

Oil & Gas Towards

By Reza Molavi

an explicit policy. Prior to privatization, the first is to reduce the number of employees using voluntary redundancy and golden handshakes, prior to privatization.

Tariffs

As mentioned above, current subsidies in Iran do not allow the international market valuation of commodities, and therefore are out of line with costs. In most cases, some of the institutions could not exist without the subsidies. Privatization would require rethinking the wisdom of such pricing policies. Post-Privatization tariff structures would need to be explicitly defined by the government.

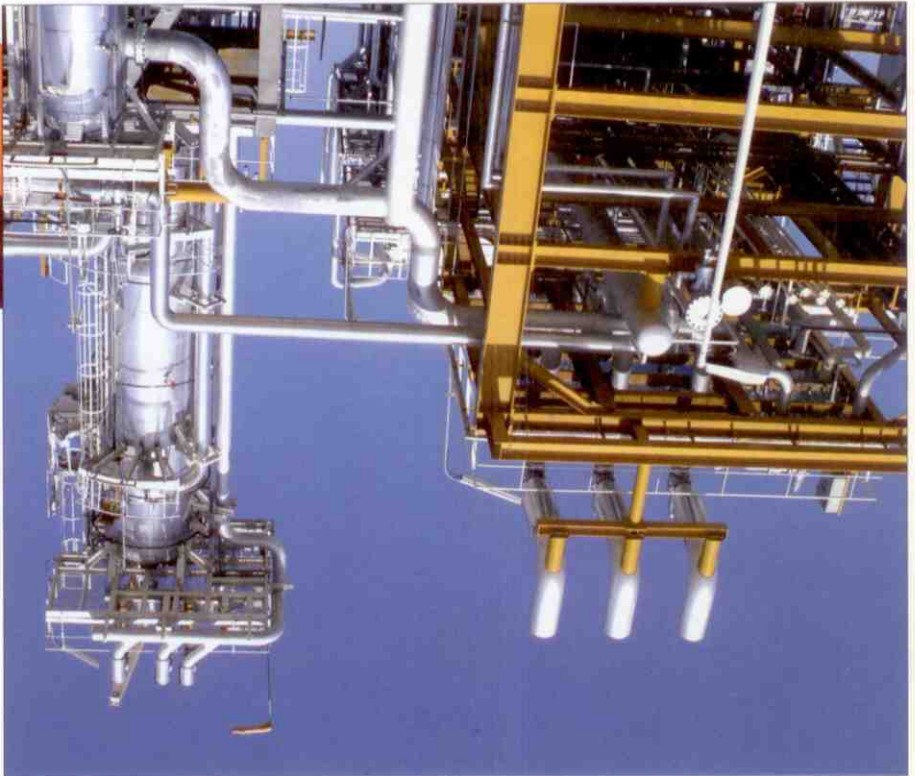
Competition And Industry Structure

The privatization of the monopoly owned by the Oil Ministry is like privatizing the entire sector. Care should be taken as to which of the affiliated companies should be privatized first.

Inter-Enterprise And Government Arrears

Like many governmental agencies, the oil industry has problems with collecting their bills from government agencies and departments who are major users of oil and gas. The existing backlog of arrears would require

The privatization of public sector institutions is one of the general objectives and strategic principles of Iran's development plans. The current government of Iran, through the various available arrangements, has made public that they are committed to increasing the number of privatized enterprises and, by doing so, wish to increase the role of the private sector in the economy. Privatization, it is generally believed, could reduce the government's financial burden and, in some cases, turn public sector bureaucratic institutions into lean, competitive, and efficient in-



lization of the economy.

It would be prudent for the government of Iran to consider the following issues in the privatization of the Energy sector:

Legal Restructuring and Corporatization

Prior to privatization, industries would be required to incorporate (corporatization). This would entail creating separate accounts and balance sheets and redefining the relationship between the parent ministry and the corporatized entity.

Employee Restructuring

Given the over-staffing of Iran's public energy enterprises, privatization would require

some radical solutions and the future regulations would have to be developed.

The "Strategic" Sectors Issue

It is important for the government to determine their role in the oil sector and what type of privatization, if any, to pursue. It is difficult for technical experts to respond to arguments for a continuing the role of the government as a producer in an industry, because the industry is described as "strategic." The strategic argument can be used to justify the public ownership of virtually any industry including rice and wheat. In dealing with the issue of "strategic industry", the government should also consider the relevance of the

The income generated from privatization could be used to retrain the national workforce and help assimilate them into the private sector. It could also reduce the existing public sector debt, by reducing subsidies being provided to these institutions.

