not afford to purchase the shares of privatised enterprises without financial assistance.[108] Thus, one objective of transferring PEs to a competent private sector to improve efficiency will not be achieved. People's participation in PEs is similar to the concept of people's capitalism and differs from surrendering wealth of the nation into the hands of a limited group of people in society. People's participation requires a mechanism which not only encourages but also helps people to buy public shares and assets. Therefore, there is a need for credit institutions to provide financial

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107– Interview with Mortaza Nabavi (MP), member of the Plan and Budget Commission on 29 July 1993. (Iranian date 25-5-1372), Tehran.

108– *Rasalat*, 26 January 1992, p.5.

assistance to competent people so that they can obtain a fair share of the profit of their enterprise. As well, the country needs a firm system of regulation and monitoring.

Participation of the vast majority of the society has not been realised in the privatisation program of Iran. *Ta'avon* (No.22, July 1993, p.5) maintains that it is simplistic if participation of a small privileged group of the society is considered as people's participation. Those who are able to buy the valuable current establishments can not be considered to be representative of society. Sattarifar (1993:6) argues that participation by individuals (not a few specific individuals who are introduced as private sector entrepreneurs and passed off as representative of the people) has not been realised in the privatisation process. It is argued, therefore, that the transfer of public assets to small groups of individuals needs more care if the interests of society as a whole are to be preserved.

Furthermore, some PEs have gained valuable assets due to their characteristic of being in public ownership. The argument is that it is unfair to give these valuable assets at a low price to the private sector and that selling these assets is a licence to capitalists to print money. However, some experts seek to justify this licence. The advocates maintain that this licence for the private sector is a reward for their investment in productive activities, thus preventing expansion of unproductive and service activities. They maintain that this licence is given in return for the creation of efficiency and productivity, which is in the public interest (*Paper of the Iran Chamber of Commerce*, No.6, September 1992, p.22). From this point of view privatisation leads to equity through a laissez-faire policy.

However, some privatisation programs were in conflict with the objectives of privatisation. For example, after some industries were transferred to the private sector, the new management sold the land and the properties. Such actions are contrary to the objectives of privatisation (*Keyhan Havai*, No.1086, 22 June 1994:26). The problem arises where the government aims to sell PEs in rush.

Since the beginning of the privatisation debate in Iran, attention has been focused on the lucrative public companies, factories and properties. Razai (1994:8) asserts that originally it was claimed that the unsuccessful PEs would be offered to the private sector, but it was the profit-making companies which were in fact transferred to the private sector. The loss-making enterprises remained in the hands of the government.

Reduction of the Role of the Government

There is a concern about the role of government in economic adjustment. The assumption by the advocates of the adjustment policy is that the government should not have any role in the adjustment policy. This opinion is promoted by the private sector and its supporters in Parliament and the board of Ministers. The role of the government is considered to be confined to policy-making and functions such as tax collection.[109] This movement towards "laissez-faire" policy is a matter of concern in this respect.

The reason for the concern stems from a shift of power from the government to the private sector. The private sector tends to take economic power

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[109]– Interview with M Bahonar (MP) and member of Plan and Budget Commission of Parliament, 31 July 1993; Interview with head of Chamber of Commerce, Industries and Mines, 9 September 1993, Tehran.

into their own hands in order to remove the obstacles to profit-making. The experience of the Iranian society has shown that the public interest cannot be protected without an interventionist government. For example, from the beginning of the "adjustment policy", up to 27 May 1994[110], the government did not intervene and let market forces and so-called "economic control" dominate the market. However, the pressure of problems made the government reconsider and restore some administrative control and intervention in the economy, although it was late.

Nevertheless, the private sector enterprises which were involved in imports and trade activity, could take advantage of this situation. The new situation caused an increase in the price of foreign goods with the result that importers and traders would make greater profits from goods they already had in stocks. The problems of the period of adjustment policy were mostly the result of the increasingly dominant role of the private sector in the economy and the decrease in the role of the government.

The problems of debt repayment, increase in imports, severe reduction in the value of the domestic currency, and so on obliged the government to intervene and exert "administrative control". These new directions have been judged to be in conflict with the adjustment policy (*Keyhan International*, 14 July 1994:3,4). However, it was the consequence of the implementation of the adjustment policy which obliged the government to intervene to prevent further deterioration of the

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110- In 27 May 1994, the Market Regulation Committee under President Rafsanjani, in line with its previous steps to limit the demand for exchange and to control exchange fluctuation, made a 14 point decisions (*Keyhan International*, 2 June 1994:11).

economy. The new decisions were mainly made to reduce the demand for foreign exchange and thus to reduce imports.

Consumers' Concern

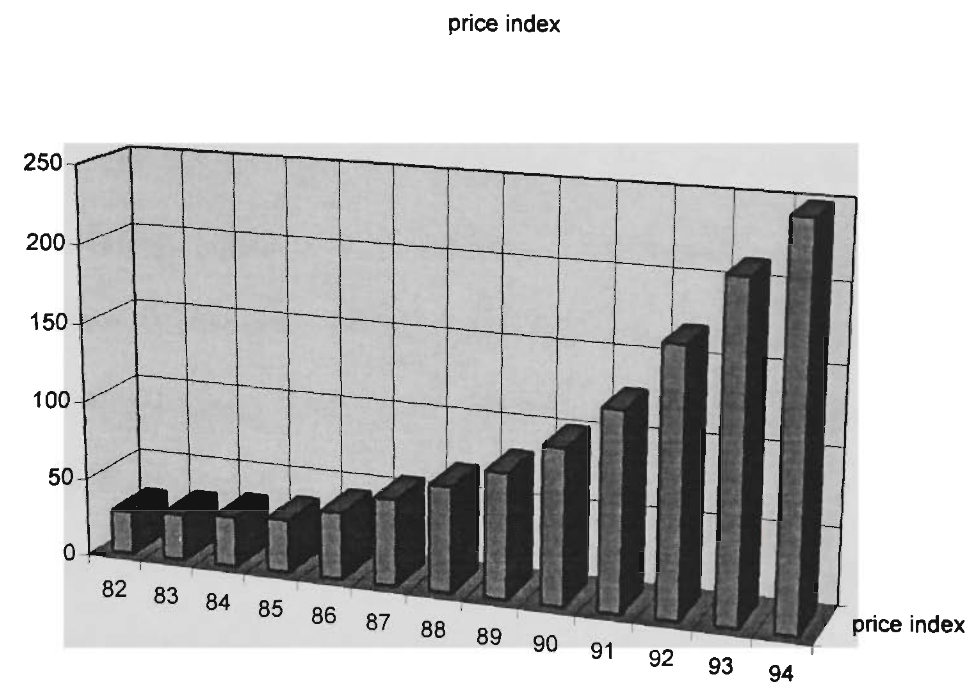
Consumer's concern were related to the increase in the prices of goods and services. One reason for price increases was the removal of monitoring and control mechanisms of prices by the government. The private sector's argument is that government price control on goods or services is not compatible with the market-based economy. The stated reason is that the competition which is created by market forces will produce an appropriate price for these goods (*Paper of the Iran Chamber of Commerce*, May 1993, p.6).

On the other hand, with problems of lack of foreign exchange and the necessity for imports of vital and essential goods, it is not possible to create competitive conditions leading to appropriate prices. Other issues such as collusion among the merchants prevent low prices in favour of consumers. Thus the trend is against consumers' interests.

The rate of inflation was very high during the FFDP (*Keyhan International*, 4 August 1994, p.6,7). In spite of the stated growth of production, the price index of consumer goods and services in Iran reached a figure of 256.2 in April 1994 (1990=100) (Figure 4.1). The argument is that nothing can erode the achievements of a nation more swiftly than inflation which brings hardship, deprivation, and hopelessness (*Keyhan International*, 3 October 1994:3). This is specially true in view of the fact that social justice - at the heart of which lies economic justice, and a fair distribution of resources - was claimed to be the core of the Republic's declared plan of action.

Figure 4.1 Price Index of Goods in Iran During 1982-94.

	price index
82	27.6
83	29.8
84	32.1
85	34.4
86	43.1
87	55.9
88	68.1
89	80.7
90	100
91	126.6
92	168.9
93	211.7
94	248.3



The general attitudes of the society are at odds with the reform process. The dissatisfaction of the society is said to be based on the increase in the prices of goods and services (*Paper of the Iran Chamber of Commerce*, No.6, September 1992:19). However, this judgment of the society arises from a lack of certainty as to the intentions of the private sector and the authorities who are implementing the reforms. Increase in prices of goods and commodities resulting from the supply-demand gap has created a negative image of the privatisation program.

Society is not satisfied with the economic adjustment policy. The presidential election of 1993, as well as the vote of confidence in the responsible Minister indicates this point. The President obtained 62.87 per cent of the votes in the presidential election of 1993 (Zanjani, 1993:15). However, in the previous election he had obtained more than 94.51 per cent of the votes. Parliament did not give a vote of confidence to the Minister of Economic and Finance Affairs. He was the only minister who did not get the appropriate vote. He was the most prominent minister dealing with the economic adjustment policy and privatisation.[111] Both these events were blows to the economic adjustment policy. Further replacements of personnel have also occurred during the process of approval of the SFDP in Parliament.[112]

Criticism has also come from the leader of the IRI. In a meeting with the President and the Board of Ministers, the leader of the IRI warned against the influence of the idea of liberalism in economic affairs. He said:

> a liberal (market) economy is the expression of the Western countries, and we are not going to follow them. On the contrary, we should follow a correct Islamic based procedure in the context of our society and our system to decrease the burden of the people.

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[111]– It is necessary to mention that, in Parliament, Ghafar Ismaili(MP) had stated that the change of the responsible authorities of the Ministry of Finance and Economic affairs was a positive response to public opinion(Keyhan, No.14825, 25 July 1993)

[112]–Dr Tabibian, the deputy president of the Plan and Budget Organisation (PBO) who had a key role in designing the economic adjustment policy resigned. He did not attend any interviews with the mass media in spite of his sensitive role in designing and implementing the economic adjustment policies (*Keyhan Havai*, No.1098, 14 September 1994:4).

Dr M Adeli the governor of the CBIRI was replaced by Dr Mohsen Nourbakhsh, Former Minister of Economy and Financial Affairs. Dr Nourbakhsh was appointed as the new Governor of the CBIRI during a cabinet meeting chaired by the President (*Keyhan Havai*, No.1099, 21 September 1994:14).

Finally, Massoud Roughani Zanjani the Vice President and the head of the PBO resigned in August 1995 and was replaced by Dr Mirzadeh (Payam-e-Ashena, No.7, July 1995:2).

He suggested:

> then, we should challenge those who discourage monitoring and control of prices in order to make prices high and to make an artificial shortages of goods thus hurting the people.

He directed the government to act powerfully on these issues.[113]

This is why Mohammad Arif (1993) arguing that privatisation in a developing country cannot solve the problem of distribution in the foreseeable future, recommends that Iran's goal of industrialisation should not be at the expense of its environment.[114] This environment has been largely affected by the privatisation program.

Workers' Concern

There is an attempt to repeal the *Labour Law* which is considered to be one of the obstacles to economic adjustment. The criticism by the private sector is that the *Labour Law* impedes employment since it does not allow the dismissal of workers and thus, they say, it is against the long-term employment of workers.[115] As well, it is argued that this law is one-sided and benefits the workers and should be revised[116], as it has not given authority to the employers to dismiss individual workers who are inefficient. The advocates of this argument suggest giving this authority to employers. Meanwhile, they request that the government pay social

113- "In the meeting with the President and the boards of ministers" *Keyhan Havai*, No. 996, 2 September 1992, p.3.

114- Mohammad Arif is Deputy Dean of the Faculty of Economics and Management, International Islamic University of Kuala Lumpur in Malaysia.

115- Interview with the head of the Chamber of Commerce and Industries and Mines, 9 September 1993, Tehran.

116- Head of the Organisation of Industries of Foundation of Infirmed (Sazeman-e- Sanayea-e- Maaloolin), *Salam*, No. 584, 30 May 1993, p.15.

security and other rights to the workers (Ranjbar Fallah 1993:47).[117] It is argued that these proposals are attempts to create an appropriate environment for private sector involvement in the productive activities in the SFDP.

The campaign against the *Labour Law* began with its enactment. The law emphasised the provision of social justice for the support of workers. However, problems associated with the implementation of the adjustment policy and weak management have adversely affected the workers.[118] A change in the *Labour Law* would mean liberating the owners of capital so that they can act with a free hand in labour matters. To that end, the suggestion is that the workers and the labour councils should be prohibited from participating in decision-making and consultation about labour affairs. It is said that illegal actions are taken to dismiss and discharge workers in some industries, while official inspectors of the Ministry of Labour are prohibited from intervention on the basis of the *Labour Law* (Shams, 1992).

There was no suggestion made, in the SFDP, that the *Labour Law* be repealed and social security abolished (Fekri, 1993:8,24). Nonetheless, the name of the Minister of Labour and Social Affairs was excluded from the list of the members of the Commission on Privatisation in the SFDP. The Minister had argued that the *Labour Law* was perfect and free from any defects, because it

[117]– The Article 21 of the *Labour Law* has predicted the termination of the work (work contract) based on the: 1- death of the worker; 2- retirement of the worker; 3- total disability of the worker; 4- termination of the contract; and 5- resignation of the worker (*Labour Law* 1990, Article 21).

[118]– Elyas Hazrati (MP), *Keyhan Havai*, No.1059, 1 December 1993:24.

protected the genuine rights of both employees and employers (*Keyhan International*, 24 August 1994:2).[119] By excluding the Labour Minister from the Commission on Privatisation, the way is paved for a unilateral movement towards privatisation in which important provisions of the *Labour Law* are ignored.

6.3 Future of Privatisation

6.3.1 The Letter of the Leader

The intervention of the Leader of the IRI in the process of economic reform and adjustment is a turning point for privatisation programs in the next stage. In a letter to the President, the Leader of the IRI cautioned the government about the future of economic reform.[120] In this letter the government is advised that the framework for the policy-making process in SFDP and privatisation of PEs should take into consideration the following points.

First, to acknowledge revolutionary values, and uphold and back up these values with the appropriate financial resources and public sector services. To ensure that priority is given to those who utilise resources for the development of the nation, the promotion of revolutionary and Islamic aspirations, and to those who have made sacrifices to consolidate the Revolution and the Islamic System such as the former war combatants and members of Basij (volunteer forces).

Secondly, to emphasise national production especially in the agricultural sector. The aim is to supply the basic needs of the society, to reduce imports of

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119– Hossein Kamali Minister of Labour and Social Affairs believes that "Iran's system of labour is based on justice, humanity and better use of human resources of the IRI.

120– Some parts of this letter have been explained under the heading *social justice and privatisation* in Section 4.

consumer items and unnecessary commodities, to improve the quality of domestically-produced commodities and to promote non-oil exports. For this purpose, some administrative reform policies are proposed.

Thirdly, to undertake managerial reform in administrative and judiciary services. The aim is to improve the performance of programs and to ensure their consistency with the goals of reducing the burden of administration. The methods to be applied are improving efficiency, employing competent, trustworthy and committed executives and drafting necessary legislation including monitoring systems to rid the administration of such moral and ethical flaws as wasteful usage of time, bribery, indifference towards personal duties as well as bureaucracy.

Fourthly, to promote social sector services to encompass such areas as public and judicial security, national culture, public education, public health and medical care, higher education and scholarship, environmental protection and physical education.

Fifthly, to move towards economic growth without sacrificing the growth of morality and virtues in society. To ensure this objective is achieved, he recommends all executive and propaganda *tabligh* operations should be oriented to promote true beliefs, revolutionary values, human ideals, creation of order, discipline and self-sufficiency as well as reduce lavish expenditure and extravagance. The Leader also made a plea for the improvement of morality, discipline and frugality.

Sixthly, to observe the economic objectives of the reform to make the nation self-sufficient on the basis of consumption requirements, and to complete unfinished projects, to ensure domestic production for defence purposes and to prevent investment in projects that are inconsistent with these goals and wasteful of capital or resources. To achieve these objectives, the Leader recommends that priorities in investment on infrastructure and other projects should complement the production chain for local and export purposes. The objectives of self-sufficiency and preventing the wasteful use of resources are the primary economic aims of the Constitution of Iran.

Seventhly, to ensure that the largest sector of the society participates in and contributes to national construction efforts, and that administrative measures for privatising PEs take the following into consideration:

A. Ensure that transfer to the private sector will promote the goals of the National Development Plan [SFDP]. Care must be taken that privatisation as a means to that aim not become a goal in itself.
B. Ensure that privatisation program is within the framework of the Constitution.
C. Ensure that such programs do not threaten national security or the sovereignty of Islamic and revolutionary values.
D. That they do not adversely affect the sovereignty of the Islamic government, or the right of the people, or create monopolies.
E. That they aim at healthy management and sound administration of business affairs.

The aim of coordinating privatisation with the national economic plan and the Constitution was emphasised in this part of the letter from the Leader of IRI. Other aspects in the letter included: adopting the necessary devices for ensuring proper and close monitoring of the plan (SFDP), and preventing adoption of arbitrary personal or sectoral practices; steps to strengthen the defence capacity of the nation as far as necessary and to be consistent with adopted policies; and to observe specified considerations in the adoption of monetary and fiscal policies.

Finally, to comply with the declared policies of the IRI in the application of its foreign policy. This part of the letter points to articles 152-155 of the

Constitution Law regarding Iran's foreign policy (*Keyhan International*, Vol. 14, No.3753, 21 December, 1993, pp.1-2).

The letter of the leader of the IRI points to a concern for administrative reform based on cultural and social values and to clear the way for an approach to economic reform that is directed towards effectiveness and efficiency and the public interest. In this version of the privatisation program, the mission is social justice. The priorities have been identified and an emphasis has been placed on the goals rather than the means which have been employed so far. Aspects of suggested economic reform include self-sufficiency, completing the production chain, and people's participation. Also the Leader's advice warns against dependence on foreign loans. This advice aims to prevent deviation from the accepted goals of society.

6.3.2 The Second Five Year Development Plan (SFDP)

The SFDP was offered to Parliament for approval in 1994. The general aims were continuation of the policies and completion of the FFDP. The draft aimed to: remove executive and implementation difficulties; deepen the adjustment policies with the goal of reforming the economic system; rely on market mechanisms; activate capital markets; unify the rate of foreign exchange; and deregulation.[121]

The advice of the Leader has made some critical changes compared to the first draft of the plan, although the main titles of the privatisation program conform to the previous adjustment policy. Social justice is shown as one of the missions of the SFDP. Some procedures were also introduced to ensure the

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[121]- Massoud Roghani-Zanjani, the Vice President and the head of the PBO, *Jomhoori-e-Islami*, No.4045, 20 May 1993.

accomplishment of social justice. Support for people who made sacrifices during the former war (Issar'garan), such as the volunteer forces (members of Bassij) and former war combatants as well as under-privileged groups in society is also referred to in the approved plan. Nonetheless, these objectives, need to be implemented in practice without contradictory actions.

General policies on privatisation included in the provisions of the SFDP are:

(i) reduction of the burden of the public sector through the transfer of some activities of PEs to the private sector and the cooperative sector;

(ii) continued acceleration of the transfer of PEs and companies under the control of the government to the private sector; and

(iii) revision of the managerial system of the PEs and changing the current procedures in policy-making and monitoring of these companies through the general assembly and superior council and establishment of a more precise control on the performance of PEs (*Keyhan Havai*, No.1096, 31 August 1994:25).

Three changes have been made in contrast to the FFDP. First, the cooperative sector which is one of the basic economic sectors of the IRI, is added to the private sector. This sector was largely ignored during the FFDP. It did not grow and, therefore, it was not able to compete with the private sector.

Secondly, in the SFDP emphasis is placed on the transfer of *activities* of PEs to the private sector or the cooperative sector. These types of privatisation programs are mostly pertinent to strategic PEs that the private sector cannot afford to invest in. Some activities, such as those found in the areas of trade, production and employment are to be contracted out to the private sector. This direction bypasses the Constitution under which the government is required to have control and ownership of strategic and major PEs. The undertaking of these activities by the private sector may lead, in some instance, to a monopoly situation.[122]

Thirdly, managerial in PEs and in the privatisation process is emphasised. In this area, the government's aim is to undertake some corporatisation activities in order to prepare PEs for privatisation. As discussed earlier, during the FFDP loss-making PEs remained in the public sector while the most successful PEs were privatised. Through managerial reform, the government intends to prepare some of these companies for privatisation.

The methods of transferring PEs to the private sector are confined to tendering or selling shares through the State Stock Exchange. Comparing the methods applied in the FFDP, negotiation has been excluded. Negotiation had created protests and complaints as it was not monitored and hence cronyism and corruption was encouraged. Nonetheless, negotiation is allowed on occasions where the buyers are Issar'garan, i.e. former war combatants, or volunteer forces (members of Bassij). These groups are given priority to buy enterprises, through regulations which are to be provided by the Ministry of Economic and Finance Affairs and the PBO (*Keyhan Havai*, No.1097, 7 September 1994:25). However, the SFDP needs considerable coordination and programming in order to give practical effect to the formal statement.

122- The effects of this policy can be shown when the head of the "Inspectors and Supervisors on Distribution of Goods and Price Control" warned the Mobarekeh Steel Company and Isfahan Steel Factory (PEs) to stop selling products to a few specified private companies, as these companies had conspired to increase prices (*Keyhan*, No.15228, 7 December 1994, pp. 1-2).

The proceeds from privatisation will be submitted to the Treasury to be spent on completing unfinished projects which are introduced in the yearly budget. This is likely to allow completion of projects to be handed over to the private sector. The revenue from the privatisation program during SFDP can be expended in one of the five sectors included in the privatisation program. This will direct the funds to help more companies prepare for privatisation.

Other policies in the privatisation program will continue during the SFDP. The emphasis is on accelerating the implementation of privatisation. This indicates that privatisation in the form of selling public assets to the private sector has not changed significantly.

Some other steps have been taken towards privatisation such as:

(i) prohibiting ministries, government organisations and banks from establishing industrial and commercial units;

(ii) reforming registration laws to safeguard rights to industrial inventions, discoveries, innovations and intellectual, scientific and technical property;

(iii) merging the Ministries of Heavy Industries, Ministry of Industries, Mines and Metals, and Ministry of Commerce - the first two Ministries have been merged already;

(iv) leaving the equipping, operation and exploitation of the previously state-owned mines to the private sector;[123] and

(v) lifting the present limits in the field of production and distribution of goods and services including steel and copper (*Iran Commerce*, 1993:55).

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[123]- This is a type of leasing, contracting out, or selling mines to the private sector.

Finally, in terms of setting the prices of goods and services, the principle of demand and supply will be dominant and prices charged by utilities will be based on their cost accounting systems. However, any monopoly in the production and distribution of goods will be prohibited (*Jomhoori-e-Islami*, No. 4045, 20 May 1993, p.17).

In summary, privatisation to the stage it has been completed in Iran, is not, by itself, a policy for achieving independence from oil revenues. The growth of GDP and the improvement in performance achieved by some privatised entities is due largely to factors other than the privatisation program. Furthermore, significant concerns have been raised by consumers, workers and domestic producers about the lack of appropriate safeguards to protect them from the unanticipated consequences of the first stage of privatisation. Therefore, the dangers of further polarisation, debt accumulation, increased dependency, and a reduced standard of living must be addressed. However, it is contended that the SFDP is directed towards a realistic approach to the reform of PEs. The next section reviews the management and administrative reforms in PEs.

7 Reforms other Than Privatisation: Administrative and Managerial Reform in PEs

The administrative environment of PEs is the result of many years of administrative efforts and attempted reforms. In Iran, administrative reforms have been under consideration for a long time. Before the Islamic Revolution, administrative reform was one of the major reforms proposed by the Pahlavi regime. After 1979, the administrative system collapsed, changing the former basis of administrative relationships. Political reliability became the criterion for selecting bureaucratic personnel for senior positions. For this purpose, emphasis was put on piety and political purity rather than on technical competence. Although this considerably lessened difficulties at the beginning of the revolutionary government, it needed to be clarified, institutionalised and stabilised.

There was a gradual change during the debureaucratisation period of the first years of the new government, when attempts were made to locate problems and to solve them on the spot. This was accompanied by gradual changes from an emphasis on piety and political purity to an emphasis on professionalism in the selection of bureaucrats. This formed a new basis for administrative and managerial accountability which needed clarification and enforcement.

However, the administrative and managerial changes did not effectively enhance the performance of PEs nor the establishment of a comprehensive and continuous system of accountability. These were the circumstances in which PEs were prepared for privatisation.

This analysis seeks to clarify whether the current system of accountability is compatible with the expected performance of PEs. Before proceeding the rationale for the reform in PEs in Iran is examined.

7.1 Rationale for Reform

Reform of public administration was necessary specifically because of the confused state of bureaucratisation in Iran. After 1979, and during an early stage of debureaucratisation, the administrative system's lack of skilled managers was compensated for mostly by the selection of the most faithful and educated people in the country (Latifi,1992:22). They were accountable to the people, their ministers, and Parliament. However, in the period of bureaucratisation, no concern was shown about the selection of such managers. The spirit of selection of technocrats and experts outweighed the choice of faithful educated people such as those found in the Cabinet of Prime Minister Rajai. This was partly due to the serious need for reconstruction programs in the country. The other reason was the influence of conservatism and pragmatism which dominated the Cabinet and Parliament. This situation called for the establishment of a control system and a system of accountability which is vital to the success of reform.

Another reason for public administrative reform stems from economic dependence on oil revenues. The government compensated for financial shortages in many organisations by relying on *soft budget* resources. This created the problem of financial deficits when there were reductions in the prices or output of oil. Under such circumstances the Government was determined to make fundamental changes in PE management and administrative procedures to ensure PEs become more efficient and economical and thus less dependent on oil revenues (JAM, 1992:15). Administrative and managerial reforms in PEs which enhance their efficiency and effectiveness are, therefore, obvious choices for the government.

Managerial reform is needed to reduce expenditures and increase government revenues. The lack of an effective system of collecting taxes has also caused a reduction in the government's revenue. Furthermore, some ministries are buying goods and manufactured products from foreign countries while similar products manufactured in the country are seeking to gain customers.[124] This has caused complaints against the administrative and managerial system of the country.

Passaran (1993:73) maintains that if the mechanism for accountability, auditing, rewards and sanctions is inadequate, then such an organisation is without power or responsibility. Complaining about some managers of public organisations, one of the Islamic authorities asserts that "unhealthy management and relying on capitalists are root causes of unlawful actions."[125] He suggests that the system can be strengthened by coordinating and monitoring it closely and demanded an administrative revolution to overcome these problems (*Keyhan Havai*, No. 996, 2 September 1992:8). Among many areas requiring reform, managerial reform is one which has not been seriously taken into account.

According to the President, one of the serious problems that confronts the government is the existence of rules and regulations that slow down the flow of administrative work and hence causes discontent in clients (*Keyhan Havai*, No. 1012, 23 December 1992:23).

Therefore, the government needs to conduct fundamental reforms in these areas.

Privatisation implementation requires a perfect administrative and managerial system. Furthermore, problems in economic management which cause damage to the economy demonstrate the need for an accountable administrative and managerial system. For example, one of the factors which intensified inflationary pressures is said to be the lack of accountability in higher positions in Iran. *Keyhan International* (3 October 1994:2) asserts that executive fatigue and a

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124– General Director of Iran Kaveh company, *Keyhan Havai*, No. 1059, 1 December 1993:10.

125– Ayatollah Jannati, Friday Prayer Sermon in Tehran: *Keyhan Havai*, No.991: 29 july 1992:9.

shocking absence of accountability in higher places were the main factors causing inflation in Iran. The lack of accountability also stemmed from a lack of clear organisational structure and harmony in economic policy-making.

Some measures of reform have been carried out in the administrative area. For example, elimination of overlapping functions in different departments was achieved in some organisations. Some of the reform initiatives include a reduction of the time of processing activities such as issuing passports, driving licences, customs regulations and so on (*Keyhan Havai*, No.1063, 29 December 1993). Other reform alternatives include reduction of the size and the role of government, reduction of the overlapping functions of different organisations, decentralisation and delegation of authority to the provinces, and people's participation in management and control of public affairs. However, much remains to be done in managerial reform and only preliminary steps have been taken.

7.2 Administrative Reform in Iran

Before 1979, "administrative reform" was undertaken by the Pahlavi regime. It was soon forgotten however, and existed only on paper. Alimard (1992: 458) states that the administrative system of the Pahlavi regime was inadequate for development. He asserts:

> ...the structure of public bureaucracies and the administrative practices of the Iranian government were not entirely responsive to the needs of the country and quite inadequate to cope with the rapid pace of development.

As a result, the reform was doomed to failure. Farazmand (1991b:555) points out that the failure of administrative reform was due to the political system which encouraged bureaucratic problems such as corruption, duplication, over-centralisation, red tape and the like. All of these immoralities were functional to regime enhancement by providing means of employment, finding new members and means of control. One of the achievements of the Pahlavi regime's administrative reform was "organisation rigidity and inflexibility" which facilitated political control and served to maintain the regime (Sherwood, 1980: 415 cited in Farazmand, 1991b:555).