A key strategic question facing Iran is the type and degree of restructuring prior to privatization. Each country's strategy must be specific and tailored to its particular circumstances. Privatization must be synchronized with other structural reforms; simply transferring public enterprises to the private sector is not enough. Privatization works best when reforms dealing with macroeconomic stabilization, liberalization of trade, tariff,

"golden share" whereby the government retains a veto on key decisions of the privatized company. The golden share concept has been used successfully by several countries who privatized strategic sectors.

Regulation

A significant reason for government ownership of infrastructure enterprises, particularly those operating in monopolies, is the fear that the private sector will abuse its market power by reducing the quality of service or increasing prices. Privatization will only lead to an increase in the standard of living if it is accompanied by proper government regulation. There are many examples from international experience in the establishment and rules of regulation; Iran will have to invest in, and work hard to, adopt the best practical regulation models. This will require government resources and commitment.

Role of Foreigners

In the case of Iran, with its own particular type of paranoia from foreign domination and hegemony, there are sufficient quantities of domestic private capital. If the government chooses, foreigners could be kept out of the

States. The foreign agencies urging privatization are mainly the IMF, the World Bank, and the USAID. Secondly, it is considered to be a response to the political interests of the business classes, foreign and domestic, who put claims on the state and seek relief from obligations to the public. Businessmen understand both that achieving their economic interests requires political action and that, by their location and wealth, they enjoy considerable leverage. Finally, business classes seek to dominate the state with a view to affect the distribution of national income in their own favor at the expense of the masses. A variant on this last point is that the poor are bound to become poorer in a free-market economy because the increasing wealth of the few and the pairing of the economy to advanced industrial nations contributes to inflation and the lowering purchasing capacity of the poor. Cognizant of this argument, political leaders fear that privatization and rapid liberalization of the economy may lead to political turmoil, a turmoil which could undermine their regimes.

Recommendations:

When the actual privatization schemes within NIOC (National Iran Oil Company) are

selling of government shares in industrial, electricity, petrochemical, agriculture, cement and services companies. As most of these companies still operate in a monopolistic or semi-monopolistic setting, and as they are the only providers of the goods and/or services they offer, clear and efficient regulations of their behavior need to be in place before they can become candidates for privatization. Some of them need to be reorganized and nursed to profitability before they are floated in the stock market. Airlines, NIOC helicopter services, tanker companies (NITC), telecommunications, public transport companies and port services are among the grouping which will need re-organization.

While one can not generalize, some of the affiliated companies of NIOC are pricing their national assets and labor out of the private sector reach, thus weakening the relationship between productivity and wages. Over protection of local labor has given the private sector a disincentive to hire locals, an issue that needs to be addressed. Furthermore, over pricing the worth of the affiliated companies discourages serious bidders from participating in the privatization of those entities.

Finally, it should be noted that privatization does not necessarily mean the total transfer of ownership from the government to the private sector. Many of the government's concerns may be partially addressed by retaining a minority government ownership, as well as instituting efficient regulation. Partial government ownership should be transitional and it should not convey the notion that the government is guaranteeing private investment.

For privatization to work in general and specifically to make privatization work in the Oil and Gas sectors, the Iranian government must be able to analyze complex policy issues, make legal changes to the existing laws, choose among alternative privatization methods (if a home grown model or template is not yet available), and complete privatization deals with transparency. Privatization is more skill and information intensive than other economic reforms. While prices, tariffs, or interest rates can be deregulated relatively easily, the expertise needed for government involvement in privatization can not be achieved without significant study and preparation. The choice of public enterprises to be privatized is not only politically controversial but requires sophisticated technical analysis, as do financial restructuring, valuation, and the design of regulatory systems.

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privatization

purchase of upstream activities entirely. Foreigners would be allowed to partner with domestic entities on upstream activities with Buy Back schemes or Product Sharing Agreements. To attract the large multi-national oil industries with their expertise and financing capabilities, it would be prudent to offer a small percentage of the stake in the downstream activities.

The strongest charge against privatization has generally been political. Firstly, it has been argued that because it has been sponsored by foreign actors, privatization reflects the interests of advanced industrial states which occupy a prominent place in the world economy, such as those of Western Europe and the United

implemented, the private sector will look to both internal and external sources to fund the acquisition of the shares. Generally, we should expect domestic deposits to absorb most of the financing burden. This is another reason why the process should be a gradual one; otherwise the reduction in deposits could force banks to curtail lending and may lead to a credit crunch. While the aim is to bring larger private sector participation, a rush to privatization without careful planning could end up disrupting private sector activities.

There are companies where the government has sold part of its share holdings without disturbing the stock market. Successful examples in public and private partnership include the