The administrative system adopted fundamental changes after the revolution. An evaluation of the impacts of the revolution on Iran's bureaucracy and civil service system serves to shed light on the question of the relationship between the revolution and the bureaucratic machinery of government.

The Iranian revolution was a general and popular uprising in which all segments of the nation participated. Its aim was to eliminate the Monarchy and to change fundamentally the economic and social system of the society. Furthermore, the revolution was directed against the bureaucratic machinery which had the primary function of maintaining the regime and helping its interests through constraints and control (Farazmand, 1991c:755). The popular expectation was that this bureaucratic machine could be smashed and reorganised in such a way as to make it accountable to public needs. This section analyses the process of administrative reform in post-revolutionary Iran.

7.2.1 Administrative Reform Phases

The administrative stages of post-revolutionary reform can be divided into four phases. In the first phase the new public sector was enlarged through the nationalisation of some enterprises. In this phase the highly centralised structure of the bureaucracy remained intact. The real power was exercised by the newly formed committees and councils in the civil service. These organisations were formed, following the leadership's command, by those whose aims were implementing major structural changes in the bureaucracy. The purpose was "to democratise the administrative system" (Farazmand, 1991c:756). Motivation to serve the society was strong. The morale of employees appeared high, and a sense of cooperation and revolutionary spirit added to the motivation of the middle and lower level personnel who implemented fundamental changes.

In the second phase (1979-82), the demand for fundamental changes in the socio-economic and political system resulted in the occupation of the American embassy. As a result, the provisional administration collapsed and a new revolutionary administration took steps to undertake basic changes in the society. The major events in this period included the presidential and parliamentary elections, the establishment of Majlis (Parliament), enforcement of legislation concerning production, further nationalisation of enterprises, the Iraqi invasion of the country thus necessitating war mobilisation activities, several military coups and other political events. It was "a turbulent period of life and death situation for the Islamic Republic of Iran" (Farazmand, 1991c:757).

Reduction of the role of the bureaucracy was the most significant impact of the revolution and a large number of independent grass-roots organisations originating in rural and urban areas arose to deliver public services. These were also engaged in developmental projects, and contributed to the defence of the country. Of these organisations, Komeeteh-e-Mahalli (the neighbourhood Committees) and Anjoman-e-Islami (Islamic Societies) in each village, office and factory were very active politically and administratively. Independent Nahadha-ye-

Enghalab (revolutionary organisations) became extremely effective in delivering basic services to the public and reaching out to the poor. They also effectively implemented a number of developmental projects throughout the country and promoted the revolutionary spirit among the population (Farazmand, 1989:190). Through a nationwide network of Bassij-e-Eqtessadi (economic mobilisation) and other organisations, rationed food was also distributed (Farazmand, 1991c:761). Without this network, many people would not have been able to obtain basic food items due to high inflation, the black market and the so called "economic terrorists" during the war and economic sanctions against the country. These organisations virtually replaced many bureaucratic organisations by performing many public administrative functions.

This administrative system was not well coordinated however. This was partly due to the revolutionary nature of many of these organisations which operated relatively autonomously and independently. One good example is the powerful and popular Organisation of Jihad-e-Sazandegi (Reconstruction Crusade), which gained a ministry rank in 1983. In many ways this fragmentation helped the revolutionary nature of the state and strengthened the capacity of the government to respond to internal and external challenges (Farazmand, 1989:190). Most of these organisations were anti-bureaucratic in nature and their administrative systems were characterised by speed, flexibility, and popular participation.

Choice of Accountable Managers

During the second phase of administrative reform process many high level managers were replaced by managers who were loyal to the government and Islamic principles (Entessarian, 1993:23). The choice of the right people to manage the authorities was considered to be all that was required to achieve success. The managers of PEs in this period were mostly chosen on the basis of criteria such as: "ceaseless effort and endeavour, intellectual and practical guidance and leadership, benefiting from the help of the self-sacrificing, trustworthy, faithful wise men" (Latifi, 1992:22). These criteria were specified by Imam Khomeini, and totally implemented, especially during the first ten years after the revolution. Sincerity, competence and being decisive were other criteria used to choose ministers. Based on these principles, the managers of PEs could overcome the problems of some nearly bankrupt companies whose managers and owners had left the country. New managers had a close relation with the ministers on the one hand, and the board of directors on the other, and they were accountable to both as well as the community.

This approach of choosing managers compensated for the lack of expert and skilled managerial teams. It lessened the problem the government had in administering various kinds of companies under its supervision. However, new managers faced real problems of widespread war before they could make a fundamental change in the productivity of PEs. Furthermore, training and recruiting managers in some PEs occurred rather late, and consequently slowed the progress of these enterprises.

The third period of the revolution (1983-9) involved a major shift in the direction of regulation of societal arrangements. The trend towards consolidation, stabilisation, and long-term planning was strengthened. The FFDP was approved by the Majlis (Parliament) in this period. The trend towards bureaucratisation of a large number of the independent grassroots organisations was the most significant change in the civil service in this period (Farazmand, 1991c:758-9). Parliament endorsed administration sponsored bills to include these organisations and thousands of their regional and local offices in the government's centralised bureaucracy. The purpose of this change was to prevent the misuse of power by some agencies which conflicted with the attitudes of some professional personnel who were loyal to both the revolution and the leadership.

As administrative performance has slowed down, public discontent with the bureaucracy has grown. One can argue that this problem is caused by the revolution, which interrupted the smooth functioning of established institutions. However, critics blame the old bureaucracy because it was corrupt, inefficient, and oppressive. "Pahlavi administration was administratively corrupt, managerially inefficient, and politically repressive" (Farazmand, 1991a:268). That was one of the reasons why one target of the people's revolution was the old bureaucratic machine.

During post-revolutionary period, the administrative discipline and values were considered significant under the Islamic government.

Farazmand (1991a:269), states:

> ... public administration in post-revolutionary Iran has been strengthened as the theocratic state under the Islamic Republic, which recognises no separation of religion and politics, has paid much attention to political, economic, and administrative independence.

This created an enterprise ideology on the basis of Islamic values in which nepotism, sluggishness, carelessness about public assets, and so on, are disapproved. [126] Control and accountability in Islamic ideology which start from

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126- Ayatollah Yazdi's Friday Prayer Sermon: *Keyhan Havai*, No.992, 5 August 1992 p.9.

personal control and personal accountability, extend to the area of public administration and public affairs as a whole (Bagheini, 1993:19). Therefore, it is imperative that an Islamic community shows overall control in the spiritual, ethical and moral sense at all levels.

The change in the bureaucratic system was revolutionary and not guided by the previously established value system in public organisations. Developing revolutionary values creates healthy communication between the administrative system and clients. There was the expectation of an accountable system that responds to revolutionary and cultural values of the society as well as the disciplinary aspect of the bureaucracy. In such a system corruption can be eliminated. This was the position pior to the rebureaucratisation period.

Administration and Privatisation

The fourth phase of administrative process accompanied by privatisation drive after 1989. Privatisation of many governmental functions and organisations has been pushed through in this phase. Some PEs have been returned to private individuals, many of whose large properties were dispossessed during the early years of the revolution. These include big landowners, industrialists and contractors.

However, the privatisation program was accompanied by rebureaucratisation, although both these policies are consistent with each other. Joint venture policy has been resumed and public financing of business continues through subsidies to the returning large landowners and industrialists (Farazmand, 1991c:763). The trend of privatisation was to solve some problems of economic inefficiency and the growing bureaucratism in administration.

The financial push towards privatisation emanates from the reduction of oil revenue at the present time. The government requested the managers of PEs not to look for *soft budgeting* policies from the government, they must make their enterprises profitable or privatise them. This occurred while many administrative and legal issues for preparing these PEs for privatisation remained unresolved (Entessarian, 1993:25).

Nevertheless, organisational and administrative reforms have received considerable attention and this encouraged the government to take other reform initiatives in addition to the privatisation program. However, this demands a genuine and fundamental reform to be introduced and implemented otherwise, the past and current characteristics of the self-serving bureaucracy will persist and cause major disappointment and frustration among the nation (Farazmand, 1991a:269).

7.2.2 Administrative Environment

The System of Control and Accountability

The system of control over the public sector is exercised through different mechanisms. These mechanisms have been defined by the Constitution and by subsidiary rules and regulations. They dominate the public sector and the administrative system from top to bottom. For example, there is an article in the Constitution which gives control over the Leader's property, even though he has the highest position in the country.

Article 142 of the Law emphasises that:

> The assets of the Leader, the president, the deputies to the president, and ministries, as well as those of their spouses and offspring, are to be examined before and after their term of office by the head of the judicial power, in order to ensure they have not increased in a contrary manner to Law (Constitution:85).

Implementing this article, Imam Khomeini sent a document listing his property to judicial authorities. This was admired by the nation as an example of Islamic leadership and was acknowledged as a guarantee for uprightness of the high level of officials in the country. Nonetheless, during rebureaucratisation and economic adjustment it has not been repeated by others, at least, openly.[127] Mechanisms of administrative accountability in Iran are legislative, financial, efficiency and effectiveness accountability.

Legislative control is exercised by the Majlis (Islamic Consultative Assembly, Parliament) through legislative and budgetary processes. Hearings, investigations, and approval or denial of proposals or bills submitted by the executive leadership are other instruments of legislative control. Monitoring of PEs is also delegated to the parliamentarians (through questions to the responsible minister, debate, or parliamentary committees) or to supervisory bodies appointed by Parliament. In Iran, as in any other system of parliamentary government, ministers have the responsibility to attend Parliament and answer questions put to them by the representatives of the people about their functions and performance as well as that of their managers and staff. Parliament also has a committee to investigate complaints about areas under their authority.

127- Mahdavi Kermani (MP), *Keyhan Havai*, No.986 24, June 1992 p.8.

Parliament represents the shareholders of government companies and has its own auditor in a committee of experts. A special court assisted by auditors and accountants is responsible for investigating the ministries and PEs and is required to report to Parliament. The budget law requires the Audit Organisation, which is under the authority of the government, to offer a report to the general assembly regarding the decisions of boards of directors of PEs and their executive procedures to this special Accountancy Court and to the Budget and Plan Commission of Parliament every three months.[128] In another part of the law, the government is obliged to include all PEs and companies in which more than 50 per cent of their shareholdings or assets belong to the government, in the budget bill. Some ministries and institutions are under special auditing, but this does not exempt them from reporting to Parliament and the special court.

Another mechanism of accountability is fiscal accountability and organisational control. This type of accountability is currently in operation in Iranian PEs. PEs such as telecommunications, post, electricity, irrigation, shipping, aviation, railroads etc., which are dependent on a ministry, have to be audited by an auditor from a section of the Ministry of Economic and Finance Affairs located in that office. The auditor also controls all financial assets and their replacements and reports any financial corruption, if there is any, to the Bureau of Accountancy. PEs which operate as companies have their own auditors. They are also audited at the end of the year by the Audit Organisation. Some companies have their budgets approved by the PBO, and their operations controlled by the same organisation as well. The INIO, which consists of some nationalised

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[128]– *Keyhan Havai* (1992), "Budget Law for 1993" p.24.

companies, is not involved in the government's budget. However, it records its income and its expenditure and is under the control of the Ministry of Industries.[129]

Efficiency accountability is another mechanism of control which is rarely applied to Iranian PEs. There is as yet no system of "efficiency audit" to supplement the financial audit, though some operational monitoring is in place in PEs involved in industrial activities. The difficulty of management evaluation and its requirements for skilled personnel can be stated as the reason for the lack of efficiency monitoring. Management evaluation is a difficult task and requires highly skilled professionals. This type of monitoring also requires the analysis of organisational and technical matters (other than the financial matters embraced under financial and fiscal accountability).

Effectiveness accountability is a kind of accountability which is rarely considered in Iranian PEs. Costs and outputs are not compared to each other specially when the program or enterprise has qualitative objectives. In those cases the cost is nearly always much higher than the output. Attempts are being made to improve the performance and minimise the costs of the inputs. However, the structural problem of a lack of skilled and expert workforce is slowing the improvements.

There exist other mechanisms for accountability, control and monitoring the public sector including PEs, such as:

[129] - Interview with Mr M. Babai, an accountant and expert in accountancy, 21 March 1994, Swinburne University, Melbourne.

(i) the control by the leadership's representatives that operate through permanent, active participation at the top of every single agency and organisation of the government;

(ii) executive control by the President through a wide range of budgetary and policy mechanisms;

(iii) judicial control which is exercised through institutions such as the High Council of Judiciary, the Supreme Court, the Court of Administrative Judges and so on (Farazmand, 1989:193).

The inadequacy of the system of control and monitoring during the last ten years has been criticised by the public. The public expectation is that this problem should be solved by sanction mechanisms for infringements in the public sector. This is especially important during ministries' involvement in reconstructing the country. Some officials' motivations have caused a tendency towards foreign contracts. The existence of a percentage or commission on foreign purchases resulted in temptation to buy foreign goods and services, in spite of the domestic availability of some of these goods and services.[130] Some PEs have spent hard currency on buying trucks or parts of factories. An example of this is purchasing 1,000 trucks for the Ministry of Oil, while similar products are being manufactured in the country. Foreign debt and the problem of balance of payment (BOP) mostly are consequences of a lack of managerial control in IRI.

In order to establish a performance appraisal system, a plan has been approved by the Supreme Council of Administration to be implemented as from

[130]– "Fastening the ways of temptation" *Keyhan Havai*, No. 1056, 10 November 1993, p.1&8.

June 1993.[131] This employee evaluation will affect annual increase in salary, promotion, and appointment to managerial posts. An information system will be established to coordinate and to program human resource and organisational improvement.

In addition, another law required a Board of Control to be established in organisations. The law is pertinent to examining infringement matters. The article covering administrative infringements, which the Board is to investigate, includes 38 matters, some of which are: (i) breaking rules and regulations; (ii) causing clients' dissatisfaction; (iii) extortion; (iv) embezzlement; (v) lapse from duty during office time; (vi) negligence in keeping public funds, properties and documents or causing damages to them; (vii) receiving money other than as sanctioned by the rules, as in bribery; (viii) misuse of status and administrative position; and (ix) discrimination, showing partial views, or non- administrative relations in the execution of rules and regulations against clients.[132]

7.3 SFDP and Administrative Reform

Some reform initiatives have been prescribed for the administrative system of the public sector in the SFDP. These are the first steps to be developed in the future. The government's principal aim in connection with these administrative procedures is to accomplish the following:[133]

131– "The Superior Council of Administrative", *Salam*, No.592, June 1993:1-2.

132– "Approving Creation of the Board of Control of Infringement by Parliament" *Keyhan Havai*, Nos. 1054-1055-1056, 27 October 1993, 3 November 1993 and 10 November 1993, pp.25-28.

133–"Procedures for the SFDP of Islamic Republic of Iran" *Jahan-e-Islam*, No.646, 23 August 1993:3.

(i) prevent centralisation through accurate separation of the government's functions;
(ii) revision of the structure of duties of provincial governors and county governors;
(iii) promoting the sovereignty role of the government and preventing executive role and revision in government organisational structure;
(iv) reasserting the importance of line functions in comparison with staff functions;
(v) merging organisations with parallel, interfering, or duplicative functions;
(vi) organising a system of reimbursement based on efficiency;
(vii) restricting employment and improving the effectiveness of employees;
(ix) establishing an appropriate system of appointment and discharge for managers;
(x) reduction and/or elimination of superfluous processes;
(xi) codifying client-oriented systems to reduce referrals to higher levels in the organisation; and
(xii) strengthening the professional and research ability of the public sector.

A consistent coordinative system is needed to achieve this planned administrative reform.

Summary

In a movement towards the standardisation of the public sector after the early stages of revolution the administrative sector has faced some contradictions. The revolutionary spirit of the staff and managers was replaced by a bureaucratic spirit among the new managers and staff. Therefore, despite the intended effect of rules and regulations, there was dissatisfaction with the administration system. Attempts have been made by the government to make a trade-off between bureaucratic procedures and the revolutionary spirit of service to society. However, it has been a difficult stage. In this stage, the Islamic culture of the society has not been fully utilised. Full utilisation of methods for enhancing accountability and productivity have not been accomplished either. Some improvements have been achieved, but not enough to meet society's expectations.

CHAPTER 5

CONCLUSION

This comparative study has described, explained and compared public enterprise reform in Iran and Malaysia since the early 1980s. The following areas formed the framework used to illustrate the research focus: the socio-political and economic environments, the role and structure of the PEs, the motives for reform in PEs, the appropriate policies and means to achieve the objectives of the reform, the implementation of the reform, and the evaluation of the reform. On the basis of the success of some reforms initiated in each country, important factors responsible for their success, or failure, were identified.

Reform in PEs includes both privatisation and non-privatisation alternatives. Privatisation of PEs has also proceeded beyond the narrow concentration on the sale of PEs. It includes the reduction of state activity, while a stronger emphasis has been placed on providing an alternative to the traditional separation of the state and the marketplace. Nevertheless, it is essential that the government takes into consideration the social-political and cultural environment of the country and prioritises its options, before bringing change in the role of PEs.

Socio-Political and Economic Environments

Malaysia covers about one fifth the area of Iran, with a population more than one third that of Iran. The majority of the population of both countries are Muslim (60 per cent of Malaysia's population and 99 per cent of the Iranian population). The IRI is a republican government based on three powers and the political and religious leader of the country.[1] The culture of both countries is influenced by Islamic values.

In Iran, the Constitution as well as the ordinary laws are based on Islamic jurisprudence. Social justice, economic independence and self-sufficiency are considered to be vital elements of the Constitution. These factors contribute to a sensitive environment for privatisation policy-making. Furthermore, ideological and constitutional issues do not allow for an absolute Western or Eastern system of privatisation in Iran. The Islamic state is committed to assuming a considerable role in the establishment and maintenance of a social justice system. Iran is a society of substantial racial, cultural and religious homogeneity, and Islamic jurisprudence is a powerful force.

Malaysia, on the other hand, is a multi-cultural community comprising Chinese, Indians and Malays. While many laws are influenced by Islamic teachings, they are not dominated by Islamic jurisprudence (Shari'a). For example, in the Fifth Malaysian Plan (1980-85), the Malaysian government stressed the importance of consistency between the material and spiritual aspects of development. This conception of development is judged not to conflict with the law and Constitution, because it includes social justice measures.

Malaysia is a Kingdom with a federal system, and practices parliamentary democracy through an elected government. Political competition plays an important role in achieving government accountability and efforts to achieve a better standard of living for the under-privileged and the indigenous Malays

[1]-These three powers are legislative, judiciary, and executive powers which are independent of each other.

(Bumiputra). This form of competition is relatively insignificant in Iran, by contrast.

Iran and Malaysia are resource-rich countries, and Malaysia was the world's largest producer of natural rubber and tin. This dependence on the revenue from the trade in commodities left the Malaysian economy susceptible to external influences. As a result, Malaysia sought to diversify and develop its hydrocarbon industry and other manufacturing activities.

Following political and social chaos in 1969, a twenty-year plan (1970-1990) was initiated to rectify social and economic inequities . The so-called New Economic Plan (NEP) was aimed at establishing a growth-equity trade-off in the Malaysian community. Government intervention through the formation of the NEP and its results shaped the conduct of economic policy towards identified objectives.

During the 1980s, however, accompanied by the economic recession and financial problems, changes were made in the development program. There was also a change in emphasis from equity to growth. As a result, important conditions in the NEP governing the level of participation of foreigners and other groups were relaxed. However, many objectives of the NEP were incorporated in the privatisation policy. For example, a minimum 30 per cent participation of the Bumiputra in any privatisation transaction reflected the intent of the earlier provisions.

The Iranian economy is dependent on oil and a few non-oil products. In fact, oil and oil products earn about 85 per cent of all foreign exchange revenue. Large manufacturing industries are more dependent on foreign material than the more labour intensive and handicraft industries. The first five year development plan (FFDP) (1989-94) was developed to reduce, and change the source of, the dependence of the country on foreign products and materials. The FFDP was also aimed at the reconstruction of war damaged areas. It was the first plan after the revolution in 1979, and after the eight-year war (1980-88) with Iraq.

The plan included a package of *economic adjustment policies* designed to rectify economic and social bottlenecks. Unlike the NEP, which was shaped by the internal policy-making process to achieve Malaysia's growth and equity targets, the policies in Iran's five year package were designed mainly to be compatible with the prescriptions of the World Bank and IMF. Indeed, the privatisation program was the main element of the package.

The features of their environments have shown clearly that Iran and Malaysia were in urgent need of appropriate means to reform their PEs in order to maximise results and minimise the negative effects on their respective societies and economies. For example, when formulating policies for privatisation, the Islamic Republic of Iran (IRI) should ensure that the policy instruments of privatisation are consistent with the objectives of economic independence of IRI. Finally, privatisation in both countries aimed at enhancing the performance of PEs, reducing the burden on government and redefining the role of government.

The Role and Structure of PEs

The factors involved in the growth of PEs in Iran and Malaysia, in general, are similar to those affecting public enterprise success in many other developed and developing countries. Implications associated with market failure and natural monopoly are among the principal reasons for the expansion of PEs in both Iran and Malaysia. In both countries, PEs were central to the economy by 1980.

In Malaysia, for example, the intervention of state planning to achieve rapid economic growth under the NEP as well as the establishment of new industrial activities in selected areas to assist low income within the Bumiputra community, resulted in the expansion of PEs, in particular during the period 1970-85, with public enterprise peaking at 58.4% of the economy in 1981.

After the 1979 Revolution in Iran, and as a result of Constitutional requirements, the government took control of PEs and most strategic industries. The number of PEs expanded as a result of the nationalisation of some twenty-seven private banks and fifteen insurance companies. In addition, large domestic and foreign debts, and the risk of an outflow of funds to foreign accounts led to the nationalisation of some industries. The government appointed its own managers to these nationalised companies. They were transferred later to the Iran National Industries Organisation (INIO), the Iran Development and Renovation Organisation (IDRO) and the newly formed Bonyad-e-Mustaz'afan (Foundation for the Oppressed) and its subsidiary foundations. The nationalisation was initially a stop gap measure motivated by the urgent need to order and appropriate management to the abandoned sections of the economy.

Eventually, the problems of managing a broad range of PEs produced financial and managerial problems which together with external and ideological pressures contributed to the formulation of policies to reform PEs and change their role. In both countries, prior to the commencement of reform, the public enterprise sector dominated the economy and the need for economic reform made public enterprise reform mandatory.

Reform Motives

In Malaysia financial problems were among the crucial triggers for the initiation of PE reform. Privatisation was implemented as a means to support short-term revenue raising efforts. However, previously, the Malaysian authorities had pursued a cautious fiscal policy, accumulating surpluses in good years and incurring deficits in scarcity years, which helped protect the economy to a considerable extent from unanticipated shocks.

The principal motive for the reform of Iranian PEs was the necessity to reduce the government's financial and administrative burden, while efficiency improvement ranked as the second priority. Unlike Malaysia, Iranian fiscal policy concerning the expenditure of revenues often had a positive correlation with the revenue of the preceding year (Rafsanjani, 1987). The more the government received foreign exchange as revenue, the more was spent in the following year. There were no explicit or cautious fiscal policy to accumulate surpluses to spend in years of scarcity. After the revolution in 1979, frugal spending of revenues prevailed in the early years of the new government. However, unrestrained expenditure of revenues continued after the wartime years (1988). Policy-making and the management of resources was not effective. In addition to the managerial problems of the Iranian PEs - lack of authority and responsibility and the lack of an effective system of accountability and monitoring - other weaknesses included ambiguity of objectives, lack of workforce motivation and education.

Poor management was the main reason for the poor financial performance of some Malaysian PEs. The government was not aware of the activities of the enterprises in which it was the major shareholder. The absence of a meaningful evaluation system also resulted in a lack of clarity of objectives, numerous principals, and a lack of transparency in evaluation.

With respect to the commercial objectives of PEs, the economic factors that contributed to the poor performance of PEs in Malaysia included: inaccurate forecasting of demand and prices, problems related to technology, and problems pertinent to debt structure. The first two factors are similar to what existed in Iranian PEs, but the third factor - problems of debt structure - appeared in Iran after the implementation of the economic adjustment policy and privatisation. Malaysia and Iran both lacked a systematic pricing policy, systems of incentives, and profit orientation.

While the management of PEs on a commercial basis, has achieved commendable results in some countries, others have paid less attention to profitability, creating the problem of high and large deficits, and ultimately dependence on external credits. Neither Iran and or Malaysia applied profitability criterion to their PEs before the implementation of their privatisation policies. The main reason was government use of the revenue base to compensate for loss-making PEs, and to support social obligations.

Malaysia was dependent on export led growth, which fell victim to external pressures following deep recession in industrialised countries. Privatisation was aimed principally at improving the structure of the economy by reducing its dependence on commodity exports. This suggests that Malaysia was responding mainly to internal pressure, rather than external pressures, to overcome the long-term constraints in the economy. The experience of Iran and Malaysia suggests that privatisation policies which are developed, primarily, in response to internal problems may bring more success and face fewer pitfalls.

Privatisation in Iran was undertaken under the external pressure of international institutions and their political and ideological preferences. Iran like Malaysia was dependent on export led growth and the economic adjustment policy was also aimed at solving this problem. In addition, unlike Malaysia where the main internal stimulus to privatisation was financial issues emanating from economic recession, the main factor in Iran was the reconstruction of war damaged areas in a framework of social and economic planning. Efficiency and the optimum utilisation of PEs were common economic and managerial objectives in both Malaysia and Iran. From a political strategy point of view, the Malaysian privatisation program was a tactical approach to pursue its own specific political and social purposes, rather than merely following the dictates of international institutions. However, privatisation programs were also used to benefit leading politicians as well as the Bumiputras, in order to guarantee the political stability of the ruling party. In Iran, the privatisation program was a pragmatic and systematic approach adopted mostly under foreign pressure to change the economic structure of the country.

Nevertheless, in terms of achieving effective outcomes from implementing a privatisation program, Malaysia is similar to Iran in that many of the loans went into non-performing projects which were not expected to yield sufficient returns to service the loans. Further, project loans, cheaper and drawn from international institutions, were seven times larger in Malaysia's case than in Iran's, during their economic adjustment phase. On the other hand, market loans were utilised in Iran more than Malaysia and the legacy was enormous debt problems.

The privatisation program in Malaysia was also accompanied by market ideology directed from abroad. The IMF loans facility came with the condition of market ideology, the consequences of which were increased dependence on international markets, the export of manufactures controlled and owned by multinational corporations (MNCs), and imports in every sphere of economic activity including food products.

However, the external pressure on Malaysia was not as harsh as it was on Iran. The intervention of the Malaysian government to establish safety clauses and equity measures such as the NEP objectives, eased the way for a reduction of any adverse consequences of privatisation on society, and this created a climate of general acceptance.

The ideological pressure for privatisation and the effect of market ideology on Iran is more sensitive and problematic. Ideological pressures were directed towards the shifting cultural and social values of the country and what was embodied in the Constitution. External and ideological pressures were linked to internal financial problems which led to an excessive dependence on foreign borrowing from international institutions.

The present analysis of privatisation reveals that internal pressures arising from inefficiency and low industrial growth have been the catalysts for external involvement in the economies of both Iran and Malaysia. The internal financial pressure in Malaysia was an apparent stimulus for submission to external institutions. This indicates that a horizontal linkage of internal and external pressures occurs by means of the channels of international finance and investment, particularly where the economy is dependent on trade. Fiscal crunch and a deficit in the balance of payments (BOP) were the joint triggers for privatisation in Malaysia. The linkage was reinforced by pressures from foreign investors and local industrialists and technocrats. This was similar in both Iran and Malaysia. However, this is not always the case, as it depends on the role of government and the extent of the pressures. Malaysia with considerable internal financial pressure was less submissive to external pressure than Iran which had less intense internal financial pressure.

Malaysia initiated an adjustment liberalisation program during 1986-90. This was a program similar to that prescribed for Iran by international institutions. Under this pressure, Iran's FFDP was directed towards liberalisation of the economy. However, there was always a concern that the plan's liberal openness to international trade, investment, and borrowing could exacerbate Iran's dependency, making it a debtor nation, worsening domestic socio-economic inequalities, and increasing Western influence. The internal pressure for privatisation in Iran, on the other hand, was less than in Malaysia (Table 5.1).

Table 5.1: Comparison of the Economic and Financial Incentives to Reform in PEs in Malaysia and Iran.

Country	Fiscal Problem	BOP deficit	Efficiency	Low industrial growth rate
Malaysia	4	3	4	4
Iran	2	1	4	4

Source: Regarding Malaysia, Gouri et al., 1991: 21-22. Regarding Iran it is the author's view.
High 4-3; Moderate 2-3; and Low 0.5-2.
Efficiency includes both economic and managerial factors.

Policy-making

In both Malaysia and Iran the political executives as well as professional groups were involved in the policy-making process. However, after 1988, the technocrats were more influential in the Iranian policy-making process, unlike Malaysia where the first group was playing the major part. Nonetheless, the ultimate responsibility remained on the shoulders of the political executives.

For the implementation of liberalisation policies, the World Bank works through technocrats within the government and through them it seeks to persuade governments to utilise projects chosen by it (see Mosley 1988:135-7). Such was the case, both in Iran and Malaysia. In Iran, such technocrats were in positions of decision-making or consulting about the implementation of the economic adjustment policy based on the prescriptions of international institutions. Some of them were expert members of the boards responsible for decision-making, and the implementation of the privatisation program. At times it would appear that some technocrats were more committed to the implementation of privatisation than to the objectives of the country's development.

In Malaysia, the policy-making measures contained a very strong element of involving the indigenous population in the privatised enterprises, and thereby achieving the national goal of redistributing wealth to the Bumiputra community. People's participation in Malaysia was based on the participation of Bumiputra in at least 30 per cent ownership of the privatised enterprises. There were limitations, however, on other groups and the proportion of shares allowed to individuals and to foreigners.

In Iran, the privatisation program was a step forward beyond what was originally intended. The advice from the Leader of the IRI, Imam Khomeini, to the government regarding more participation of the people in economic activities was biased towards selling shares and assets to those who could afford to purchase them. This was different from the concept of people's participation in countries such as the United Kingdom and Korea. For example, in Korea, privatisation was essentially applied as a means of bringing about a greater involvement of the people in the functioning of successful PEs through an equitable distribution of company shares to low-income groups on a preferential basis.

Implementation of the structural adjustment programs was initiated originally as a condition of obtaining loans, aid and investment for Iran and Malaysia. These programs, in Iran, included trade liberalisation (moving away from licences and quantitative restrictions on imports, to reducing the scope and size of tariffs); getting domestic prices in line with world market prices; reforming the administration of taxes; and decreasing government deficits by lowering public expenditure, especially subsidies.

Pressure from the IMF and foreign investors did not allow Iranian policy-makers the option of safety clauses, or the maintenance of social justice elements in the law, to protect workers and consumers from the negative effects of structural adjustment. The outcome was similar to those observed by Gouri et al. (1991:31) in countries such as the Philippines and Sri Lanka. Privatisation in Iran involved no specific social justice measures and created large social unrest because emphasis was placed on reducing the government's financial burden at the cost of equity.

The prescription of the IMF regarding the devaluation of the domestic currency was advanced to reduce the trade deficit by decreasing imports and increasing exports. However, devaluation of the domestic currency could be effective only if the elasticity of foreign demand for internal products was high. It was not an effective policy because national demand for foreign products was strong. This also proved that elasticity of demand is rarely achievable for products of developing countries, because the prices of these commodities are determined mainly in world markets.

Malaysia sought selective lending and advice rather than high level assistance from the World Bank. However, the sharp increase in external debt increased the overall dependence of the economy on external resources. The strengthening of major foreign currencies led to an increase in the external liabilities of the PEs, especially those which were involved in heavy industries. A further reason was that the devaluation of the domestic currency in Malaysia was accompanied by the devaluation of the US dollar in relation to other main foreign currencies after September 1985.[2]

Unlike Malaysia, Iran did not follow a policy of selective lending advice. Iranian adjustment policy was largely dependent on the advice and prescriptions of the World Bank and IMF. Despite the small amount of borrowing from the World Bank and IMF, about one per cent of the total expenditure of the FFDP, the adjustment policy was fully compatible with the advice of these international

[2]–The revenue of the country was mainly based on the US dollars, and depreciation of the Ringgit reduced the value of the revenues, however, the debt was not denominated only in US dollar but other currencies as well. In this situation, the value of exports decreased and the cost of imports increased.

agencies. Some advice such as trade liberalisation and financial liberalisation had some detrimental effect on the economy and particularly on the under-privileged groups in society as it increased external debt and inflation. Devaluation of the Iranian Rial against other foreign currencies in 1992 was a similar decision to the depreciation of the Malaysian Ringgit as a stage of the adjustment policy. In Iran, liberalisation of the financial market caused debt problems without any significant positive results in the short term. In Malaysia, financial liberalisation produced problems of debt servicing.

Theoretically, efficiency is considered to lead to equity through effects such as enhanced quality and lowering prices. Market forces, however, may only impose an incentive to decrease costs in order to improve profit rather than to benefit consumers through lower prices. The interests of consumers and workers normally require the establishment of regulatory bodies to protect and monitor the public interest. As a result, many countries have attempted to include equity issues in their policy-making and to provide regulatory structures to take such issues into account.

Malaysia shares the same concern with the additional worry of securing equity for the Bumiputra population. It has neither ignored equity nor left it to be realised as a by-product of the privatisation exercise. In Malaysia, provision has been made to avoid any disturbance to the workers as an adverse consequence of privatisation. This provision has been helpful, although workers are not satisfied with privatisation as they feel their interests have been sacrificed to those of the private sector. In the absence of social security, the impact of privatisation and rationalisation as perceived by workers has to be justly dealt with and equitable solutions have to be designed. Relying on market forces, by itself, may not provide immediate or obvious benefits to these groups.

In Iran, where workers are protected by the Islamic Work Law, the concern is about changing the law in favour of the entrepreneurs. Iran, is moving towards deregulation in favour of these entrepreneurs and owners and this has created concerns about the privatisation process. Privatisation policy has lacked sufficient sensitivity to the adverse consequences on under-privileged groups. Regulatory failure was replaced by market failure. Excessive emphasis on efficiency without concern about equity only uncovered the inherent immaturity of these privatisation programs.

However, in both Iran and Malaysia, the choice of enterprises for privatisation was mainly based on a comprehensive study of economic measures. In Malaysia, after an analysis of a large sample of 424 PEs, 246 entities were considered as privatisable and put in Malaysia's action plan. In Iran, 391 PEs out of 770 entities were considered privatisable. However, the study by sub-committees or independent committees was questionable. For example, a consensus was not reached about the identification of big mines which should be excluded from privatisation where as the Ministry of Mines and Metals has decided that there is only one big mine, in Iran, to be excluded from privatisation (see *Keyhan Havai*, No.995, 1992:17).

Privatisation, through the sale of PEs may fail to improve the current internal economy. Instruments and modalities of privatisation have, therefore, to be broadened to encompass encouragement to the private sector, development of capital markets and restructuring of PEs. There are various modalities from which each country needs to choose the relevant ones in accordance with its economic situation, society perception, and the Constitution.

In Malaysia, divestiture and non-divestiture options were commonly used. They included private sale, public offering, private placement, joint venture, market contract or lease, build-operate-transfer and management buy-out. In Iran, the divestiture modality of privatisation was employed in the form of selling shares and selling assets. The major non-divestiture modality which has been applied in Iran was contracting-out some services of universities, hospitals and some other organisations to the private sector. More radical privatisation measures were adopted in Iran than in Malaysia.

PEs may use social obligations as a cover for their inefficiencies. This can be true for any country, not only Malaysia or Iran. However, in Malaysia, the government tries to control PEs which take into account public interest and social activities by partial privatisation and keeping the majority of shares in its own hands. In Iran, the privatisation program functioned on the basis of separating those which have primarily commercial and business tasks from those which are more relevant to social activities. The first group was chosen for privatisation.

There are different modalities of sale of PEs such as: (i) to a single party, (ii) to the public and to the workers in the enterprise. The first alternative has generated a general reaction against privatisation. This is, first, due to the fear of a general reduction in employment. Secondly, there is a fear of replacing a PE monopoly by a private enterprise monopoly (Gouri, 1991c:244). In Malaysia, total divestiture of PEs did not rank high on the agenda. Malaysia has applied partial divestiture with the involvement of the Bumiputra population. The limitation of shares and specific Bumiputra share participation has prevented the accumulation of shares in the hands of one person or a small group of people. Therefore, it has mitigated public reaction against privatisation and its monopoly consequences. Control of entities by means of a golden shares was applied as a way of safeguarding the public interest in Malaysia.

In Iran, a safety measure was taken to reserve 33 per cent of shares for workers and staff (*Approval Letter of the Assembly of Ministers*, No.5283, 19 June 1991). However, shares acquired by workers and staff must be purchased within a year. As the workers and the staff cannot usually afford to buy shares in these companies, this safeguard has not been effective in preventing the establishment of private monopoly enterprises. However, selling as much as 67 per cent of PEs to a single person has occurred.[3]

Implementation of Reform

The requirements which must be met to achieve the successful implementation of a privatisation policy are: clarity of objectives, choice of appropriate instruments, development of market structures, careful planning with built-in safety clauses, and the monitoring of impact.

In both Iran and Malaysia, privatisation planning was undertaken by a high-level committee. In Malaysia, safety clauses were designed and implemented. Golden shares were retained by the government to maintain ultimate control over the performance of the enterprises, and regulatory bodies were established to

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[3]- The case of privatisation of Arak Aluminium Factory was one of those cases in which one person bought 67 per cent of the shares. The 33 per cent remainder has been put aside as the shares to be sold to workers and staff if they can afford to buy them.

create a competitive environment and prevent monopoly. However, in Iran the privatisation program relied on the existing laws and regulations. The government was advised by technocrats to remove any control on the market as part of the process of deregulation. Although there were no anti-trust or trade practices Acts in Iran, regulatory bodies and appropriate safety clauses were not established.

Preparation for privatisation requires the existence of a well developed capital market and local entrepreneurs who are able and willing to participate in the sale process. Capital markets in Malaysia were developed and played an active role and in spite of some shortcomings this contributed to the financial success of the privatisation program. In Iran, the capital market which was inactive during wartime, was restructured under the Islamic Banking Law. However, the legal provisions for protecting the vital resources of the country were not compatible with the economic adjustment policy implemented in Iran. Financial liberalisation paralysed the ability of the Central Bank of the Islamic Republic of Iran (CBIRI) to control and supervise the privatisation program and to create a stable situation. Price liberalisation exacerbated economic problems and overshadowed the implementation of privatisation.

In similar circumstances, the Chinese authorities decided to retain price controls to control producer prices. The government's policy in China and India was that once the cash constrained non-state sector became large enough to compete with the old state sector in product markets, the government could relax prices (see Kane, 1993:175). This caution was not incorporated into Iranian privatisation policy-making since the financial liberalisation occurred very early.

Foreign participation is one of the sensitive issues in privatisation programs in all countries, developing as well as developed ones. Governments are generally reluctant to transfer control over assets, particularly those which are considered to be of strategic importance, to foreign investors for political and social reasons. These countries wish to limit participation to particular groups of shareholders and exclude some potential purchasers. These restrictions have also been found in developed countries. For example, Japan does not allow foreigners to purchase shares in the Japanese telecommunication company (Nippon Telephone and Telegraph: NTT). Britain and France also imposed some restrictions on foreign ownership (see Hemming and Mansoor, 1988:11). In British privatisation, the British government backed down over the Land Rover sale to American interests to prevent too much foreign ownership (see Wiltshire, 1986:354). However, in developing countries, external leverage through loans is used to make borrower countries comply with foreign participation in strategic enterprises.

In Malaysia, the rule about limiting foreign equity participation to 30 per cent continued until 1984, when it was relaxed in order to encourage more foreign investment in high technology industries. Nonetheless, regulations were established pertinent to control and ownership by foreigners, providing the Bumiputra with opportunities for participation and employment, while managing adverse environmental and strategic effects. One hundred per cent foreign ownership is allowed only if these enterprises can export 50 per cent of their products or employ 350 full-time Malaysian workers. Nonetheless, domestic private investors feel that the government has not committed itself enough to the promotion of domestic investment as compared to investment from overseas.

In Iran, foreign investment is forbidden, based on the Constitution. However, efforts have been made to ease the way for foreign participation by repealing the Act of 1953, which limited foreign investment to 49 per cent of the investment. In 1992, under pressure from international institutions the Investment Supreme Council lifted the limitation set by the Act, and allowed 100 per cent foreign investment. However, the conflict with the Constitution has continued. Other ways of promoting the potential domestic private sector participation such as participation by industrialists, professionals, managers and workers have not yet been seriously examined. This explains why Shirley and Nellis (1991:13-14) said that governments have often tended to ignore the need for legal changes when they consider the details of restructuring of PEs. Privatisation implementation has to conform with the Constitution and the laws concerning the rights of society. The other option may be revising existing laws to make possible changes in the labour law or the Constitution.

Implementation of the economic adjustment policy and the privatisation program (1989-94) in Iran's postwar era was aimed at relieving the cause of economic dependence and the recovery of war damaged areas. However, an unintended consequence of these policies contributed to the establishment of an economic regime which could benefit only a small group of beneficiaries.

Evaluation of the Reforms

Malaysia has implemented a moderate amount of privatisation, whereas in Iran there has been only a small amount of privatisation. The major reason is that Malaysia started its privatisation program from 1983 onwards, while Iran's program for privatisation only commenced in 1989. The key incentive for privatisation in Malaysia was originally to settle financial problems. However, in Iran, privatisation was originally planned to be carried out in a rush in response to external pressures. As a result, structural problems, mainly management and legal issues, hindered the speed of the movement in Iran. The adverse consequences of privatisation emanating from its negative effects have exacerbated the economic and social situation and increased the level of resistance against privatisation. Privatisation in Iran during the period of FFDP was not a successful experience.

In Malaysia, improvement in the performance of some privatised enterprises has been observed. Nonetheless, the performance improvement has been observed in both groups of enterprises - those undertaking divestiture and those adopting non-divestiture modalities, i.e., remaining within government ownership. This indicates that reform in managerial and economic aspects of PEs has been effective to some degree even without changes of ownership.

There is a shortage of information about the performance of the privatised enterprises in Iran. The reason is, first, that the Divan-e-Mohassebat (Bureau of Accountancy) is virtually unable to monitor the performance of new enterprises and the same is true about Parliament.[4] Secondly, the period of privatisation so far has been too short for it to be possible to have an overall evaluation. Finally, government has not established a system of monitoring and evaluation to follow the performance of privatised entities.

The most important report officially issued was the report of the Iran National Industries Organisation (INIO). The report indicated there had been an

[4]– Similar concerns have been raised about British privatisation (see Wiltshire, 1986:355; Stretton and Orchard, 1994).

improvement in the performance of those partially privatised enterprises, which are still under the control of INIO, a governmental organisation. One reason for the improvement of productivity and profitability has been the increase in prices and the change of product mix (Banki, 1994). This suggests that profitability and productivity can be improved in a public ownership situation. However, improvement in profitability is not necessarily accompanied by efficiency enhancement. Furthermore, efficiency is not matter-of-fact, it is a slippery, value structured concept.

Some indicators such as GDP growth have been regarded as proof of the improvement in efficiency and enhancement of the performance of the privatised enterprises in Iran. However, the lack of growth in investment to the predicted level and the diminishing trend of GDP growth are indicative of factors other than the privatisation program. The utilisation of spare capacity of industries and the injection of foreign exchange (hard currency) have been the real causes of GDP growth. The modalities which have been employed were not efficiency enhancing. Furthermore, most of the privatised entities have been working under the same board of directors and management. The new owners have not taken control of the enterprises they have acquired. Therefore, in none of these cases has privatisation, in the form of transferring public ownership to private ownership, been the main factor in the enhancement of performance.

In Iran, the increase in prices - following privatisation and implementation of the economic adjustment policy - was high. This was due to the removal of subsidies on essential goods and the devaluation of the domestic currency. Then the increase in prices extended to the products of privatised as well as non-privatised enterprises. The anxiety of consumers was based on the anticipated increases in prices as the government allowed private owners to set and determine prices in order to maximise profits.

However, in Malaysia provision for stability of prices decreased the resistance of consumers to the policy. As a result, consumers enjoyed the same prices and tariffs as before privatisation.

The open door policy prescribed by the World Bank and IMF increased the volume of imported goods, which caused an increase in foreign debt in Iran. The debt problem exacerbated economic difficulties by increasing inflation. This has also endangered some domestic industries faced with bankruptcy. Imports of foreign goods have also had a negative impact on the value of PEs since most of their products were not competitive with similar foreign products. Some of these PEs incurred considerable losses because of the trade liberalisation policy.

There were legal obstacles to privatisation in both Iran and Malaysia. However, these legal obstacles are difficult to remove in spite of pressure from international agencies. The privatisation program should conform to the existing laws and regulations, which may not be compatible with the prescriptions of the World Bank and IMF. Otherwise, legal reforms will be necessary if some aspects of the privatisation program are to conform to the law. In each situation the national interest and social justice should be protected to prevent political and social disturbance.

It is hard to create public support for privatisation while no specific attractive social factor for the ordinary people is involved in the privatisation program. Equity goals which have often been advanced in the developed as well as developing countries did not contribute to the goals of privatisation during FFDP in Iran. Privatisation in Iran, in practice, has overlooked the widespread equity goals contained in the Constitution.

In Malaysia, a built-in safety plan was designed to guard against the subsidiary consequences of market failure. It was achieved by establishing regulatory bodies which had control over prices of products and by preventing private monopolies. In Iran, market failure has been ignored in a disorganised process of privatisation. The efficiency of the PEs was one of the stated objectives of privatisation. However, implementation of privatisation without planning built-in safety clauses led to an increase in prices and more pressure on under-privileged people. Not only were regulatory bodies not established, but the government was advised not to intervene in the market by any means. This led to market anarchy, forcing the government to adopt price controls and to establish market controls in 1994 (see *Keyhan International*, 2 June 1994:11). Any privatisation program or any specific privatisation project would need to be clearly perceived by the public not only as consistent with public interest, but in fact, ensuring equity to avoid public resistance.

In Malaysia, in order to create a coordinated process for considering the interest of the private sector together with the public interest, the *Malaysia Incorporated policy* was established when planning for reform. In Iran, a gap between the private sector and the public interest has developed as an adverse consequence of privatisation and the economic adjustment program.

Economies which have embarked on rapid privatisation under the IMF's pressure have often gained only marginally (see Shirley and Nellis, 1991:71). This could have been a reason for Iran to create a longer-term program for the formulation and implementation of reform in PEs and privatisation by applying more appropriate modalities, including equity measures, safety clauses and appropriate regulatory bodies.

In Iran, privatisation and its modalities as adopted were not appropriate means to settle the problem of efficiency and to solve economic problems of dependence on export led growth. The change of ownership has not generally been accompanied by efficiency improvements since a public monopoly has been replaced by a private monopoly in many cases. In other situations, the profit orientation has replaced the earlier public interest orientation. Managerial changes have not taken place and a regulatory regime has not been established to protect the consumer and the workers from increases in prices and dismissal of workers. The establishment of a sound managerial and administrative system and the enforcement of a system of accountability and control should be a prerequisite for any alternative policy of reform in PEs.

For a sound policy of reform in PEs, it is necessary to initiate administrative and managerial improvement. This type of reform can be applied as an alternative to the privatisation program, or it can be used as a facilitator for privatisation wherever it is necessary. To implement privatisation successfully in the context of any country, the first requisite is having a sound and strong administrative and managerial structure and this is also applicable in the case of Iran and Malaysia. Some comparative aspects of privatisation, discussed above, such as motives, control over policies, implementation and monitoring are shown in Table 5.2.

Table 5.2: A Comparative Perspective of Effective Factors and Success of Reform in Malaysia and Iran.

Reform Measures	Malaysia	Iran
Pressure for reform of PEs	Internal factors predominated	External factors predominated
Control over policy-making	Executives, politicians and professionals	World Bank, IMF and domestic professionals
Criteria governing reform of PEs	Clearly defined: social, political and economic objectives	Less clear: reconstruction of war damaged areas, economic and managerial objectives
Control over implementation of reform	Clearly defined: diversity of modalities, application of safeguard policies	Less clear: mainly sale of shares and assets, lack of safety clauses
Outcomes	Relatively successful	In progress
Winners	Many	Not many
Losers	Not many	Many

Alternatives other than Privatisation:

Managerial and Administrative Reform

PEs in developing countries need a powerful managerial and administrative discipline to be acceptable to the society. The reasons for privatisation and reform in PEs emanate largely from the managerial and administrative problems of some PEs. The administrative and managerial reform of PEs, however, can be effective as an alternative to reform initiatives such as privatisation and deregulation. Managerial and administrative changes are not conditional on privatisation, although improving performance can encourage privatisation of PEs. This research has shown that control is more crucial than ownership. Internal reform of PEs is an alternative option for realising substantial gains. The efficiency of an enterprise is determined not by its ownership, but by the quality of its management.

The experience of privatisation and reform of PEs in Malaysia and Iran has shown that change of ownership is not the sole factor responsible for improvement of the performance of PEs. The important factor is the competitive environment which is needed for efficiency improvement. This competitive environment can also be created through maintaining control in the hands of the public sector.

Secondly, administrative and managerial reform initiatives and enforcing accountability and monitoring should be part of a reform in PEs whenever it is necessary. From the managerial point of view, in the implementation of privatisation in Iran, lack of effective economic management and resource management were the major contributing factors to the failure of the privatisation program. Some structural problems also were encountered. The system of accountability in Iran needs to be strengthened. It especially needs to be accompanied by a system of rewards and sanctions in administration. In Iran, the need is not to make more laws and regulations for accountability and monitoring, but rather to actively and accurately implement the laws and regulations which exist. There are also some institutions such as the Divan-e-Mohassebat (Bureau of Accountancy), the Inspectorate Organisation and the Bureau of Administrative Justice, which are not as active as they should be in enforcing laws and regulations. In Malaysia, the Anti-Corruption Agency (ACA) is a government institution directly responsible for enforcing the laws against corruption. It is an active organisation which deals with different types of corruption. Furthermore, the Central Information Collection Unit (CICU) has been established to monitor the performance and financial position of 841 PEs in which the government has a stake. The Public Complaints Bureau is also responsible for dealing with PEs. The Implementation and Coordination Unit (ICU) acts as a coordinating machinery for the ministers to coordinate policies and activities of all PEs.

Thirdly, the administrative systems of the country need to be consistent with its social and cultural evolution. In Iran, after the Islamic revolution the administrative system underwent a critical change to adapt to an Islamic culture. However, this change was mainly a natural evolution rather than an institutional change based on enforcement of law and rules. The public consensus was that all the authorities have a commitment to Islamic beliefs and behaviour. Therefore, there was little attention paid to creating laws concerned with corruption or embezzlement. This contributed to the lack of activity in the organisations concerned with inspecting and preventing embezzlement. Organisations and institutions dealing with offenders need to be more active to prevent damage to the economy. Any reform in PEs such as privatisation needs to be preceded by strengthened administrative arrangements. Creation of a strong discipline through establishment of a system of follow up, follow through, and inspecting, is essential for an effective administrative system. Otherwise, privatisation will not succeed, and the national objectives will be overshadowed.

The experience of PEs reform either by privatisation or restructuring, in Malaysia and Iran, has shown that it is complicated and sensitive. Effective reform requires a set of agreed objectives consistent with the Constitution, the law and the cultural imperatives of the country; well structured policy instruments; and a high level committee to plan and monitor results. An independent reform policy based on the specified objectives would require a sound and strong administrative and economic management structure. Accordingly, the government should play a significant role, particularly, in the establishment of (i) regulatory framework with adequate safeguards; (ii) a measure of financial control until establishment of a competitive product market and stable economic climate; (iii) equity measures; and (iv) a system of performance monitoring. Privatisation is a means to economic, managerial and social objectives which should not be pursued as an end in itself. The inclusion of equity measures is significant for acceptability and for achieving national objectives.

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APPENDIX A

The interviewees in Iran and Malaysia:

Dr Mohsen Nourbakhsh Minister of Economic Affairs and Finance, Tehran: 29 July 1993 (Iranian date 7-5-1372).

Mr Tehrani, the secretary of privatisation sector in Ministry of Economic Affairs and Finance, Tehran: 1 August 1993 (Iranian date 24-5-1372).

Mr Mortaza Nabavi, member of the Commission of Economic and Finance Affairs in Islamic Consultative Assembly (Parliament), Tehran, 29 July 1993 (Iranian date 7-5-1372).

Mr Mohammad S. Beziani, director of privatisation sector of Iran National Industry Organisation (INIO), Tehran: 16 August 1993 (Iranian date 25-5-1372).

Mr Hossain Khoshpoor director of the office of Economic Firms in Budget and Planning Organisation, Tehran: 7-September 1993 (Iranian date 16-6-1372).

Mr Mohammad Reza Bahonar, member of the Commission of Economic Affair and Finance in Islamic Consultative Assembly, Tehran: 31 July 1993 (Iranian date 9-5-1372).

Mr Mustafa Niroomand director of Tehran Stock Market of CBIRI, Tehran: 8 September 1993 (17-6-1372).

Dr M Sinai, An expert of Tehran Stock market, Tehran, 8 September 1993 (Iranian date 17-6-1372).

Mr Mehdi L. Amini, Chief of Ownership and Shares Department in Industrial Development & Renovation Organisation of Iran (IDRO), Tehran, 6 September 1993 (Iranian date 15-6-1372).

Dr Shoja-addini, Head Officer of Economic Surveys of CBIRI, Tehran: 18 August 1993 (Iranian date 27-5-1372).

Mr Zarrin Ghalam, Vice President of the Office of Economic Surveys of CBIRI, Tehran: 18 august 1993 (Iranian date 27-5-1372).

Mr Khoshtinat, member of academic staff of the College of Economic andFinance Affairs, Tehran 19 August 1993 (Iranian date 28-5-1372).

Dr Hossain Yaghoubi, Economics expert and former high-level official of CBIRI, Tehran 27 August 1993 (Iranian date 5-6-1372).

Mr Ahmad Khoddami, member of academic staff of the University of Kerman, Kerman: 25-August 1993 (Iranian date 3-6-1372).

Mr Alinaghi Khamoushi, Head of Iran Chamber of Commerce, Industries and Mines, Tehran: 9 September 1993 (Iranian date 18-6-1372).

Mr Bijan Latif, director of Privatisation Office in Deputy Ministry of Economic and Finance Affairs, Tehran: 15 August 1993 (Iranian date 24-5-1372).

Mr Mohammad Ebrahimi, director of the Office of Public Properties in Kerman Public Company of Coal, Kerman: 28 August 1993 (Iranian date 6-6-1372.

Mr Mohammad Ali Babai, accountant and expert in accountancy PH.D scholar at the University of Swinburne, Melbourne, 21-3-1994.

Dr Ali Rezaeian, Dean of the Faculty of Public and Business Administration of the University of Tehran: 30 August 1993 (Iranian date 8-6-1372).

Homayouni, Mohammad Ali From Ministry of Jihad-e-Sazandegi (Construction Crusade) of Iran, Melbourne, 12 February 1994, (Iranian date 22-11-1372).

Dr Mohammad Arif, member of academic staff of the Faculty of Economic and Management in International Islamic University of Kuala Lumpur Kuala Lumpur 15 September 1993 (Iranian date 24-6-1372).

Dr Zeinuddin Abdulrahman, director of the Privatisation Sector of Economic Planning Unit (EPU) in Prime Minister Department, Kuala Lumpur: 16 September 1993 (Iranian date 25-6-1372).

Mrs K. Sundari, director of Administration Reform Section, in Malaysian Administrative Modernisation & Management Planning Unit (MAMPU) Kuala Lumpur: 17 September 1993 (Iranian date 26-6-1372).

Mr Badruddin B. HJ Md. Salleh, Director of Public Firms in Ministry of Public Enterprises: Kuala Lumpur: 17 September 1993 (Iranian date 26-6-1372).

APPENDIX B

Organisations Which Provided Primary Data in Malaysia

(i) the Faculty of Economics and Management at the International Islamic University of Kuala Lumpur;
(ii) the Privatisation Sector of the Economic Planning Unit (EPU),
(iii) the Administration Reform Section of the Malaysian Administrative Modernisation and Management Planning Unit (MAMPU); and
(iv) the Ministry of Public Enterprise; and
(v) the Asian and Pacific Development Centre.

APPENDIX C

Main Sources of Secondary Data in Iran.

1) Iran Central Bank Annual Report;
2) The report of "Parliament and Search" (Majlis va Pejoohesh);
3) Weekly report of Tehran Stock Market (Gozareshe Haftegie Bourse);
4) Reports of the Iran Chamber of Commerce (Namehe Otaghe Bazargani);
5) Reports of INIO such as "About Public Enterprises' Turn over" (Piramoone Vagozarye Sherkathaie Doulati);
6) Annual reports of privatised companies;
7) Annual Economic Reports;
8) World Bank Country Reports; and
9) Reports of the Research Group of Parliament.

APPENDIX D

Questionnaire

Questions

What is the organisation of PEs in Iran?
What is the size and the role of PEs in Iran?
How is government control exercised upon PE?
    Does a system of monitoring and accountability exist?
    What is the extent of management autonomy?
    What managerial control is exercised?
To what extent are large industries under the government control?
To what extent, if any, are PEs efficient, accountable and effective?
Is policy making responsive to public interest (to consumers, Labourers and managers)?
How is the performance of PEs?
What are the problems of PEs?
Do PEs need to undergo reform?
What kinds of reform, if any, are needed to improve the performance?
What are the objectives of PE reform?
    managerial objectives (efficiency, effectiveness, control, monitoring, and accountability)
    economic objectives (Public Sector Borrowing Requirement PSBR, budget deficit relief, widening share ownership, external debt relief, and investment)
    political objectives (gaining political advantage, and respond to external pressure)

What strategies were employed for reform in PES?
Is privatisation just a change of ownership?
How can the production system be changed?
How is market condition? Competitive, monopoly or other types?
What measures have been taken for increasing competition?
How does private sector link with market force?
Is it a demand creative system?
What do the different economic groups think about it?
Which sector(s) is (are) mainly affected by privatisation?
Who are opposing and why?
How has the international order influenced the content of structure of the reform policy?
What is the role of the World Bank and International Monetary Fund (IMF)?
How is the economy adapting with changing international economy?

How is the reform policy dealing with public interest?

Is it responsive to poverty, Labourers problems, consumers, low classes society, and managers dissatisfaction?

Is the trend of privatisation towards wealth distribution?

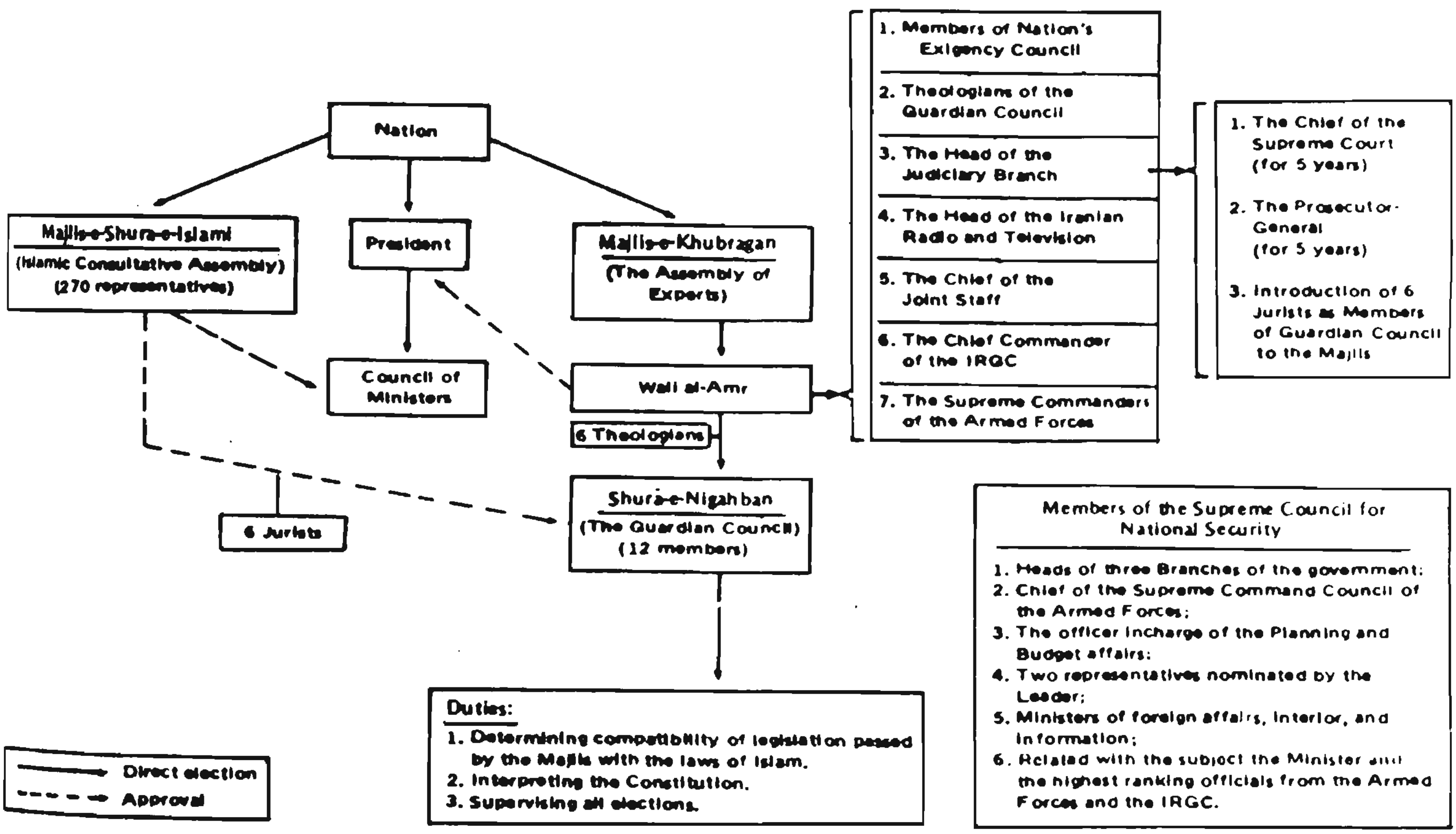
How does the government integrate various sectors into one market mechanism?
How can the structural adjustment be organised to integrate various sectors of the economy into a market mechanism?
Will it affect the organisation structure?
How can this reform mobilise the market force?

What institutional and structural resources were taken to support policy measures?
What will be the state overall role?

APPENDIX E

Iran Political Structure

State Structure of the Islamic Republic of Iran



APPENDIX F

Malaysian Privatisation and Action Plan (list of companies)

OVERVIEW OF THE PRIVATIZATION MASTER PLAN-STRATEGIC ISSUES, OPPORTUNITIES AND FUTURE THRUSTS

PRIVATIZATION ROLLING PLAN 1992-1993

1993

ENTITIES NEED TO BE PREPARED RESTRUCTURED BEFORE PRIVATIZATION

1. Selangor Water Supply +#
2. Penang Water Supply #
3. Malaysian Urban Sewerage Treatment
4. Karak-Kuantan Highway "
5. South Klang Highway "
6. Segamat-Tangkak Highway "
7. Penang Port #
8. Kuantan Port #
9. Livestock Farm Air Hitam, Johore
10. KEJORA-Commercial Activities
11. Diary Products Center, Veterinary Department
12. FAMA Trading Activities
13. Housing Loans, Treasury #
14. Radio Televisyen Malaysia #
15. BERNAMA
16. Polytechnics #
17. Stadiums
18. MARA Holdings Sdn Bhd @
19. The Malaysia Army Armoured Workshop
20. Perbadanan Nasional Berhad (PERNAS) @

ENTITIES TO BE PRIVATIZED

1. Labuan Federal Territory Water Supply
2. General Printing, National Printing Department
3. Malaysian Rubber Development Corporation
4. Medical Laboratories and Store, Ministry of Health
5. Kilang Sawit Panji Alam
6. Ketengah Jaya Sdn Bhd
7. Ketengah Perwira Sdn Bhd
8. Printing Department, Dewan Bahasa dan Pustaka
9. PERDA's Juice Production Activities
10. Telok Mas Industrial Estate Malacca
11. Masjid Tanah Industrial Estate Malacca "
12. Bintulu Port
13. Labuan Port
14. KL-Karak New Highway "
15. Kulim-Butterworth Highway "
16. Malaysia-Singapore Second Crossing "
17. Shah Alam Highway "

OVERVIEW OF THE PRIVATIZATION MASTER PLAN-STRATEGIC ISSUES, OPPORTUNITIES AND FUTURE THRUSTS

18 North-South Highway Link"

19 Penang Brige

20 Light Rail Transit System"

21 Abattoirs,
Veterinary Department,
Ministry of Agriculture

22 FAMA Trading Activities

23 Pahangbif Sdn Bhd

24 Pembangunan Leasing
Corporation

25 Tanjung Bidara Beach Resort Alor
Gajah, Melaka

26 Centre for Instructors &
Advanced Skill Training (CIAST)

27 Fire Alarm Monitoring and
Communication Network System,
Fire Department

28 Land Reclamation at
Rancha-Rancha, Labuan Federal
Territory"

Note:

@ Trust Companies
+ State Government-Owned Entities
" New Projects
Corporatization

OVERVIEW OF THE PRIVATIZATION MASTER PLAN-STRATEGIC ISSUES, OPPORTUNITIES AND FUTURE THRUSTS

20.	RISDA Marketing Activities	Management Contract	1987
21.	Tradewinds Berhad	Sale of Equity	1988
22.	Maintenance of Tube Wells, Labuan	Management Contract	1988
23.	Syarikat Gula Padang Terap Sdn. Bhd.	Sale of Equity	1989
24.	Cement Manufacturers Sarawak Berhad	Sale of Equity	1989
25.	Government Security Printing	Lease + Sale of Assets	1990
26.	Shah Alam Abattoir (Swine Section)	Lease	1990
27.	Lori Malaysia Berhad	Sale of Equity	1990
28.	Edaran Otomobil Nasional Berhad (EON)	Sale of Equity	1990
29.	Holiday Villages Sdn. Bhd.	Sale of Equity	1990
30.	Cement Industries of Malaysia Berhad (CIMA)	Sale of Equity	1990
31.	Pernas International Hotels and Properties Berhad	Sale of Equity	1990
32.	Peremba Berhad	M.B.O.	1990
33.	Kumpulan FIMA Berhad	M.B.O.	1990
34.	Sungai Long Quarry, Selangor	Sale of Assets	1990
35.	Kuala Dipang Quarry, Perak	Sale of Assets	1990
36.	Penanti Quarry, Pulau Pinang	Sale of Assets	1990
37.	Syarikat Telekom Malaysia Berhad	Sale of Equity	1990
38.	Langkawi Island Resort	Sale of Assets	1991
39.	Malaysian Shipyard Engineering Sdn. Bhd.	Sale of Equity	1991
40.	Far East Holdings Berhad	Sale of Equity	1991
41.	Perbadanan Nasional Shipping Lines Bhd.	Sale of Equity	1991
42.	Tanjung Jara Beach Hotel Sdn Bhd..	Sale of Assets	1991
43.	PERNAS Hotel Chain (Sel) Sdn.Bhd.	Sale of Equity	1991
44.	Motel Desa Sdn. Bhd.	Sale of Equity	1991
45.	Kedah Cement Sdn. Bhd.	Sale of Equity	1991

OVERVIEW OF THE PRIVATIZATION MASTER PLAN-STRATEGIC ISSUES, OPPORTUNITIES AND FUTURE THRUSTS

46.	Delima Industries Sdn. Bhd.	Sale of Equity	1991
47.	Antara Steel Mills Sdn. Bhd.	Sale of Equity	1991
48.	Sabah Shipyard Sdn. Bhd.	Sale of Equity	1991
49.	Penang Shipbuilding Corporation Sdn. Bhd.	Sale of Equity	1991
50.	Masmara Tours & Travel Sdn.Bhd.	Sale of Assets	1991
51.	Tenaga Nasional Berhad	Sale of Equity	1992
52.	Perusahaan Otomobil Nasional Sdn. Bhd. (Proton)	Sale of Equity	1992
	Corporatization		
53.	Lumut Dockyard		1991
54.	Postal Services Department		1992

OVERVIEW OF THE PRIVATIZATION MASTER PLAN-STRATEGIC ISSUES, OPPORTUNITIES AND FUTURE THRUSTS

APPENDIX II

PRIVATIZATION ROLLING PLAN 1992-1993

1992

ENTITIES NEED TO BE PREPARED/RESTRUCTURED BEFORE PRIVATIZATION

1. Postal Services Department #
2. Labuan Federal Territory Water Supply
3. General Printing, National Printing Department #
4. Perak-Hanjoong Simen Sdn Bhd @+
5. Land Reclamation at Rancha-Rancha, Labuan Federal Territory
6. Land Reclamation at Teluk Victoria, Labuan Federal Territory"
7. Kedah Marble Berhad. @+
8. Malaysian Rubber Development Corporation
9. Medical Laboratories and Store, Ministry of Health
10. Printing Department, Dewan Bahasa dan Pustaka
11. PERDA's Juice Production Activities
12. Airports #
13. Malayan Railway (KTM) #
14. Bintulu Port #
15. Johor Port #
16. Labuan Port

ENTITIES TO BE PRIVATIZED

1. Tenaga Nasional Berhad
2. Perusahaan Otomobil Nasional (Proton) Sdn. Bhd.
3. Perak Hanjoong Simen Sdn Bhd @+
4. Sabah Gas Industries Sdn. Bhd.
5. Kedah Marble Berhad. @+
6. Selangor Oil Palm Industries Corporation Sdn. Bhd. @+
7. Animal Vaccines-Production and Supply, Ministry of Agriculture
8. Aman Fishmeal Industries Sdn. Bhd. @+
9. Klang Port
10. Seremban-Port Dickson Highway"
11. Bukit Jong's Quarries, Terengganu +
12. Malacca Port
13. Tanjung Belungkur-Changi Ferry Services
14. Penang Municipality Bus Services +
15. Kumpulan Ladang-ladang Terengganu Sdn Bhd +
16. PERMINT Timber Corporation

OVERVIEW OF THE PRIVATIZATION MASTER PLAN-STRATEGIC ISSUES, OPPORTUNITIES AND FUTURE THRUSTS

17 Penang Municipality Bus Services +

18 Penang Bridge

19 KL-Karak New Highway

20 Kulim-Butterworth Highway "

21 Malaysia-Singapore Second Crossing "

22 Shah Alam Highway "

23 Light Rail Transit System "

24 Lembaga Padi dan Beras Negara #

25 Malaysian Agricultural Park, Bukit Cahaya Seri Alam #

26 Kumpulan Ladang-Ladang Terengganu Sdn Bhd +

27 Abattoirs, Veterinary Department, Ministry of Agriculture

28 Pahangbif Sdn Bhd

29 Public Trustee Department #

30 Cardiology Institute of Malaysia #

31 Government Saloon Cars

32 Industrial Training Institute, Prai

33 Industrial Training Institute, Kuantan

34 Advanced Youth Training Institute, Sepang

35 Centre for Instructors & Advanced Skill Training (CIAST)

36 Commercial Vehicles Inspection, Road Transport Department

37 Fire Alarm Monitoring and Communication Network System, Fire Department"

17 Sawira Sdn Bhd.

18 Sindora Sdn Bhd +

19 Pasaranika Dara Sdn Bhd

20 Abattoirs, Veterinary Department Ministry of Agriculture

21 Industrial Training, Institute Prai

22 Industrial Training, Institute Kuantan

23 Advanced Youth Training Institute, Sepang

24 Air Keroh Country Resort, Melaka @+

25 Pulau Layang-Layang Resort

26 Plaza Rakyat "

27 Post-Video facilities, FINAS

APPENDIX G

Iranian Privatisation and Action Plan (list of companies)

NO.	NAME OF COMPANY	NO.	NAME OF COMPANY
1	Iran Cable-making co.	41	Shirvan Fibres and Sponges
2	Pars Battery Productions	42	Pars Alvan (colours/paints)
3	Payam Radio and TV	43	Tehran Derakhshan
4	Pars Electric	44	Gilan Gloves
5	Arj JS[1] company	45	Dena JS company
6	Azmayesh Ind.[2] Company	46	Sahand Plastic Ind.
7	General (Jabal) Ind. Company	47	Iran Electric Non-Tranferers
8	Sarma-afarin Ind. Company	48	Farsiran JS Company
9	Hava-afarin Ind. company	49	Keyan Tyre
10	Iran Lantern-making	50.	Kanaf JS Company
11	Blades Production Co.	51	Iran Tyre Lining
12	Iran Khanehay e Pish Sakhteh	52	Pars Products Company
13	Fabis JS Company	53	Shiraz Plastics Company
14	Pars Household Goods	54	Pars Petroleum Company
15	Electric Goods JS Company	55	Yurtan JS Company
16	Electric and Household trading	56	Khorasan Synthetic Fibre
17	Iran Espan JS Company	57	Shirvan Synthetic Fibre
18	Hafez Tiles JS Company	58	22 Bahman Nippon
19	Pars Tiles JS Company	59	Wood-Work Ind.
20	La'abiran JS Company	60	Mobliran (Iran couch)
21	Saadi Tiles JS Company	61	Badavam Timber Ind.
22	Nilo Tiles JS Company	62	Asalam Timber Ind.
23	Pashm Shisheh Iran JS co.	63	Iran Wood & Paper Ind -Choka
24	Madak Bricks JS co.	64	Alborz Cartons
25	Mina Glass	65	Mashhad Cartons
26	Ilam Bricks	66	Harir Paper Products
27	Iran Shahr Lime/Sand Bricks	67	Qaemshahr Paper-making Ind.
28	Esfahan Soofalin JS company	68	Iran Form
29	Italran JS Company	69	Namchin JS company
30	Sepahan Concrete	70	Laleh Wall Papers
31	Concrete-maker (Lushan)	71	Tabriz Matches
32	Sakhtamanhayeh Pish-sakhteh	72	Iran Cartons
33	Zamineh JS Company	73	Fars Chemical
34	Mohandes Pakro Buildings	74	Tehran Productive Companies
35	Tabriz Plantation and Renovation	75	Tehran Productive Groups
36	Isfahan Plantation and Renovation	76	Iran Minerals
37	Nabor JS Company	77	Abou Reyhan JS company
38	Akam Builders' Group	78	Alhawy JS company
39	Engineers work Centre	79	Asweh JS company
40	Gharb Concrete	80	Iran Hormoon

1. Joint Shares.

2- Indus[illegible]

NO.	NAME OF COMPANY	NO.	NAME OF COMPANY
81	Iran Darou[3]	117.	Chahar Mahal Cube sugar
82	Beh Ara JS company	118.	Gorgan Cotton Seeds
83	Pars Kol JS company	119.	Qahestan Cube Sugar
84	Pars Darou	120.	Mashhad Food Products
85	Tehran Chemicals	121.	Iran Packaging Ind.
86	Jaber ebn Hayyam JS Co.	122.	Mashhad Packaging ind.
87	Hakim JS co.	123.	Persuis JS Company
88	Radak JS co.	124.	Qasem Iran JS company
89	Amin Chemi-medicines	125.	Iran JooJeh (chooks)
90	Mrtyr.[4] Dr Faqihi JS co.	126.	Iran Sausages
91	Koathar JS company	127.	Neishabour cube sugar
92	Kimi-Darou JS company	128.	Balouch cube sugar
93	Loqman JS co.	129.	Bafkar JS company
94	Jam Darou	130.	Laleh Towels
95	Sobhan Pharmacy	131.	Kashan Silk and Velvet
96	Daroupoosh JS co.	132.	Momtaz JS company
97	Razi Distributions	133.	Qaemshahr Nassaji[5]
98	Hejrat Distributions	134.	Provision, Prouducing and Exportation of Aria Cotton
99	Ferdo'us Distributions		
100	Amaliyat Movers	135.	Far Nakh[6]
101	Exporters of Medicines Group	136.	Meh Nakh
102	Shimico Trading	137.	Azadi Weaving
103	Margarine Vegetable oil	138.	Yazd Kord-Baf
104	Shiraz Narges vegetable oil	139.	Naz Nakh
105	Pichak JS co.	140.	Alborz Nakh
106	Pars Choclate	141.	Iran Barg Wool-weaving
107	Vitana (Bitanan) JS co.	142.	Pars Fastoun
108	Mino Pars Ind. co.	143.	Toos Wool-Weavins
109	Khorramdarreh Mino Ind. co.	144.	Qods Weaving
110	Jiroft Plantation and Industries	145.	Fajr e Eslam[7] JS co.
111	Piranshahr cube sugar	146.	Kashan Industries
112	Taakestan Food company	147.	Ekbatan Carpets
113	Jowin cube sugar	148.	Iran Graphics
114	Jam company cube sugar	149.	Kanaf Kar Js Company
115	Dezfool Cube Sugar	150.	Qaemshahr Sack-weaving
116	Waramin Cube Sugar	151.	Iran Jika JS company

. Medicines.

. Martyr (Shahid).

. Textiles Factory.

. Nakh= Thread

. The rise of Islam.

No.	NAME OF COMPANY	NO.	NAME OF COMPANY
152.	Beh Poosh JS company	185.	Lorestan Machine Making
153.	Jameh JS company	186.	Nic Meters (Countor)
154.	Gilan Carpets	187.	Arak Farm Spices production
155.	Mod Jeans	188.	Oxygen Welding
156.	Naz Poosh JS company	189.	TechnoKar JS company
157.	Piroozi Shoes	190.	Foolad Bor Marine Services
158.	Maghloob[8]JS company	191.	Boosh Car Aparatus
159.	Piyoo Iran JS Iran company	192.	Rona Ind. Group (Aam)
160.	Azarin Industrial Group	193.	Bolboring Iran
161.	Alvand Industrial Group	194.	Indamine Shock Absorber
162.	Pakhsh Yaftehaye Iran	195.	Iran Meatl ind.
163.	Weaving Industry Distributing	196.	Khuzestan Tube making
164.	Exportation of weaving and	197.	Systems Development
	Clothing Ind's	198.	Iran shock absorber, Tooly Pas
165.	Pars Carpets	199.	Khorasan Leather and Skin
166.	Barg Industrial Group	200.	Makhzan Saz JS company
167.	National Management Services	201.	Teaching ind.
168.	Investment of the INIO	202.	Industrial City Rasht
169.	BehShahr Industrial	203.	Serliran JS company
	Development company	204.	Pars Aloom (Khass)
170.	Balouchestan Planting Investment	205.	Industrial City Kareh
171.	Development Of the West of the	206.	Iran fire proof Products
	Country's Investment	207.	Gharb Weaving Wool
172.	Pars Toosheh Investment	208.	Aloopen (Alborz Alluminium)
173.	Iran-Yasa Tyre and Rubber	209.	Development of West of
			Iran's investment
	IDRO[9]	210.	Torbat Heidarya Cube Sugar
174.	Nir Pars JS company	211.	Industrial City Alborz
175.	Sang Gozar JS company	212.	Gharb Weaving
176.	Sa'ne (Hocks Iran Deasle)	213.	Teaching Buildings
177.	Sokaii House Building	214.	Khavar Weaving
178.	Mrtyr Soltany Industrial Co.	215.	Abzaran JS company
179.	Cas Iron (Palsel)	216.	Steel Frame and Stores
180.	Akam Metals	217.	Iran Car Apparatus production
181.	Firoza Engineers	218.	Iran Car and Pipe Making
182.	Technician (Technology Of	219.	Navahi Maskan Engineers
	Iranian Ind.)	220.	Industrial Consulting Engineers
183.	Provision of Moulding Sand	221.	Management Of Iran Ind. Plans
184.	Provision and Distribution of	222.	Ind. of Metal Wastage
	Moulding Ingredients	223.	Engineer Consultation of Iran
			Transportation Equipment

. Marghoob= Desirable Quality

. Iranian Development and Renovation Industries Organisation.

No.	NAME OF COMPANY	NO.	NAME OF COMPANY
224.	Technical Services Machines	245.	Iran Shindler Lift Making
225.	Iran Centre for Research Applied	246.	Iran Home Building
226.	Gostaresh Building (Mana)		MA[10]
227.	Heavy ind. Centre for Research	247.	Jiroft Plantation and ind.s
228.	Khod Kafai Research Centre	248.	Fars Meats JS company
229.	Generator Technic		
			Iran National Ind. Organisation
	Ministry of Mines & Metals	249.	Alborz Electric Industry
230.	Sound and Heat Non-transferrers	250.	Pars Shahab Lamps
231.	Foolad Bor Marine Services	251.	Pars Khazar Industrial Company
232.	Isfahan Steel City	252.	Pars Sheid Industrial Company
233.	Transformation of Metal Ind.	253.	Pars Nic JS co.
		254.	Pars Services
	Ministry of Trade	255.	Alborz Battery Trade
234.	Mazda Yadak (Led Horse)	256.	Alborz Commercial company
235.	Morattab No'w JS company	257.	Hotco JS company
236.	Pars Yadak	258.	Pars Calory co.
237.	Sadoug Ascensor (Lifts)	259.	Farbot JS company
		260.	Sazco Sand company
	Ministry of Islamic Guidance	261.	Mana Building Apparatus Prod.
238.	Development of Iran Inns	262.	Akam Ready-made Concrete
239.	Development of Sepahan Inns	263.	Zimens JS company
		264.	Akam Sand ind.
	Ministry of Petroleum	265.	Akam Homes JS company
240.	Iran Gas JS company	266.	Exporting House Materials
241.	Iran Persi JS company	267.	Alborz Ceramics
242.	Iran Silander JS company	268.	Pars China JS company
243.	Persilander JS company	269.	Qazwin Glass co.
		270.	Abgineh Glass co.
	Ministry of City Construction	271.	Saweh white Cement
244.	Tessis Installations	272.	Tehran Plaster JS company

[10]. Ministry of Agriculture.

NO.	NAME OF COMPANY	NO.	NAME OF COMPANY
273.	Tehran Cement JS company	314.	Simorgh JS company
274.	Kerman Cement JS company	315.	Bistoun Cube sugar
275.	Kermanit JS co.	316.	Bardsir- Kerman Cube Sugar
276.	Gach san JS company	317.	Firuzkuh Glucose and Starch
277.	Industry Innovation Company	318.	NakhKar JS company
278.	Shomal (North) Cement	319.	Mardom (People) Clothing
279.	Fars & Khuzestan Cement	320.	Arak Industries
280.	Mazandaran Cement	321.	Melli Shoes JS company
281.	Soofiyan Cement	322.	Shahed Shoes JS company
282.	Iranit JS company	323.	Azadeh Shoes JS company
283.	Azarit JS company	324.	Fars Shoes JS company
284.	Peressit JS company	325.	Iran Industrial Shoes JS co.
285.	Pakasan JS company	326.	Pouya Shoes JS company
286.	Sulfiran JS company	327.	Konjeh Shoes JS company
287.	Tehran Plastic Goods and Sticky	328.	Melli Boots
	Tape	329.	Konjeh Weaving and Knitting
289.	Alborz Pipe Welding	330.	Gilan Leather JS company
290.	Shahid Bahonar Shuutle-Making	331.	Roudbar Leather JS company
291.	Iran Matches Distribution	332.	DeraKhshan Leather JS co.
292.	Beh Bood JS company	333.	Kaouchook Melli JS company
293.	Latif Paper Products	334.	Zireh Melli JS company
294.	Laleh Paper Products	335.	Glue and Chemicals JS co.
295.	Espart Modern Trade	336.	Melli Mould-Making JS co.
296.	Espart No Zohour (Newly Risen)	337.	Firouzan Nakhtab JS company
	Khuzestan Harir JS company	338.	Pars Chap (Printing)
297.	Pars Packaging company	339.	Melli Tasmeh (Ribbons)
298.	Kerman Plastics company	340.	Sika Iran JS company
299.	Yazd Plastic Company	341.	Melli Car Making and eng'ing
300.	Bandary (Port) Services	342.	Sarpaii Melli JS company
301.	Plastic Ind. Engineering and	343.	Shomal Clothes Knitting
302.	Research	344.	Distribution of Knitting ind.'s
	Industrial Wool-Weaving O.[11]		Paints and Apparatus
303.	Teif JS company	345.	Baft-Iran JS company
304.	Iran Chemical Products	346.	Moghaddam JS company
305.	Kar Cartons JS company	347.	Wayan Leather making
306.	Darou (Medicines) Production	348.	Melli Knittings Ltd.
307.	Behshahr ind. company	349.	Barg Services JS co.
308.	Behyak JS company	350.	Sheh Baf Distribution ind.
309.	Shirvan cube Sugar	351.	Iran Pouplin JS company
310.	Dev. of Oily Seeds Production	352.	Melli ind. Investment Group
311.	Mino Ind. Company	353.	Negahdar JS company
312.	Behpakhsh JS company	354.	Melli Trade and Exportation
313.			

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NO.	NAME OF COMPANY	NO.	NAME OF COMPANY
355.	Iran Provision and Distribution of Unprocessed Apparatus	377.	Iran Radiators JS co.
356.	Omdeh Clothing JS Co.	378.	Dev. and Renov. Ind. of Iran Trading Services
357.	Poushan JS company	379.	Iran Automobile Services
358.	Shafiq Clothing JS co.	380.	Nirooyeh Moharrekeh Trading
359.	Sanaati Gloves JS co. NIU[12]	381.	International Delivery of Dev. and Renov. of Iran
360.	Tis Iran JS company NIU	382.	Tabriz Car making Trade Serv.
361.	Khosrawy Now Leather co. NIU	383.	Khawar Technical Services
362.	United Chemical JS co. NIU	384.	Dev. of Pars Khodro Technical Services
363.	Iran Skin and Leather NIU	385.	Iran Large Moulds ind. co.
364.	Mehraban Knitting JS co. NIU	386.	Dev. of Pars Khodro Services
365.	Iran- Rasht Electric NIU		*Ministry of Educ. & Training*
366.	Iran Pins Making NIU	387.	Alborz Ink JS company
367.	Alborz ind. company		MHCME[14]
368.	Computer Technics JS co.	388.	Shirin Darou JS company
	MHI-IDRIO[13]		*Ministry of Agriculture*
369.	Agricultural Services JS co.	389.	Qarim Wood ind.
370.	Delivery of Dev. and Renov.of+	390.	Shafarou Forests JS company
371.	Iranian Ind.	391.	Neka- Choob (Wood) JS co.
372.	Jounid JS co.	392.	Sefid Roud Livestock Training
373.	Production of Electric Car Parts (Lucas Tondor)		
374.	Nosaz Building and Services		
375.	Financial and Supervision Services		
376.	Raz Products JS company		

12. Not In Use.

13. Ministry of Heavy Industries- Iranian Development and Renovation Industries Organisation.

14. Ministry of Health Cure and Medical Education.